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Temporary Crisis and Transition Framework: Dealing with Crisis and Transitioning to a Net-Zero Economy – But At What Cost?

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Introduction

State aid rules have existed since the Rome Treaty and have a negative integration logic: Member States should refrain from distorting competition by helping their own undertakings (an in-depth analysis on state aid, in Hancher, Ottervanger and Slot, see here). These rules naturally trigger tension between what Member States can do with their money and what the European Commission (Commission) will allow them to do with their money, mindful of any potential distortions to competition and to the European integration process that might be caused by such money injections. Since the economies of the 27 Member States are deeply interconnected and interdependent, the Commission enjoys exclusive competence to examine state aid programmes and decide whether fair competition across the single market is preserved or threatened. If the implications are too damaging, the Commission will strike down the proposal, effectively prohibiting a Member State from disbursing the subsidies.

In reality, though, around 91% of state aid initiatives are exempted from the Commission's scrutiny, such as social assistance, development, transport infrastructure, natural disaster relief, culture, education, environmental protection, innovation, and digitalisation. However, a small but critical fraction of subsidies – those with a marked industrial character – must be carefully assessed by the Commission. When a crisis hits, such subsidies with a distinct industrial character might be more frequent, as undertakings will turn to governments for protection. But, this funding may distort competition.

So far, the Commission has been a flexible and generous 'crisis regulator'. [1] Flexible because it has used soft law instruments (e.g. guidelines, communications) to provide guidance to Member States, and generous because especially after 2008 it has been granting more leeway to Member States, allowing them to grant state aid to deal with serious disturbances in their economies as per Article 107(3) b TFEU.

Steps to deal with the crisis and facilitate the green transition

A by-product of this approach is the existing **Temporary Crisis Framework** (TCF), adopted on

23 March 2022 and amended on 20 July 2022 and 9 March 2023. Initially, the TCF was adopted to mitigate the economic crisis triggered by Russia's invasion of Ukraine and the ensuing energy crunch; to add greater flexibility to the internal assessment; and to enable faster approvals with a wider scope. Rightfully, the Commission expected that the war would create serious problems for energy-intensive industries, increase production costs for the agri-food sector, and exacerbate the disparities and inequalities in the EU. For this reason, the TCF aimed to complement the existing state aid toolbox. It allowed Member States to provide compensation to undertakings for damages directly suffered due to the war in Ukraine while facilitating the transition to clean energy. [2]

Reaching independence from Russian gas before 2030 and phasing out dependence on oil and coal, diversifying supply, accelerating the roll-out of green energy technologies and reducing the demand for energy became key objectives of the Union. As a result, state aid rules **were relaxed** to offer Member States options to provide short-term relief to undertakings and farmers affected by high energy prices, and help reduce their exposure to energy price volatility in the medium to long term.

The TCF was consistently prolonged and amended to increase the limited amounts of aid measures; to allow Member States to provide guarantees or subsidized loans to energy undertakings, and to enable Member States to recapitalise undertakings facing solvency issues. Specifically, on 20 July 2022, the Commission **adopted a first amendment** to complement the Winter Preparedness Package. This allowed Member States to grant temporary support to facilitate the roll-out of renewable energy, storage and renewable heat and the decarbonisation of the industrial production processes. On 28 October 2022, the Commission **prolonged and amended** the TCF in view of the continued aggression by Russia against Ukraine and the feedback received from Member States. [3]

Recently, the focus has expanded from an episodic energy crisis to a long-term concern with the green transition. On 9 March 2023, the Commission adopted **a new Temporary Crisis and Transition Framework (TCTF)** not only to deal with the energy crisis but also to foster the transition to a net-zero economy, in line with the Green Deal Industrial Plan.

The TCTF **sought** to enable Member States to further cushion the economic impact of Russia's aggression on Ukraine and EU's countersanctions by (i) granting amounts of aid to the affected undertakings; (ii) ensuring sufficient liquidity of affected undertakings; (iii) compensating undertakings for the additional costs incurred due to exceptionally high gas and electricity prices; and (iv) incentivising additional reduction of electricity consumption.

Member States would be able until 31 December 2025 to grant aid to foster the transition to a net-zero economy. Such aid would be granted, in particular, (i) to accelerate the roll-out of renewable energy, storage and renewable heat; (ii) to decarbonise industrial production processes; and (iii) to accelerate investments in key sectors of the net-zero economy (e.g. batteries, solar panels, wind turbines, heat-pumps, electrolysers and carbon capture usage). Furthermore, the **TCTF** simplified the conditions for the granting of aid to small projects and less mature technologies (e.g. renewable hydrogen) by lifting, under certain conditions, the need for a competitive bidding process; expanded the possibilities of support for the deployment of all types of renewable energy sources and decarbonisation of industrial processes; and provided for higher aid ceilings and simplified aid calculations.

Internal frictions: threats to the EU integration project

While it is important to have a framework dealing with crises and the green transition, the current framework raises critical questions. The existing framework **may lack transparency and be incompatible** with the State Aid Procedural Regulation. Simultaneously, there is always the risk that temporary rules become permanent. It should not be overlooked that the TCTF is based on an exceptional provision – Article 107(3) b TFEU – and has been consistently prolonged and extended allowing significant amounts of aid to be granted to individual undertakings.

Furthermore, even though the Commission allows everyone to grant state aid under the same conditions, it is important to note that not all Member States have the same capacity to grant aid. In other words, not all Member States are **able** to channel national funds to help their undertakings. The **statistics** released by the Commission are illustrative in this regard. Since March 2022, Germany and France together account for 77% of the €672 billion approved programmes. The Commission approved Germany to grant over €356 billion in economic support – 53% of all extraordinary aid –, while France granted 24%, (approximately €161 billion). Italy came a distant third, securing approval for €51 billion (7.65% of the total), and Denmark stood in fourth place, with €24 billion (3.57% of the total). The rest of the bloc collectively accounted for less than 12% of the remaining state aid approved by the EU Commission (approximately €78 billion). [4]

Unsurprisingly, therefore, the relaxation of state aid rules has brought and will continue to bring considerable controversy across the EU. Germany and France **joined forces to call** for a new subsidy push, and even **a 'Made in Europe' strategy**, while others, including the Netherlands, Ireland, Poland, the Czech Republic and the Nordics, have asked for caution before further relaxing state aid rules. [5]

A cursory look at Eurostat's 'Industrial production statistics' and growth numbers can only raise further question marks since a dissonance can be observed between received aid and economic performance.

Specifically, according to Eurostat, the country with the largest manufacturing output was Germany, with 27% of the EU's value of sold production in 2021, followed by Italy (16%), France (11%) and Spain (8%). Thus, Germany and France accounted for 38% of total industrial production. However, according to the **World Bank**, the entire EU economy was worth $17.18 trillion in 2021, with Germany contributing $4.26 trillion and France adding $2.96 trillion. Thus, Germany and France accounted for over 42% of the bloc's GDP yet they received approximately 77% of the total aid. Such a mismatch can only undermine the single market and further entrench the North-South divide within the Union. In other words, the aid given seems to be motivated not purely by objective criteria such as economic performance or need but affected by the bargaining power and economic resources of each Member State.

The TCTF by further relaxing the Union's state aid rules could amplify the already existing *de facto* unequal treatment of Member States and further entrench structural inequalities within the Union. Hence, a more lenient state aid policy could undermine the single market project by enabling 'national champions' policies, and by leading to national markets with varied degrees of competitiveness.

The TCTF includes **certain measures** that seek to address this issue. For instance, small and medium-sized enterprises ('SMEs') as well as undertakings located in disadvantaged regions are eligible for higher support by their national governments, to ensure that cohesion objectives are duly taken into account. Yet, it is unlikely that these measures will be sufficient due to the different resources and capacities that the various Member States have. The European Commission has **pledged** to establish a 'European Sovereignty Fund' to offer sources of common financing to those governments that cannot afford or refuse the option of aggressive state aid. Yet, the Parliament's biggest voting bloc **opposes the project** and it is unclear how the Fund will be bankrolled, especially since the bloc's seven-year budget is already negotiated and has barely any space left to accommodate fresh expenditure. The idea of issuing common EU debt, as the bloc did to set up the **€800-billion coronavirus recovery plan**, has gained traction but **remains opposed** by some frugal countries, including, crucially, Germany. In addition, the framing of the Fund may prove a **thorny issue**. For instance, if the fund takes the form of an investment vehicle for European start-ups, **it is unclear** how it would mesh with the €10 billion European Innovation Council, established under Horizon Europe for the same purpose. It is also unclear if this Fund, once established, will be able to compensate for the German-French subsidy push noticed above.

Reacting to geopolitical developments: a subsidies war?

The Commission's TCTF strategy as well as its pledge to the European Sovereignty Fund come also as a reaction to **China's economic policy** and to US **Inflation Reduction Act** (IRA). [6]

On August 16, 2022, President Biden signed the IRA into law, marking the most significant action Congress has taken on clean energy and climate change in US history. The IRA contains a **massive programme of tax credits, performance requirements, direct rebates and subsidies** and favours American-made green technology. Specifically, the Act **will grant** in the following ten years up to $370 billion to undertakings and consumers who wish to produce, invest and buy things like solar panels, wind turbines, heat pumps, electric vehicles, batteries and electrolysers if these products are predominantly manufactured in North America. Given that the subsidies granted by the IRA depend on the localization of production, they might be found illegal under **WTO law**.

Some have called it an instrument of a "***climate trade war***", others label it as an unprecedented tool of **industrial policy**, whereas others see it as a welcome plan to bring **equity and environmental justice** or as a "***seismic shift***" which will change the course of innovation in the US. Be that as it may, the IRA will most definitely **affect** global competition. These developments have been **alarming** European officials. French President Emmanuel Macron stated that the IRA is "***super aggressive***", whereas Josep Borrell, the Union's High Representative, expressed **doubts** as to whether the US is still Europe's economic ally. Hence, the TCTF framework could be viewed as the European response to the avalanche of American green subsidies that might otherwise trigger an industrial exodus of Europe-based firms to the other side of the Atlantic. [7] In this sense, the TCTF is also a tool to deal with market-distorting subsidies of US origin ensuring that European businesses remain competitive and keep their economic activities at home despite the changes brought by the IRA. [8]

Without a doubt, the TCTF and the European Sovereignty Fund pledge are suggestive of a subsidies race and a broader global shift towards industrial policy. While subsidies might be necessary to promote certain benevolent purposes (e.g. EU becoming the first climate-neutral continent by 2050) or to deal with emergencies, they might trigger a 'subsidies war', where the key (and narrow-minded) concern would be whether the amounts mobilised by the IRA (or any other initiative) are higher than the existing public subsidies to the European industry. Apart from reinforcing the North-South divide within the Union, such a subsidies war may also lead to inefficiencies or overcapacity in sectors where there is already sufficient supply and other countries are more competitive (e.g. solar panels in China). In addition, it might tolerate or even stimulate unsustainable patterns of growth (e.g. subsidies granted to carbon-intensive industries of strategic importance for the European economy). For this reason, President Von der Leyen **noted** "*we also know that state aid will only be a limited solution which only a few member states can use*".

Moving ahead within the EU

There are ways to remedy some of these challenges. Perhaps a more intensified judicial review could ensure that the aid provided is funnelled into efficient and viable projects and does not excessively distort competition. An additional option could be to make sure that state aid policy allows Member States to respond to crises without leading to discrimination that may cause a distortion of the level playing field. Next-generation funds such as the European Sovereignty Fund could offer a way out of this conundrum, since as the Court has recognized, "*the Union budget is one of the principal instruments for giving practical effect, in the Union's policies and activities, to the principle of solidarity*" (**Case C-156/21**, and **Case C-157/21**, para 147).

Yet, the Commission should not lose sight of the fact that the TCTF should be a temporary measure. As **noted** by Vice-President Margrethe Vestager such policy can only "*be a short-term boost*" or a "*temporary adjustment*", Europe should not be building competitiveness out of subsidies, but out of well-functioning, dynamic and innovative markets.

Nonetheless, the TCTF policy, even if coupled with a European Sovereignty Fund, may still suffer from one key flaw: its core assumption. While it is easy to draw an automatic link between providing green subsidies and stimulating sustainable practices – after all, rational profit-maximizers generally respond to punishments and rewards – things might prove a tad more complicated in practice. Transitioning to more sustainable practices also involves also adopting forms of circular economy as pointed out by Raworth, while certain environmental problems may not be solvable by utilizing economic incentives or only by mobilizing market-based tools and mechanisms, in line with Buller's and Sandel's research. For this reason, public finance may be needed in particular for investments that private investors are not considering attractive enough, because they do not generate a rapid and sufficiently high financial return. For this reason, additional regulation (e.g. banning certain technologies, implementing eco-design rules, setting reduction targets for resource and energy consumption) might also be crucial to halt wholly unsustainable patterns of production (e.g. carbon-intensive industries) and to green well-entrenched patterns of consumption (e.g. by supporting low-income households to shift to renewable energy, or by re-skilling and up-skilling workers who will need to transition to new green jobs).

Mobilizing public finance – despite its ensuing risks highlighted above – might indeed be necessary for fostering the green transition, especially in the current geopolitical context. Yet, it is unlikely to prove sufficient unless it is combined with other regulatory tools. The various measures and regulatory techniques should be assessed on the basis of their contribution to the deployment of a coherent strategy for achieving eco-development. In the end, what matters is whether the EU will be able to revive growth while changing its quality and whether it will be able to reconcile economic development with environmental preservation.

[1] See, for instance, Proposal for a Regulation of the European Parliament and of The Council establishing a Single Market emergency instrument and repealing Council Regulation No (EC) 2679/98.

[2] **Notably**, the EU imports 90% of its gas consumption, with Russia providing more than 40% of the EU's total gas consumption. Russia also accounts for 27% of oil imports and 46% of coal imports.

[3] The amendment also took into account the Regulation on an emergency intervention to address high energy prices ('Regulation (EU) 2022/1854?) and the Commission's proposal on a new emergency regulation to address high gas prices in the EU and ensure the security of supply this winter.

[4] These figures are subject to daily change and were based on 200 decisions taken by the Commission.

[5] In the **words** of Swedish Prime Minister Ulf Kristersson, "*We need to start a real discussion on how to improve productivity, how to enhance competitiveness and how to attract more undertakings based on our own capabilities and not based on long-term state aid rules*".

[6] The European Commission has also announced an **upcoming Net Zero Industry Act**.

[7] It should be noted that according to the **TCTF**, in exceptional cases, Member States can provide higher support to individual undertakings, where there is a real risk of investments being diverted away from Europe. In such situations, Member States may provide either the amount of support the beneficiary could receive for an equivalent investment in that alternative location (the so-called 'matching aid') or the amount needed to incentivise the undertaking to locate the investment in the EEA (the so-called 'funding gap') whichever is the lowest.

[8] Illustrative are the **words of Commissioner Thierry Breton**: "*In drawing up our industrial, economic and geopolitical ambitions, we of course need to consider the rest of the world, including how our so-called "like-minded partners" are ramping up in the industrial and technological race that is taking place. The Buy American Act, the US Chips Act, the Defence Production Act and most recently the Inflation Reduction Act are all examples of determination and audacity. While I do not suggest we emulate these word-for-word, given the EU's openness and commitment to international trade, let's not be naïve. It is high time we show more assertiveness – including the necessary financing – to defend our European strategic interests*".

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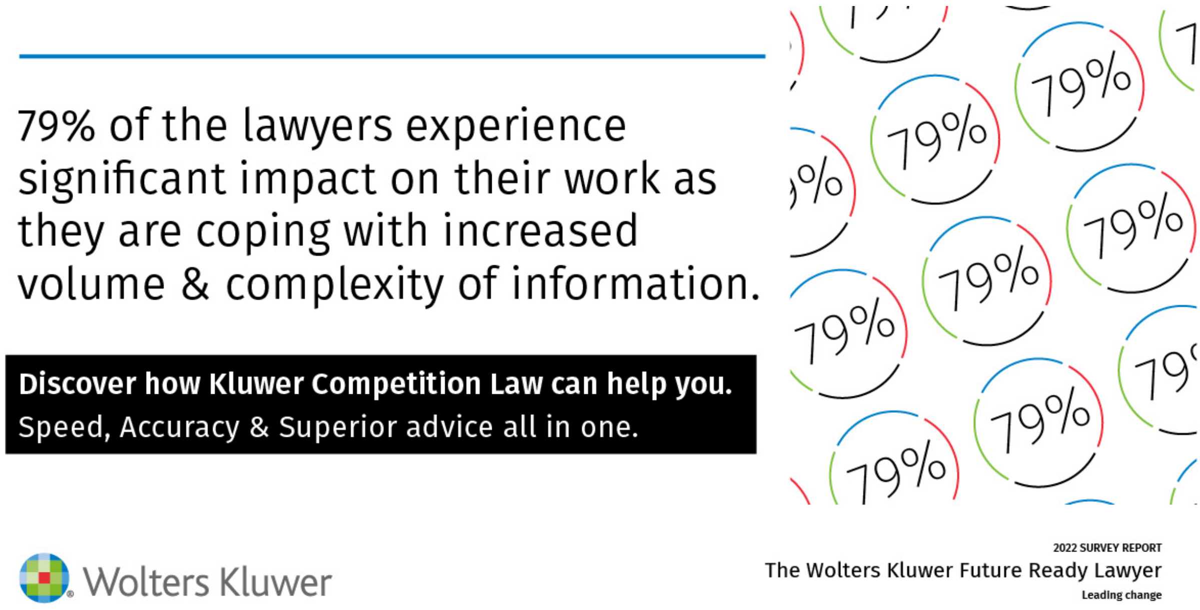

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