

Environmental mainstreaming in EU State aid policy

Recommendations for a consistent integration of environmental considerations

Key messages and recommendations

- There is currently no environmental mainstreaming in State aid policy, resulting in a lack of safeguards against environmentally harmful aid. The European Commission should address this shortcoming by developing a more environmentally ambitious State aid policy. It has the legal tools to do so and its approach should be based on three main pillars:
 - First, a systematic verification of compliance with EU environmental law and the application of the “Do No Significant Harm” principle to State aid measures should be horizontally integrated across State aid policy.
 - Second, environmental conditionalities should be integrated in State aid policy and attached to individual State aid decisions where relevant.
 - Third, taking into account environmental considerations when assessing the potential negative effects of an aid measure on competition and trade is sometimes desirable, necessary, or unavoidable, in light of the growing environmental risks which impact most economic sectors.
- Environmental mainstreaming across State aid policy, in combination with increased transparency and accountability, would inevitably increase resilience of companies, which in turn would contribute to sustainable development and promote competitiveness in the EU.

1 Introduction

ClientEarth is a not-for-profit environmental law organisation that uses the power of the law to protect people and the planet. We are legal experts working to shape and enforce the law to tackle the world's biggest environmental challenges. For several years, we have been advocating for State aid rules to align with and integrate environment and climate protection objectives, as outlined in the European Green Deal.¹

This briefing first sets out the current state of play in State aid policy² with respect to its lack of environmental mainstreaming (Section 2). It then addresses the legal boundaries that surround the possibility to implement environmental mainstreaming, in light of the case-law of the Court of Justice of the European Union (CJEU) (Section 3). Finally, it sets out concrete recommendations of how environmental mainstreaming can be achieved in State aid policy (Section 4).

In this briefing, environmental mainstreaming refers to the integration of environmental considerations and objectives in State aid policy. It encompasses climate change but also other environmental considerations such as biodiversity conservation, pollution reduction, and sustainable natural resource management.

2 The state of play in EU State aid policy

2.1 The role of State aid in the EU internal market

State aid is defined as an advantage in any form whatsoever conferred by national public authorities to undertakings on a selective basis. Despite the general prohibition of State aid set out in Article 107(1) Treaty on the Functioning of the European Union (TFEU), State aid is sometimes necessary for a well-functioning and equitable EU internal market.

EU State aid control is a cornerstone of the EU internal market. It is enforced by the European Commission (Commission) and aims to preserve competition and trade between Member States while allowing State aid to the extent necessary. A well-balanced and sustainable State aid policy is therefore a valuable tool for the **competitiveness of the EU internal market**.

Member States use State aid as a **policy tool** to boost certain economic activities and industrial policies, address market failures, promote economic development of certain regions, or provide crisis response. Considering these policy objectives that are set out in Article 107(2) and (3) TFEU, the use of State aid can have an **impact on the environment**. It can be used to achieve environmental and climate objectives, but conversely, it can also be used to support economic activities that are inherently environmentally harmful (e.g. fossil fuel activities).

State aid expenditure across the EU has steadily increased in the last decade. Excluding the spikes due to the COVID-19 crisis and the war in Ukraine and energy crisis, expenditure doubled over the period 2011-2019. Member States spent around 1% of the EU Gross Domestic Product (GDP) on State aid, with significant spending differences ranging from 0.6% up to 4.6% of the national GDP. Given its financial importance, State aid not only impacts competitiveness in the internal market, it also heavily influences its sustainable development.

¹ More information about our advocacy efforts and cases can be found on our website: www.clientearth.org.

² Broadly consisting of the European Commission decision making practice, its regulations, guidelines and communications.

2.2 The absence of environmental mainstreaming in EU State aid policy

There are political commitments as well as legal principles and obligations that strongly plead in favour of environmental mainstreaming in EU State aid policy:

- Article 3 of the **EU 8th Environmental Action Programme**³ requires the Commission and Member States to strengthen environmentally positive incentives and to phase out environmentally harmful subsidies, in particular fossil fuel subsidies, at Union, national, regional and local level, without delay. Similarly, **Target 18 of the UN Kunming-Montreal Global Biodiversity Framework**⁴ requires to identify by 2024, and eliminate, phase out or reform incentives, including subsidies, harmful for biodiversity. EU State aid policy, as an enabling framework whereby subsidies and other types of support are granted, has an important role to play in achieving these objectives.
- In line with **article 11 TFEU – a core constitutional principle** – environmental protection requirements must be integrated in the definition and implementation of the Union’s policies and activities, in view of promoting sustainable development. Article 11 TFEU, read in conjunction with Article 3(3) TEU, Article 3 TFEU, Article 4(3) TFEU, Article 7 TFEU and article 37 EU Charter of Fundamental Rights compel the Commission to take due account of environmental requirements when elaborating State aid policy and enforcing State aid control, not only for environmental State aid but for all types of aid.

Nevertheless, **there is currently no environmental mainstreaming in EU State aid policy**:

- State aid is being granted and approved by the Commission without systematic verification of compliance with EU environmental law, or at the very least the Commission does not record it in the findings of its State aid decisions.
- Despite the thorough revisions of the State aid framework in the past years to align with the green and digital transition, environmental considerations are not systematically integrated throughout State aid policy, for instance through the horizontal application of the “Do No Significant Harm” (DNSH) principle. Indeed, reference is made to this principle in a few State aid instruments only.

Instead, **State aid policy takes a siloed approach**. Parts of State aid policy are aimed at supporting environmental objectives, such as the Guidelines on State aid for Climate, Environmental Protection and Energy⁵ (CEEAG), while other parts of the State aid policy are aimed at supporting other objectives without taking any account of environmental considerations. **The lack of a holistic approach creates loopholes for environmentally harmful aid measures** and undermines the sustainable development of the EU.

Finally, in its latest report, the **European Scientific Advisory Board on Climate Change recommends State aid policy to be made more consistent with the EU climate goals** (Chapter 4, Recommendation E1).⁶ It notes that fossil fuel subsidies continue being channelled through State aid approved by the Commission, impeding the decline of fossil fuels and decarbonisation of industry.

³ Decision 2022/591 of the European Parliament and of the Council of 6 April 2022 on a General Union Environment Action Programme to 2030.

⁴ Decision of 19 December 2022 adopted by the Conference of the Parties to the Convention on biological diversity, 15/4. Kunming-Montreal Global Biodiversity Framework.

⁵ Communication from the Commission – Guidelines on State aid for climate, environmental protection and energy 2022.

⁶ European Scientific Advisory Board on Climate Change, Towards EU climate neutrality : Progress, policy gaps and opportunities, Assessment Report 2024, 18 January 2024, see notably pp. 10, 22-23, 48, 59, 80, 236, 238, 248.

3 No legal boundaries to environmental mainstreaming in State aid policy

The Commission exercises its State aid control powers through State aid policy, within the boundaries of the treaty provisions, as interpreted by the CJEU.

In this context, there are **no legal obstacles to environmental mainstreaming in State aid policy**. Nevertheless, there are some legal boundaries that need to be taken into account:

1. The **primary goal of State aid control** is to preserve competition and trade between Member States in the EU internal market by only allowing State aid when and to the extent necessary.
2. When assessing the compatibility of a State aid measure, the Commission must verify that the **aid measure does not breach EU law** (including general principles of EU law).⁷
3. When assessing the potential **negative effects of the aid measure on competition and trade** between Member States, the Commission is not required to take into account any other negative effects of an aid measure beyond the impact on competition and trade.
4. More specifically, in line with Article 194 (2) TFEU, **State aid policy on energy** must respect Member States' right to determine the conditions for exploiting its energy resources, its choice between different energy sources, and the general structure of its energy supply. Yet, Member States are also subject to environmental and climate obligations that indirectly – and unavoidably – limit the exercise of their right to choose their energy mix.

4 Recommendations for environmental mainstreaming in State aid policy

Within the legal boundaries set out in Section 3, the Commission can and should implement the following recommendations in its State aid policy:

1. **A systematic and thorough verification of compliance with EU environmental law, should be horizontally integrated in State aid policy.**⁸ Such verification should go further than the current practice whereby (i) the notifying Member State confirms that the relevant provisions of EU law are complied with; and (ii) the Commission verifies the pending EU infringement procedures, which only represent a fraction of the existing breaches of EU environmental law. To increase transparency and accountability, the findings of the compliance check should be recorded in the State aid decision.
2. As State aid is a strong tool for Member States to pursue policy objectives, **State aid policy should continue to support aid measures that pursue environmental objectives** (e.g. in the area of climate and biodiversity protection), especially when linked to a market failure (such as arising from

⁷ Case C-594/18, Austria v. European Commission (Hinkley Point C). Based on recent caselaw of the CJEU, this verification by the Commission can be limited to infringements that are inextricably linked to the object of the aid measure and aspects closely linked to the object of the aid.

⁸ The Commission should at the very least verify any breach that is inextricably linked to the object of the aid measure or aspects closely linked to the object of the aid measure.

negative externalities) or equity considerations. This is already the case for the CEEAG and the General Block Exemption Regulation⁹ (GBER), albeit subject to certain reservations¹⁰.

3. **A horizontal and holistic approach to environmental mainstreaming in State aid policy**, with the aim of effectively implementing Article 11 TFEU – whether the aid pursues environmental objectives or other objectives (e.g. regional aid, rescue and restructuring aid), should be achieved through:

- a. **The horizontal implementation of the DNSH-principle in State aid policy as a safeguarding tool to ensure State aid does not cause harm to the environment.**

The DNSH-principle has so far been occasionally integrated as a guiding principle in State aid policy, notably in the CEEAG¹¹, the Regional aid guidelines¹² (RAG) and in certain parts of the Temporary Crisis and Transition Framework¹³ (TCTF). The Important Project of Common European Interest Communication¹⁴ (IPCEI) goes a step further and requires a supported project to comply with the principle. Such requirement should be integrated generally across State aid policy (in all guidelines and regulations) in order to close loopholes for environmentally harmful aid. This would be consistent with the Commission's intention to streamline the DNSH-principle across all EU funds under the next Multiannual Financial Framework.

The purpose of applying the DNSH-principle should be to go beyond verifying compliance with environmental law. The principle must be strengthened to address some of its weaknesses and inconsistencies such as those encountered when applied in the context of the Recovery and Resilience Fund and in the Taxonomy¹⁵ delegated acts.

- b. **The implementation of environmental conditionalities where relevant and/or necessary.** Depending on the supported activity or sector, environmental conditionalities for disbursement of aid are key to prevent or limit harmful effects on the environment, beyond the application of the DNSH-principle. It is also key in supporting the sustainable transition of many economic activities in view of a competitive, resilient and sustainable development.

Environmental conditionalities can take many forms, both in terms of design as well as their differentiated effectiveness. The options range from *ex-ante* environmental eligibility criteria (e.g. only companies meeting certain standards are eligible for aid) to binding *ex-post* commitments with a clawback mechanism to recover the aid in case conditions are not

⁹ Regulation 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

¹⁰ For a more detailed overview of the CEEAG, please consult [ClientEarth's briefing on the CEEAG](#). For a similar overview of the GBER, please consult [ClientEarth's briefing on the GBER](#). It must be stressed that both the CEEAG and the GBER leave room for State aid to fossil fuels, mostly for fossil gas. Especially the safeguards to limit aid for fossil gas in the CEEAG (e.g. a project needs to demonstrate that lock-in of fossil gas is avoided and that it contributes to the EU's climate targets) appear to be weak in practice, as the aid approval decisions for the LNG terminal in Alexandroupolis (SA.105781) and Brunsbüttel (SA.102163) testify.

¹¹ CEEAG, para. 72 and 134.

¹² Communication from the Commission Guidelines on regional State aid, para. 105.

¹³ Communication from the Commission Temporary Crisis and Transition Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia, para 77q and 78q.

¹⁴ Communication from the Commission — Criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest, para. 20.

¹⁵ Regulation 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment.

respected (e.g. this is already the case for aid in the form of reductions from electricity levies for energy-intensive users that need to meet energy efficiency obligations – although these obligations are largely insufficient). In general, *ex-ante* conditionalities are to be preferred over *ex-post* commitments because this allows to mitigate environmental impacts from the outset. Importantly, not only the initially agreed conditionalities matter but also their **monitoring and enforcement** in case they are not followed through.

Nonetheless, the Commission seems reluctant to integrate such environmental conditionalities in its State aid policy or apply them in individual State aid decisions. For example, for certain parts of the TCTF, the Commission only *invited* Member States to consider setting requirements related to environmental protection.¹⁶ Unsurprisingly, Member States have barely engaged¹⁷ with this invitation. In this respect, it is worth deflating the concern that environmental conditionalities always result in higher aid amounts and are therefore detrimental to competition and trade on the internal market, since:

- Environmental conditionalities do not always require extra spending/costs. For example, sufficiency targets¹⁸ do often not require investments and are unlikely to involve higher operation costs.
- Costs related to the implementation of environmental conditionalities must not per definition be eligible for State aid. Aid measures can be designed in a way that costs related to environmental conditionalities are borne by the beneficiary.

4. Notwithstanding the boundaries formulated in the CJEU's caselaw regarding the assessment of the negative effects of aid on competition and trade in the internal market (see section 3, point 3), it is sometimes **desirable, necessary or unavoidable to take environmental considerations into account as part of the assessment of potential negative effects of an aid measure on competition and trade**. This applies regardless of the aid objective pursued.

Growing climate and biodiversity risks are liable to impact not only finance, but also competition and trade in most economic sectors. After all, providing aid to undertakings and sectors that are unlikely to be competitive for much longer in view of climate and biodiversity risks, and a fast changing regulatory framework, is likely to be inefficient and hamper competition and trade. This also underpins the approach taken by the Commission in the CEEAG: “*These distortive effects can be particularly important when the aid is granted to projects that provide a limited transitory benefit but lock out cleaner technologies for a longer term, including those necessary to achieve the medium-term and long-term climate targets enshrined under the European Climate Law.*”¹⁹ For these reasons, supporting energy produced from fossil fuels is often considered to aggravate

¹⁶ See point 38 TCTF. The invitation to set environmental protection requirements only applies to aid for additional costs due to exceptionally severe increases in natural gas and electricity prices (section 2.4 TCTF) and to aid for accelerated investments in sectors strategic for the transition towards a net-zero economy (section 2.8 TCTF).

¹⁷ In a Lithuanian aid scheme (SA. 103781) aimed at remedying the energy price increases faced by undertakings that are directly or indirectly affected by the serious disturbance of the economy caused by the Russian aggression against Ukraine (section 2.4 TCTF), the authorities require undertakings applying for aid to either stop fossil fuel (gas) use or reduce their fossil fuel consumption by at least 20% while investing the aid received under the notified measure in order to enable reduction in fossil fuel consumption. Many Member States have adopted similar aid schemes but without any environmental conditionalities.

¹⁸ For an example of a condition that incentivises energy savings without requiring extra investments from and therefore extra aid to beneficiaries, please refer to point 71(e) TCTF. In this point, the Commission specifies that in determining the maximum eligible costs based on consumption of natural gas and electricity, it will not take into account any costs related to a consumption that exceeds 70% of the consumption in the same period in the prior year.

¹⁹ CEEAG, para 67.

market inefficiencies, given the available cleaner technologies as well as the efficiency and sufficiency possibilities.

5. Based on the above, there is no doubt that environmental considerations can impact the overall compatibility assessment of State aid, regardless of the aid objective pursued. Therefore, **as a general approach**, we suggest that when developing State aid policy in the future, the following guidelines are to be observed:

The more an aid measure increases – or does not mitigate – negative environmental or climate effects (e.g. in terms of biodiversity or greenhouse gas emissions),

... the more long-term the negative environmental or climate effects of an aid measure are (e.g. because of the life-time or persisting pollution of the supported investment or activity),

... the more alternative measures exist that would be less harmful to the environment or avoid negative environmental effects altogether, and

... the less ‘safeguards’ for mitigating negative environmental effects are proposed by the beneficiary of the aid or imposed by the granting authority, then

- ***the less an aid measure can be considered to be in line with the sustainable development in and competitiveness of the EU internal market, and the more restrictive the compatibility conditions should be.***

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