ETS Review proposal and implications for energy-intensive industries: The chemical industry case

Plenary Meeting of the Sector Social Dialogue Committee, European Chemical Industry

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cefic

EC Energy package

EU Commission:

New industrial revolution that will transform Europe into a highly energy-efficient and low-CO_2 energy economy

5 key areas are addressed:

1. Internal Energy Market
2. Climate Change
3. Energy Efficiency
4. Renewable Energy
5. Security of supply

Emission Trading Scheme Directive Review is a major legislation in this context.

Emission Trading Scheme Directive Review

The European Commission proposes:

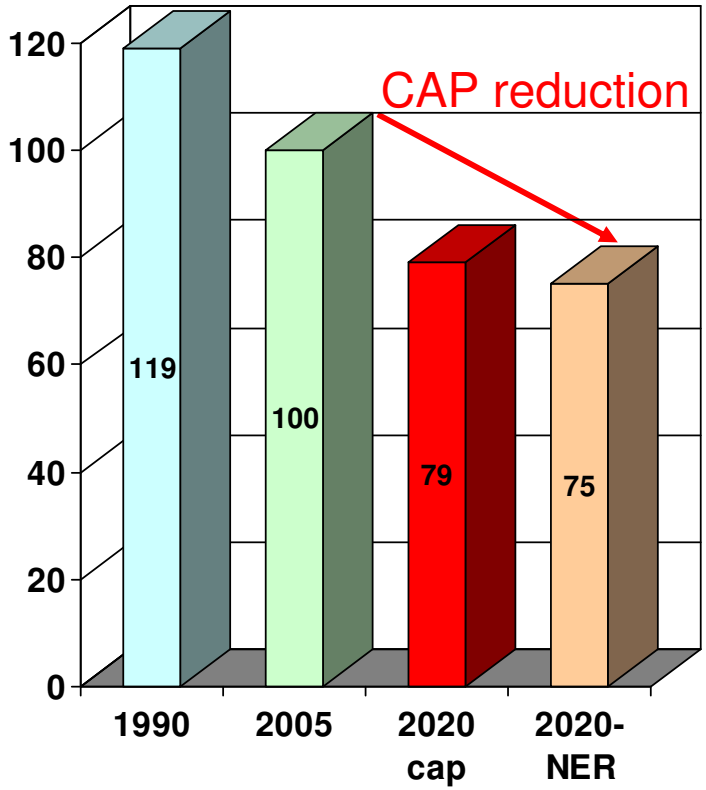
- New levels of greenhouse gas reductions (at least 20%)
- New coverage of large industrial emitters: extension of the current ETS to sectors such as chemistry and aluminium
- Introduction of full auctioning for CO2 allowances for all market participants

Legislative timeline:
- EU aims at agreement on ETS until early-2009
- EP plenary vote in first reading planned for Dec. 2008
- EP committee votes planned for July and October 2008

Key issues for the European Chemical Industry: Target must be feasible and allocation methodology must not distort global competitiveness

The EC Proposal:

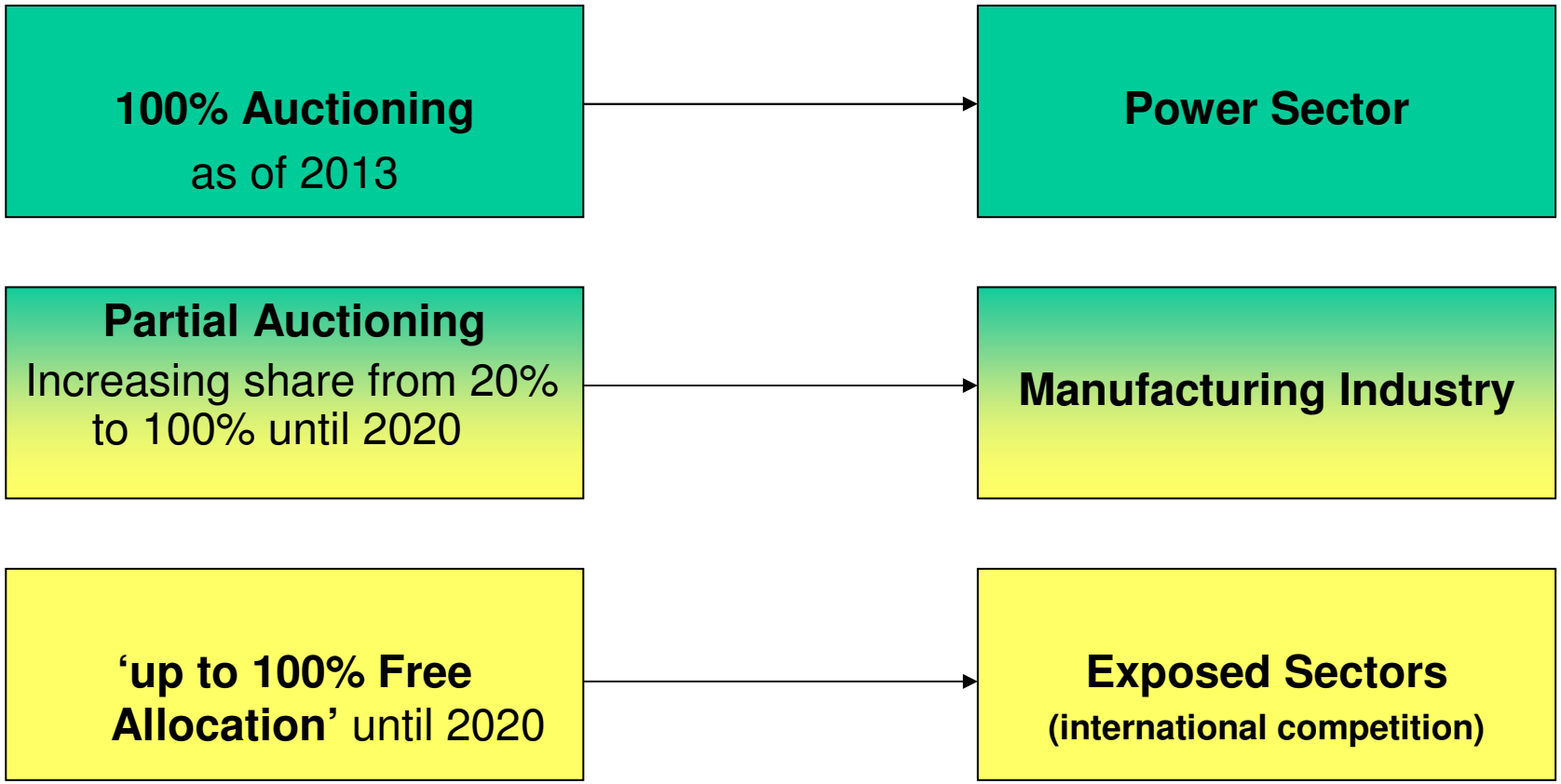
Reduced number of allowances under a reduced cap



The EC proposal:

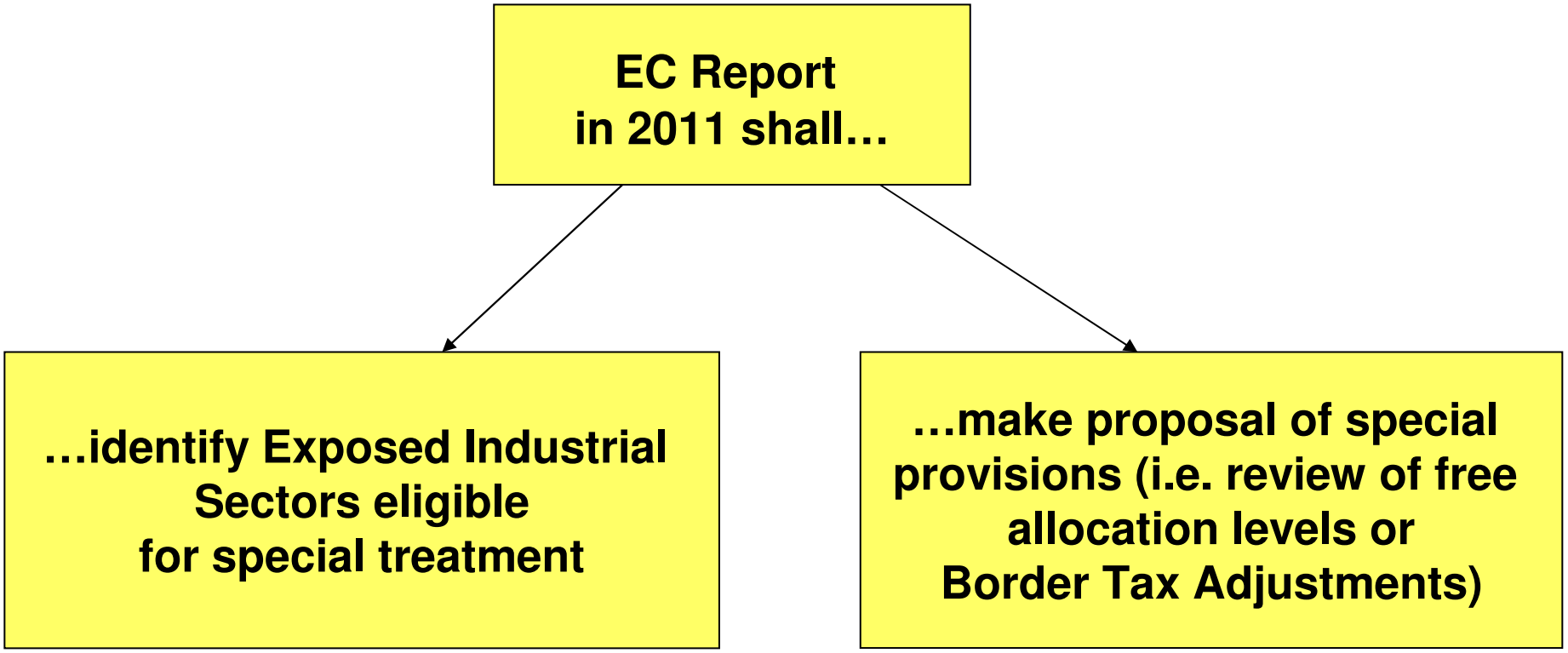
- **Sets a** – 21% **reduction cap in 2020 compared to 2005** for CO2 emissions
- **results for ETS sectors in a cut by >30% in 2020 compared to 1990**
- **new entrants reserve (NER) of 5 % leaves** 75% **to incumbents**
- **Missing allowances:** 40% compared to 1990 or in a 'business-as-usual' (BAU) scenario **to be bought on the market or off-set by credits (CDM/JI)**

Allocation Methodology: EC proposal



EC envisages full auctioning for all sectors by 2020

Exposed Sectors: EC proposal
Clarification postponed…



The European Chemical Industry is energy intensive and in strong international competition and must therefore be treated as Exposed Sector

EC Proposal leaves essential elements open

Unclear until 2011 on

1. Exposed sectors and criteria
2. Allocation methodology for exposed sectors

➔ no predictability for investment decisions (freeze of investments)

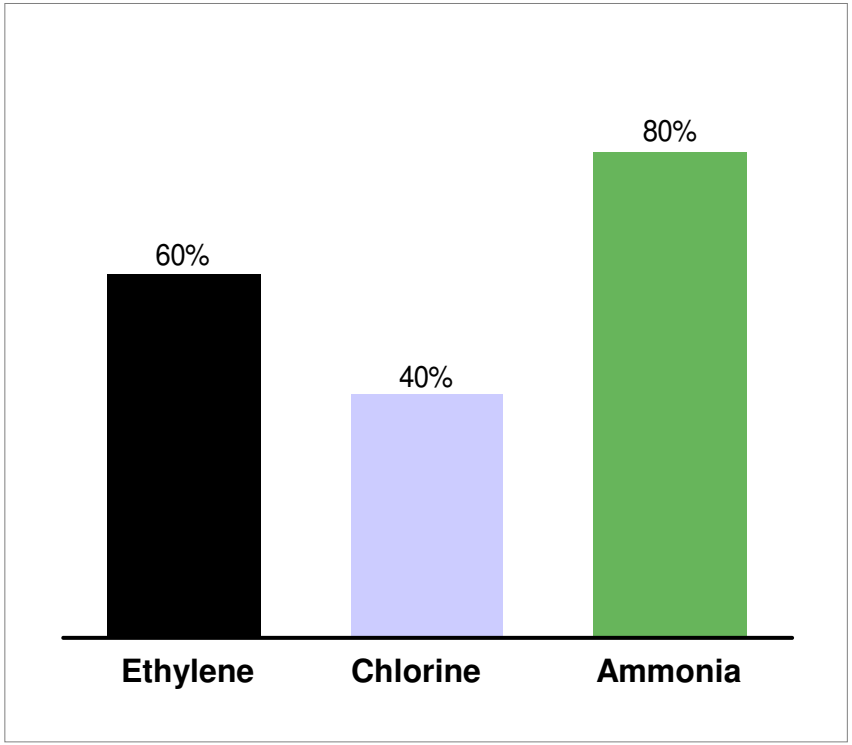
➔ Decisions by comitology procedure lack transparency

The European Chemical Industry needs clear answers before 2011:

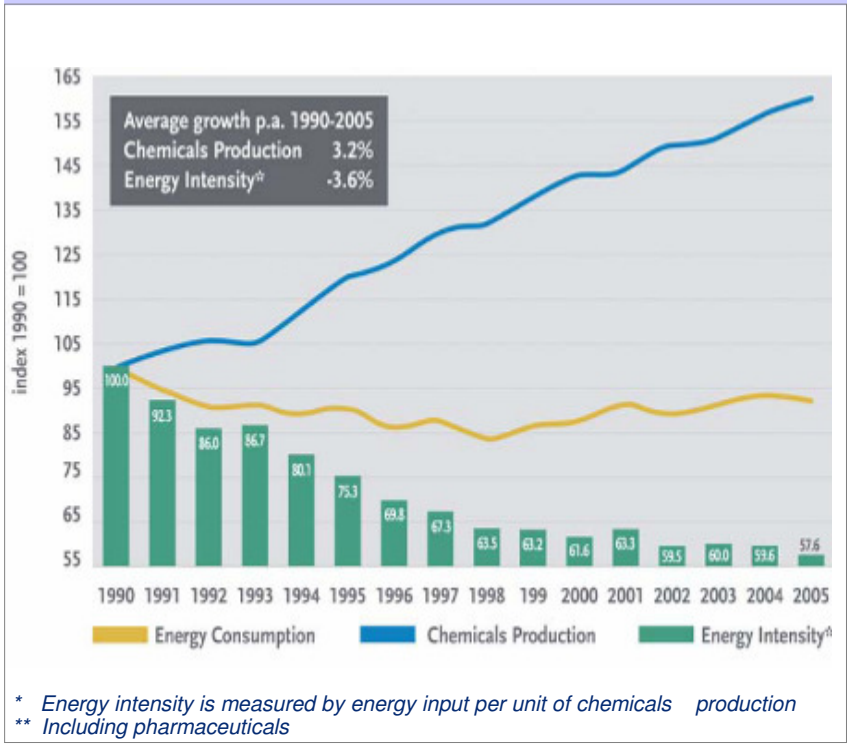
List of exposed sectors and allocation methodology must be part of the ETS Directive now

Despite efforts to improve energy efficiency, the chemical industry remains an energy-intensive industry

Energy costs as part of total production costs(1)



Energy intensity of EU chemical industry(2)



* *Energy intensity is measured by energy input per unit of chemicals production*
** *Including pharmaceuticals*

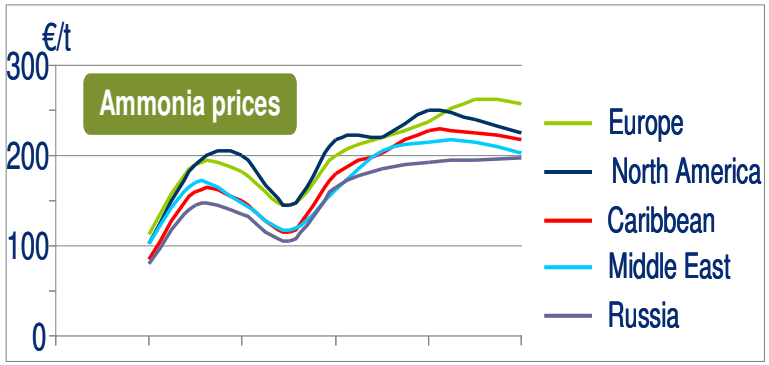
As such, special attention should be paid to the impact of the new ETS not only on emissions costs but also on energy costs

Sources: (1) Prochemics "Impact of electricity price on the competitiveness of the European Chlor-Alkali Industry" 2007
IEA (2007) "Tracking energy efficiency and CO2 emissions", Technon "Parpinelli Report"
(2) Cefic, Eurostat

Exposure to international competition

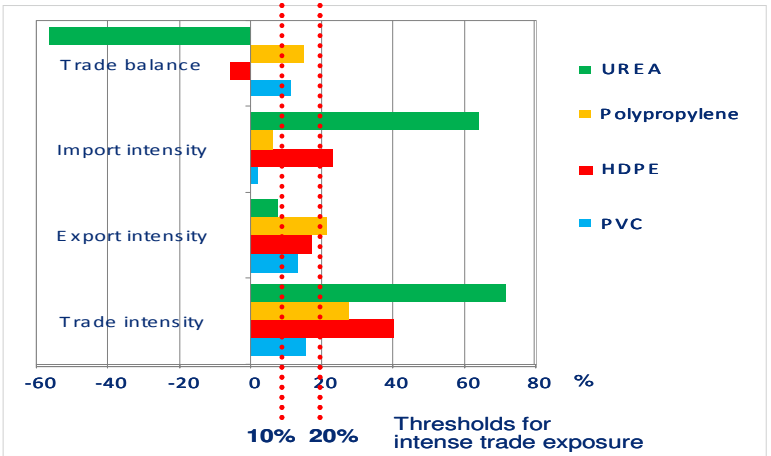
Base products are indirectly subject to international competition

- Base products exhibit global market prices
- There is a global market for all chemicals in which prices cannot be adapted asymmetrically in one region



Downstream products are exposed to international trade

- This exposure is revealed through intense trading (>20%) of downstream products which impacts markets for base products



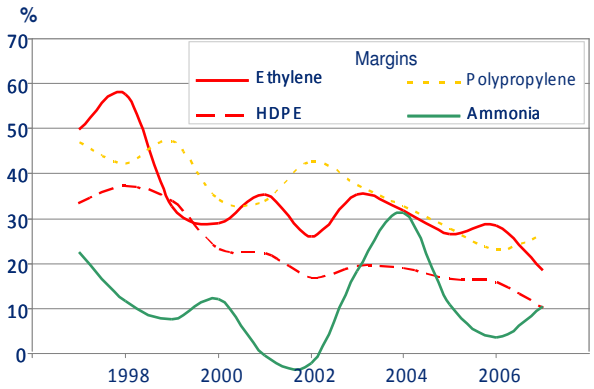
The EU chemical industry is exposed to a competitive global market in which prices cannot be changed asymmetrically

Source: Appe, Eurochlor, EFMA

Economic impact

2002 marks the beginning of a downwards slope for the chemical industry

- The pressure on margins is due to the influence and negotiating power of suppliers and customers. Higher costs and a limitation on prices result in lower margins and lower profitability for the chemical industry

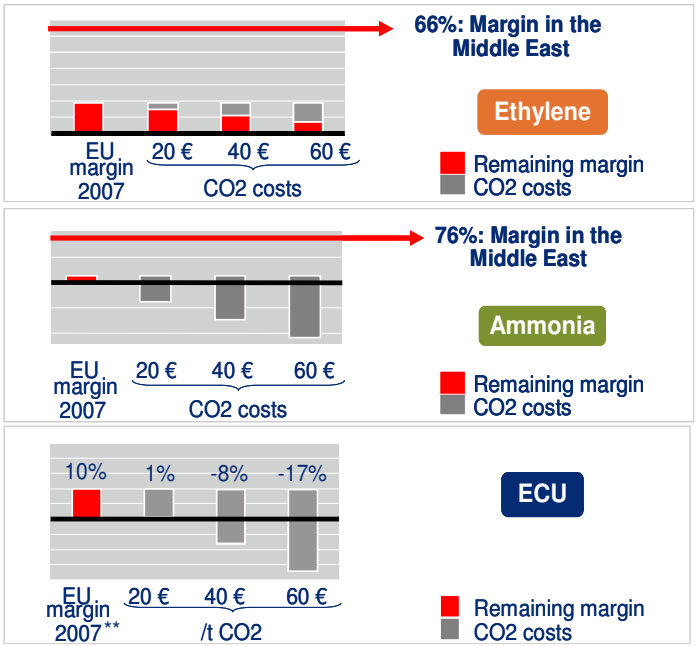


Suppliers (Oil Industry)

CHEMICAL INDUSTRY

Customers (Consumer Industries)

The EU chemical industry cannot afford to see its margins reduced by 25 to 50%, below the lowest profitability level worldwide, or even disappear*

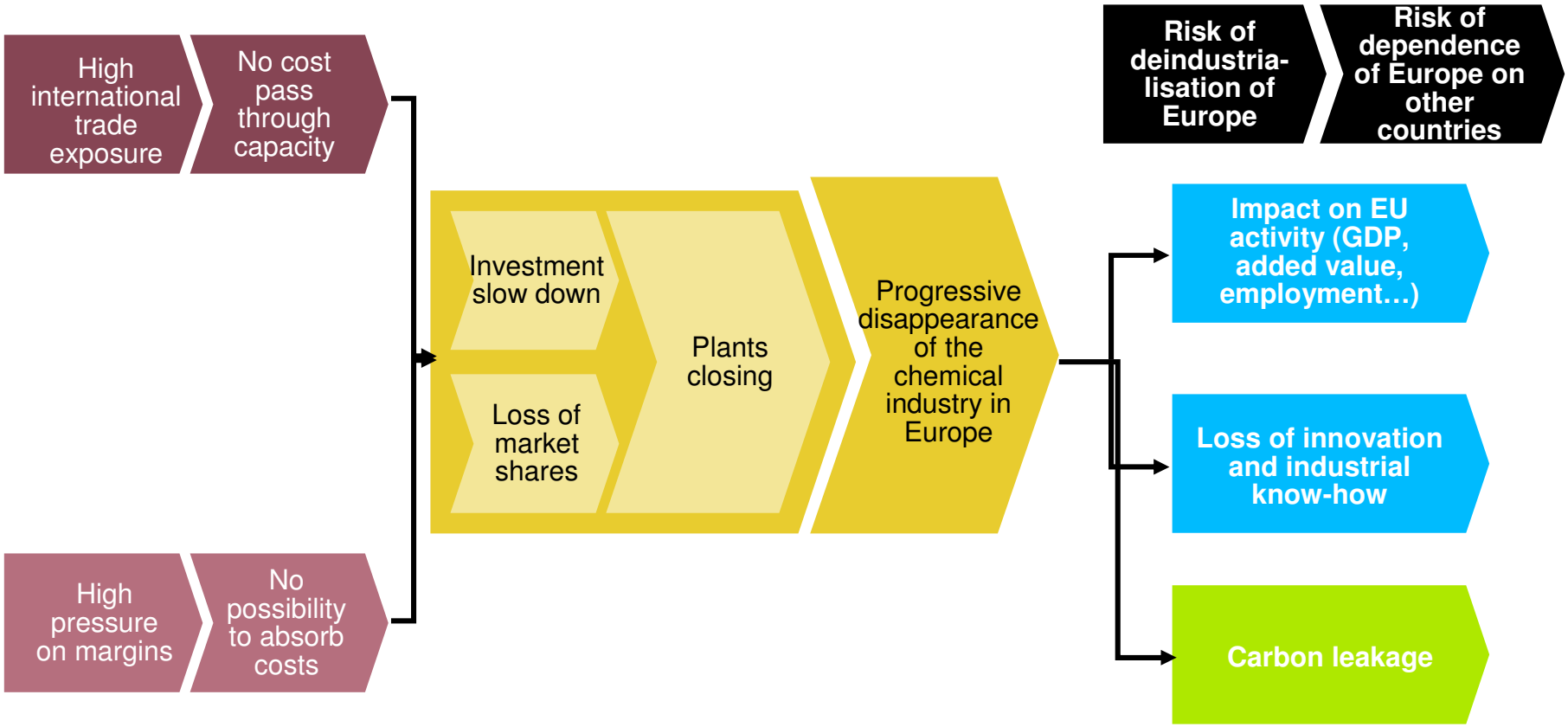


The extra CO2 costs resulting from the ETS would bear a fatal blow on the EU chemical industry which is already striving to defend its margins and market shares

* Detialed impact for all products is given page 32 and following of Cefic's docuemtn submitted for DG Enterprise on April 18th 2008
** Margin in Germany considered most representative

Sources: Appe, EFMA, Eurochlor, DG Enterprise

Summary of potential impacts of ETS



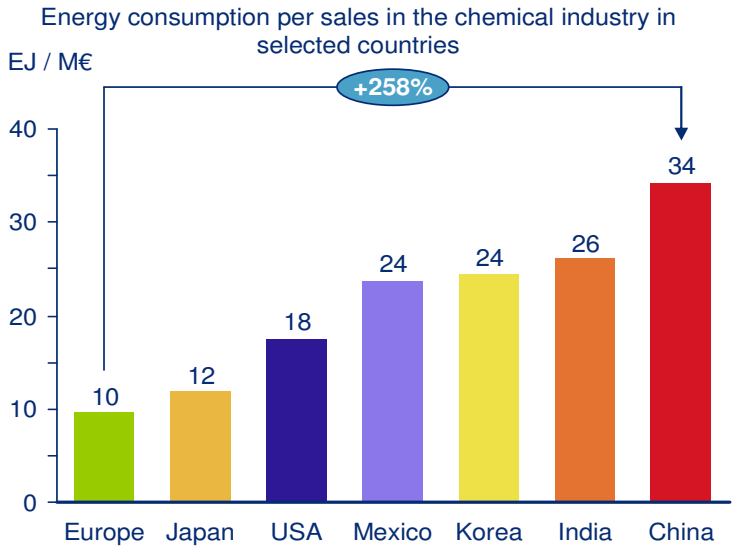
Important CO2 costs, which the chemical industry could neither pass on nor absorb, would lead to a progressive disappearance of the chemical industry in Europe

All of this will happen to an industry that is essential for climate change solutions through their products – counterproductive approach by EC

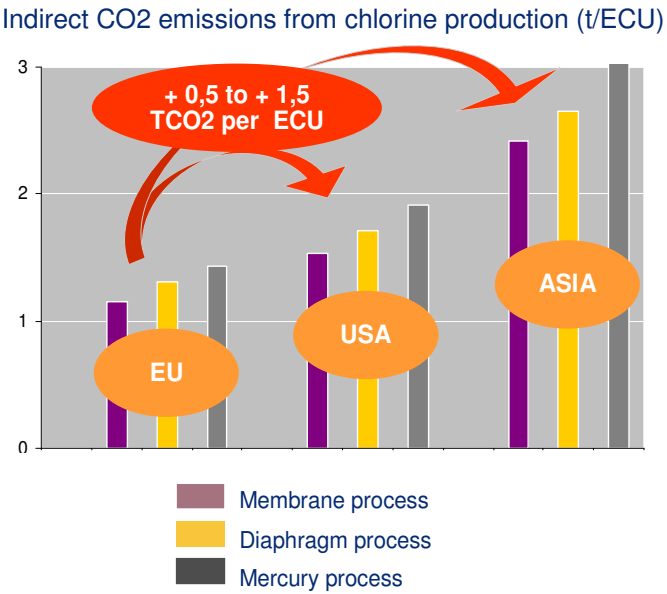
Environmental impact:

Carbon leakage leads to increased emissions worldwide

The energy intensity of chemicals production is lowest in Europe



The CO2 intensity of electricity is better in Europe



If chemicals are produced outside of Europe, carbon leakage will occur as a result of less efficient processes on the one hand and higher indirect CO2 emissions from electricity production on the other hand, leading to an increase in worldwide emissions

Sources: IEA (2007) "Tracking energy efficiency and CO2 emissions", Eurostat and Cefic, EFMA
IEA World Energy Outlook, DG Enterprise

Conclusions

Required legislative outcomes

1. List of exposed sectors and allocation methodology for exposed sectors should be part of the ETS Directive to create planning certainty and avoid freezing of investments
2. The chemical industry is recognized as an exposed sector
3. 100% free allocation based on performance benchmarks is the preferred allocation methodology for our industry as it provides the same environmental incentives at lower overall costs

Support by all stakeholders necessary for a sustainable European Chemical Industry

Contacts

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Backup Slides

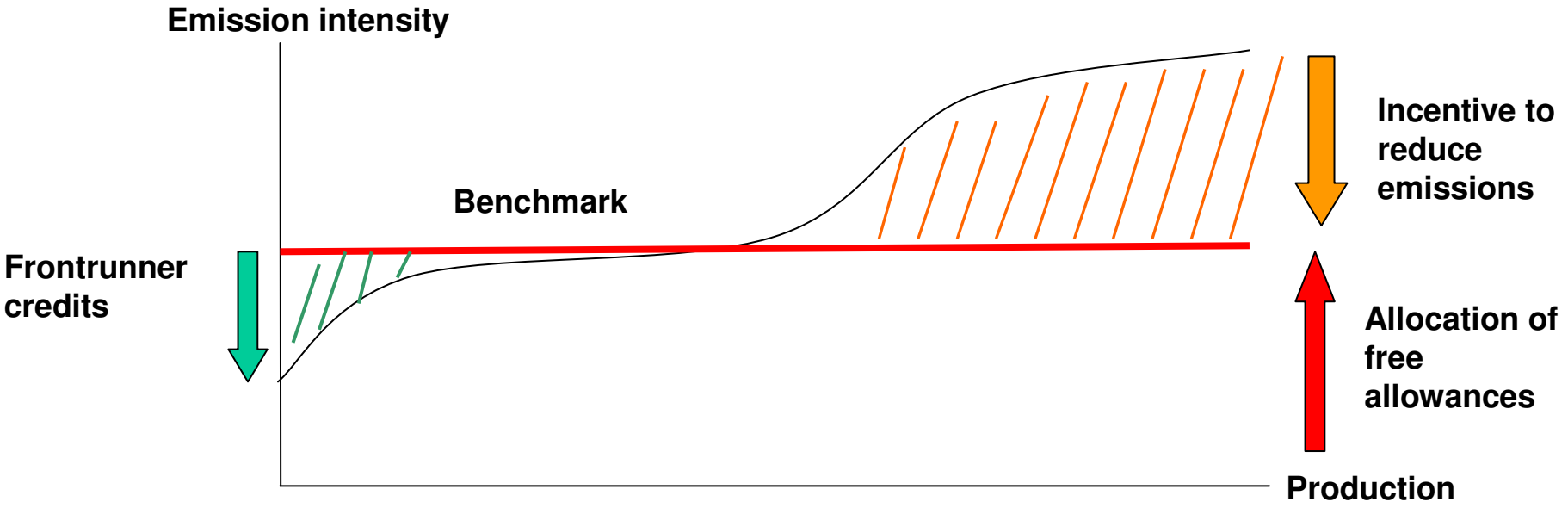
Key messages

- **Chemical industry is an exposed sector**
  - ✓ Built on energy-intensive building blocks (such as ethylene, ammonia, chlorine)
  - ✓ Competing globally and highly exposed to trade
  - ✓ Not able to pass through unilateral cost to its customer industries
  - ✓ At risk for delocalisation and carbon leakage

- **Allocation methodology for CO2 allowances: Free allocation based on performance benchmarks**
  - ✓ This provides same incentive to reduce CO2 emissions as auctioning

Free allocation based on benchmark provides same incentive as auctioning to reduce CO2

- Creates incentive for continuous emission reductions: Frontrunners can sell credits
- Benchmarks recognise performance whilst encouraging transition towards energy-efficient, low-carbon and competitive manufacturing
- Transition towards low-carbon economy through improved efficiency rather than reduction of EU production
- Reduced spending on allowances allows for investment and R&D in cleaner technologies and products



Free allocation based on performance ≠ free ride

- Ambitious benchmarks will require investments, improvement of CO2 performance
- The main difference between full auctioning and a benchmark-based allocation is the total cost for industry: the total cost for purchasing required allowances would be much lower while achieving the same incentive for improving performance.

Allocation to chemical industry installations must be 100% free based on performance benchmarks