Sector Social Dialogue Committee Chemical Industry

WG Industrial Policy, Competitiveness and Employment meeting on 5 Dec 2008

ETS Review: Update

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European Chemical Employers Group

cefic

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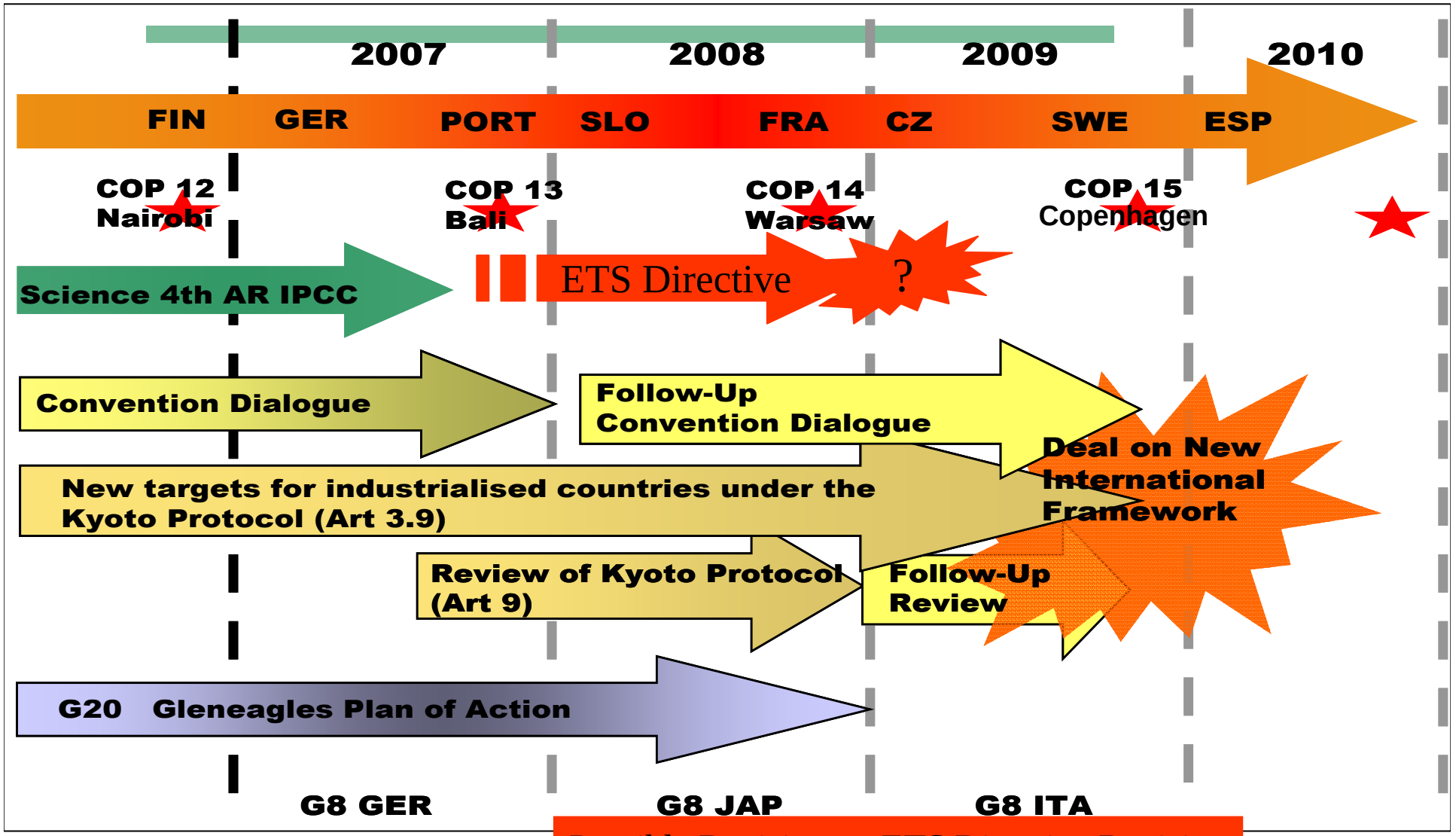
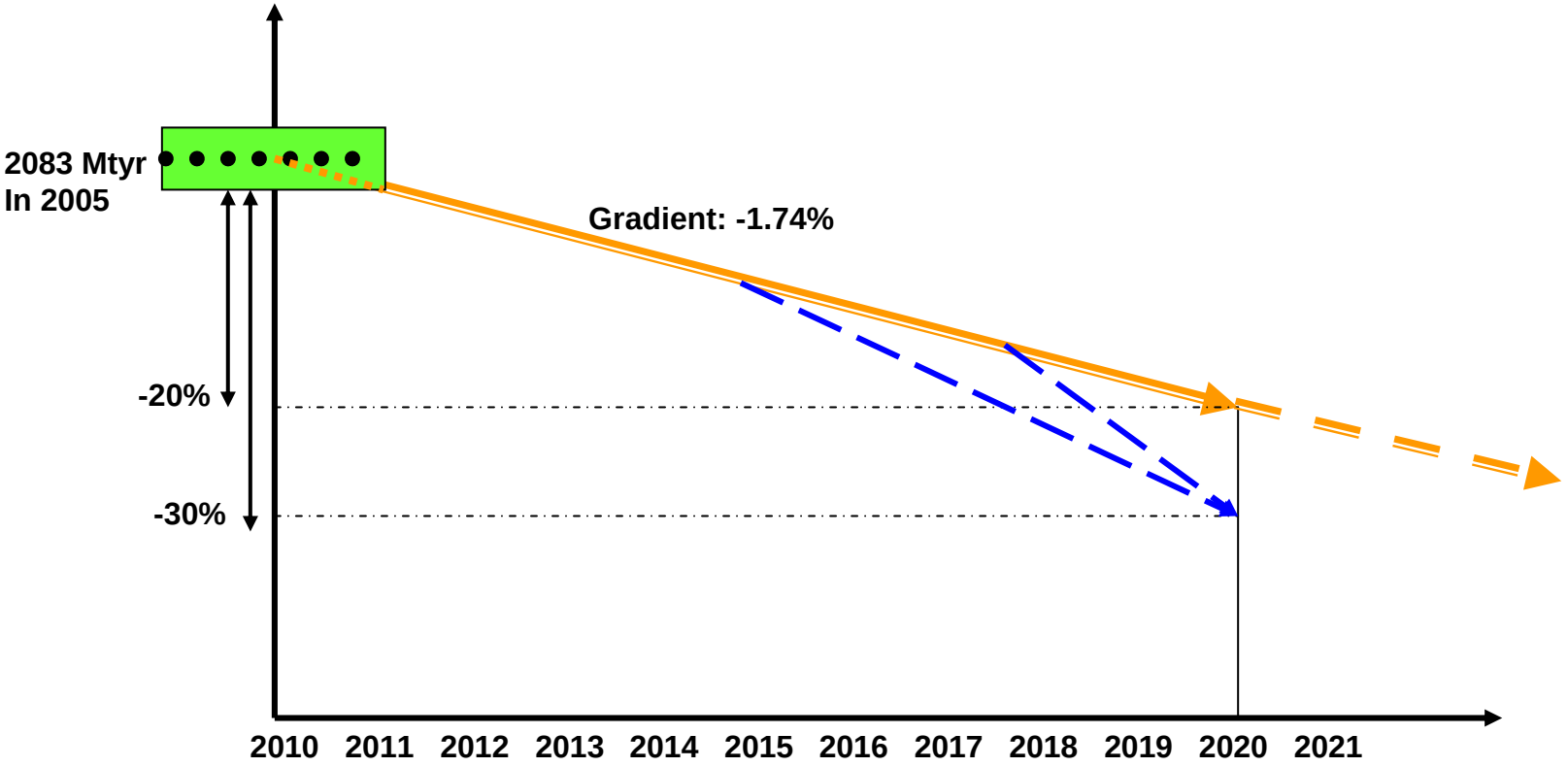
Global scene: Busy negotiations



Possible Decision on ETS Directive Revision
End of 2008 ?

EU response: ETS Cap setting



Emission Trading Scheme Directive Review

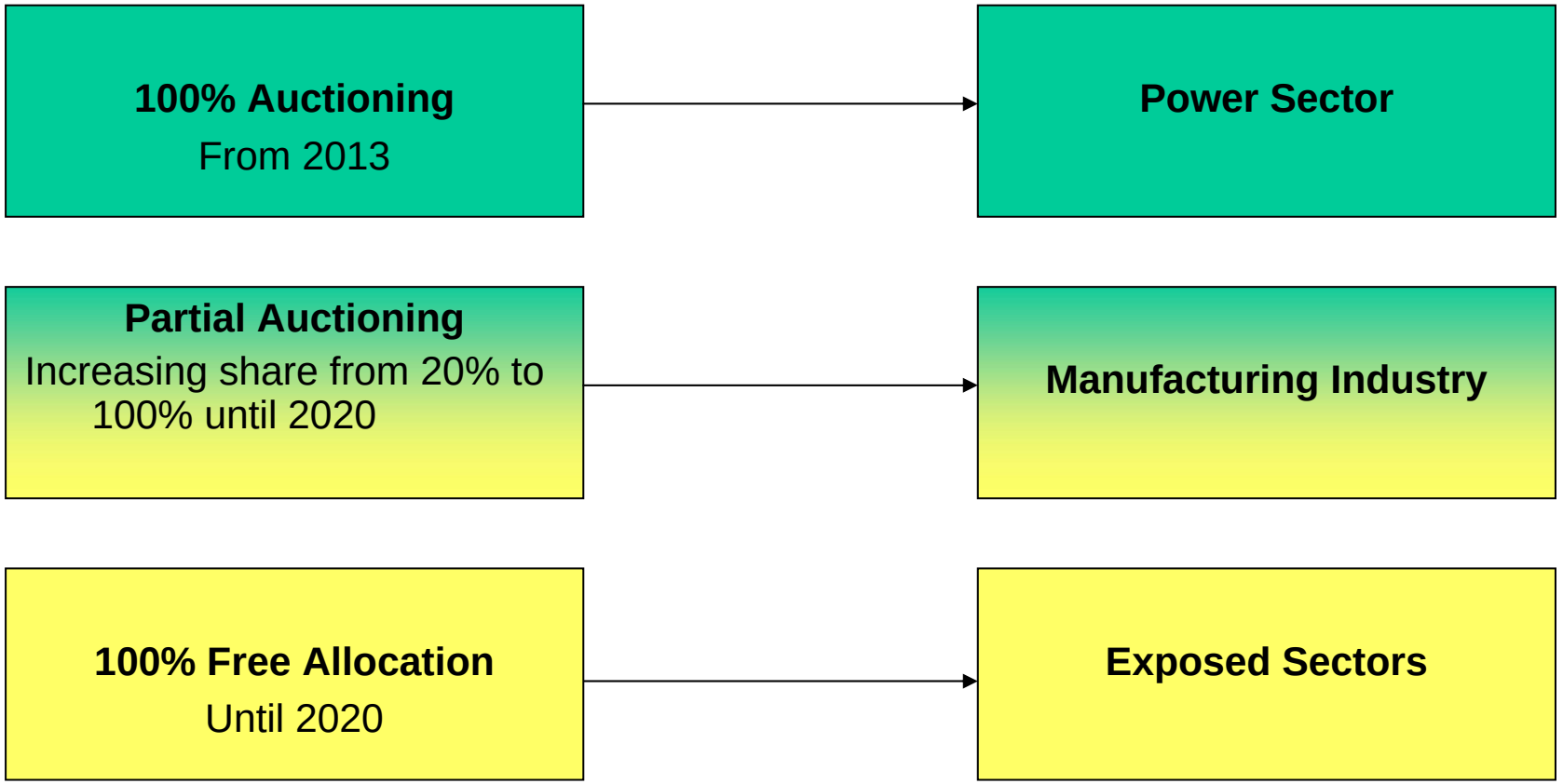
The European Commission proposed in January 2008:

- Automatic trigger to -30% in case of « international agreement »
- No recognition of and no solution for indirect emissions
- No special treatment for CHP
- Full auctioning for all sectors by 2020
- No criteria for exposed sectors
- List of exposed sectors by 2011 only
- Everything in Comitology
- Benchmarking as allocation basis hardly mentioned (only in recital without legal relevance)
- …

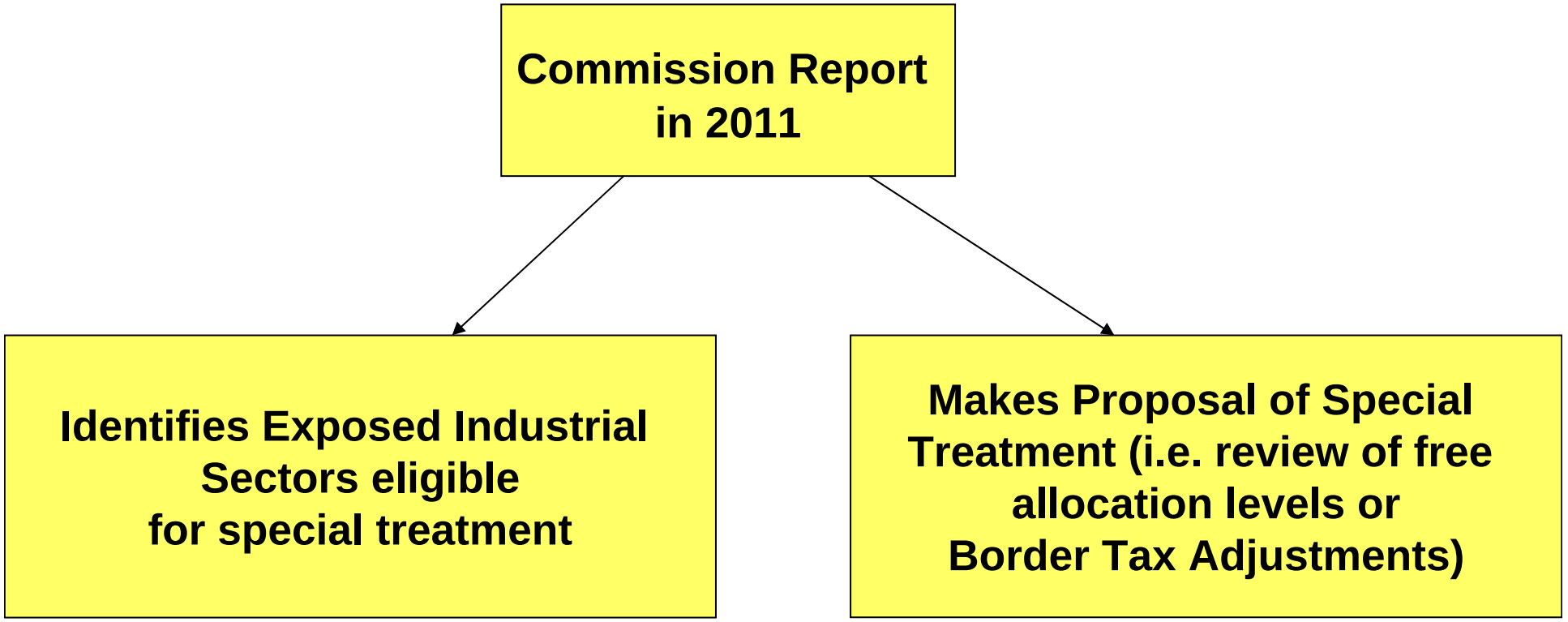
Key issue: Type of allocation methodology decides about global competitiveness

Allocation Methodology: EC proposal

Target: Full auctioning for all sectors by 2020



Exposed Sectors: EC proposal Jan 2008



Problems and solutions

1. Uncertainty until 2011 on
    1. Exposed sectors
    2. Allocation methodology

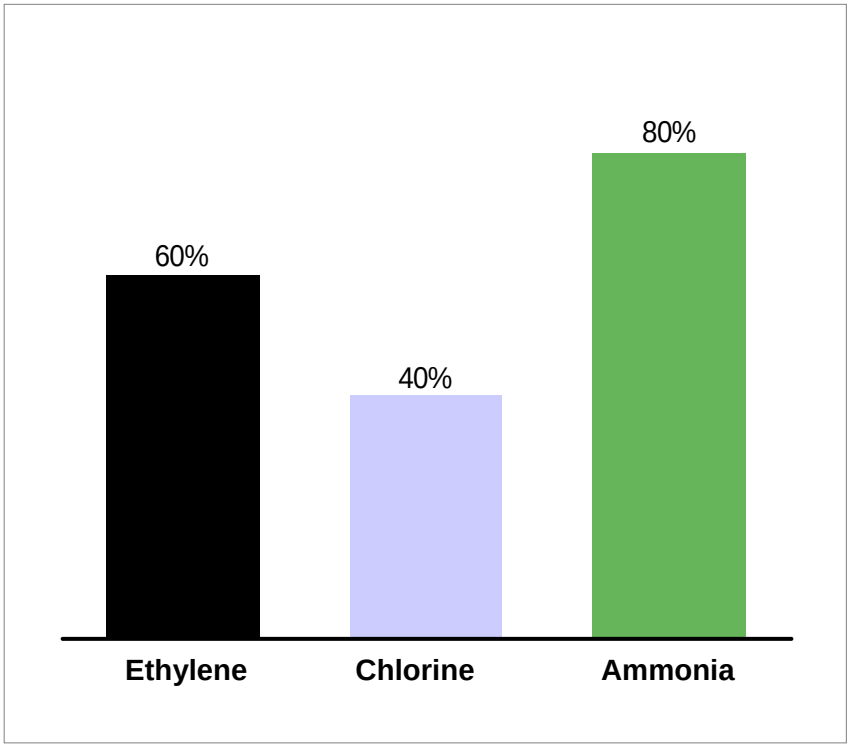
    ➔ consequences for investment decisions
2. Decisions to be made by comitology procedure ➔ lack of transparency

Solutions: Required legislative outcomes

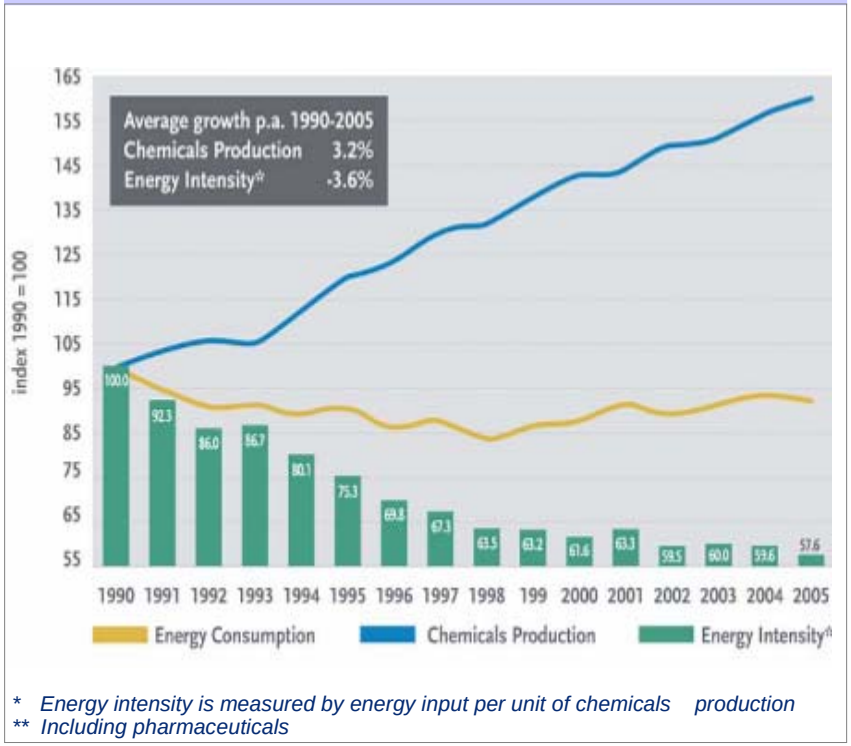
1. Clear criteria and thresholds enabling immediate listing of exposed sectors and
2. Allocation methodology for exposed sectors should be part of the ETS Review Directive to give planning certainty

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*

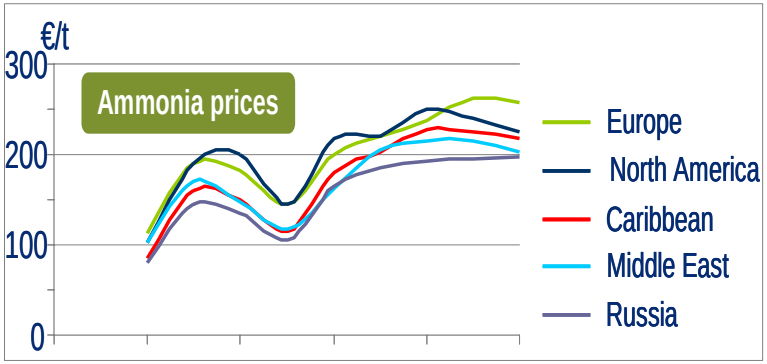
As such, special attention should be paid to the impact of the new ETS not only on emissions costs but also on energy costs

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

We are exposed to international competition

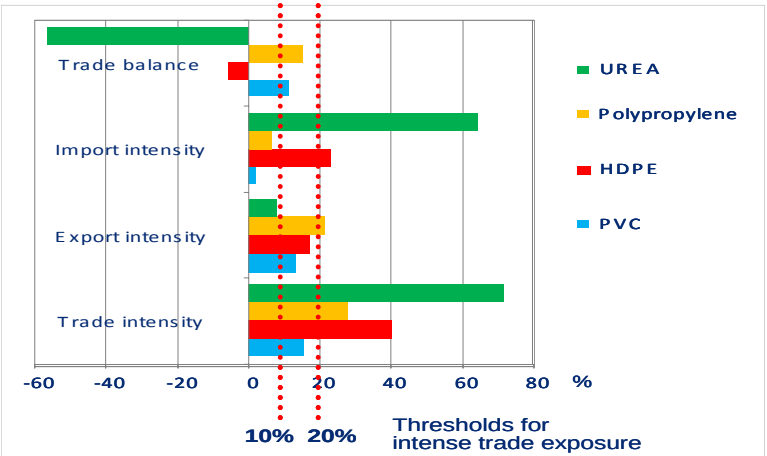
Base products are indirectly subject to international competition

- 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



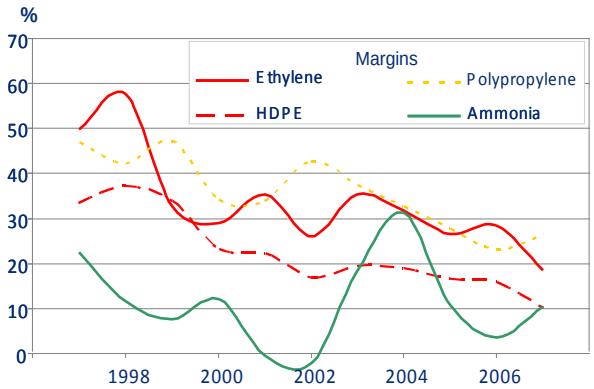
The EU chemical industry is exposed to a competitive global market in which prices cannot be changed asymmetrically

Source: Appe, Eurochlor, EFMA

Economic impact: EU CO2 costs eat up margins

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

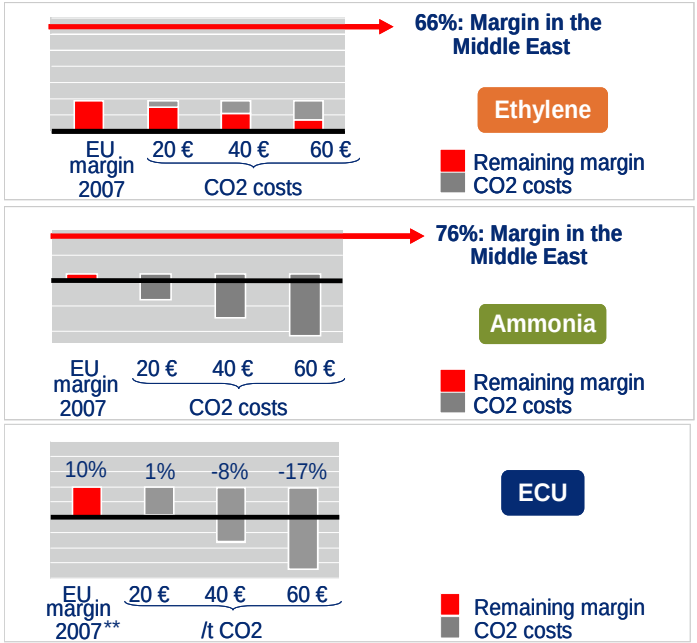


Suppliers (Oil Industry)

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*

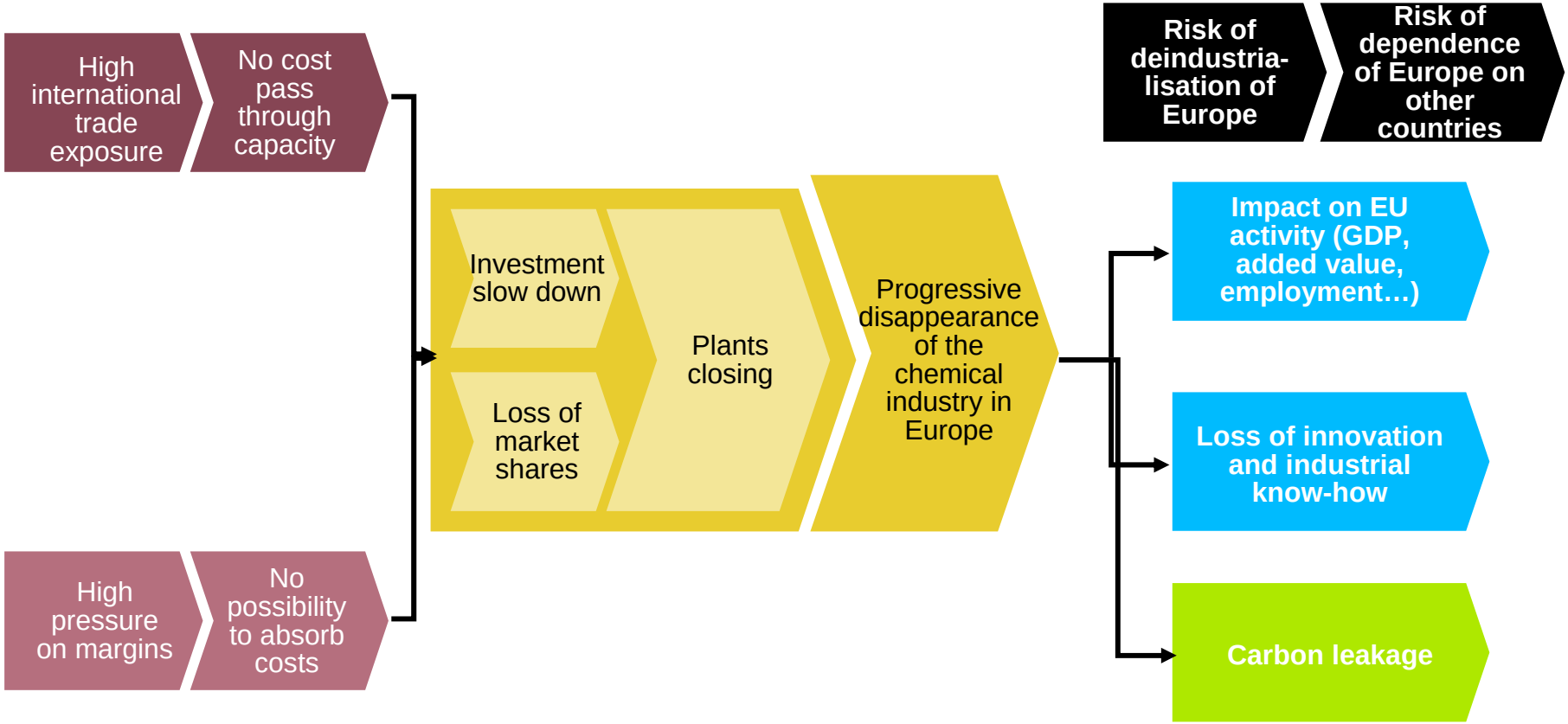


The extra CO2 costs resulting from the ETS would bear a fatal blow on the EU chemical industry which is already striving to defend its margins and market shares

* 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

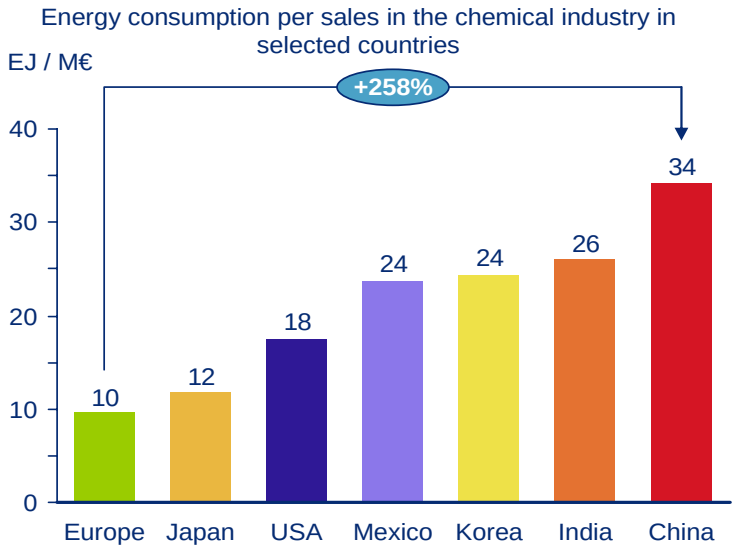


Important CO2 costs, which the chemical industry could neither pass on nor absorb, would lead to a progressive disappearance of the chemical industry in Europe

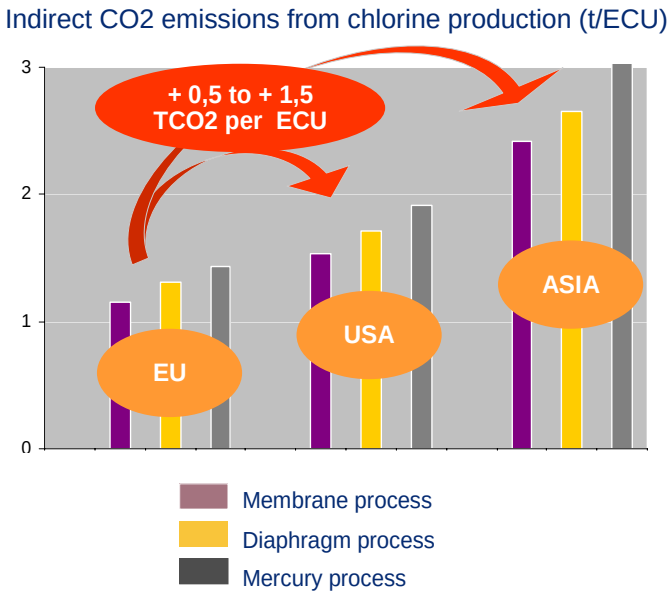
Environmental impact:

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



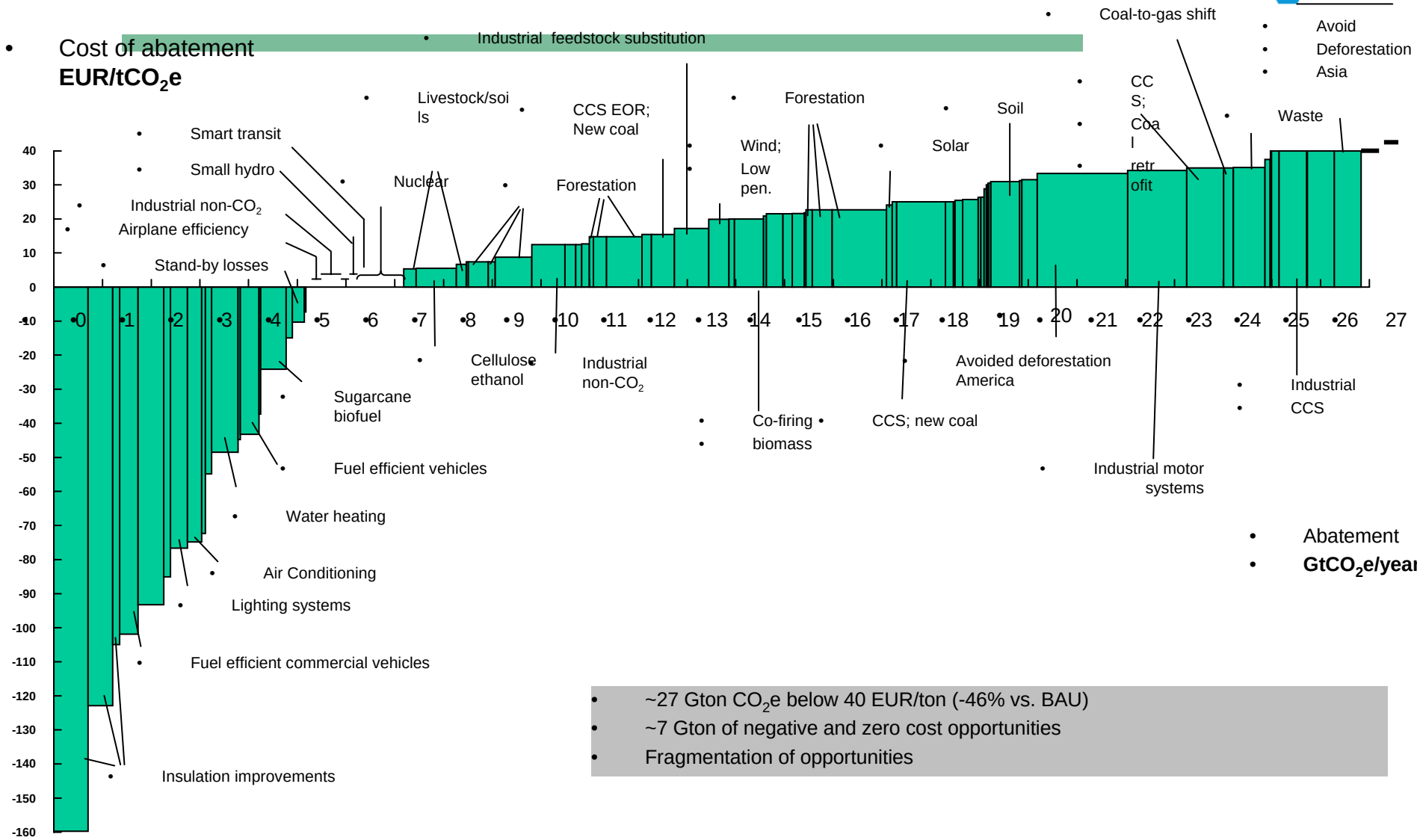
If chemicals are produced outside of Europe, carbon leakage will occur as a result of less efficient processes on the one hand and higher indirect CO2 emissions from electricity production on the other hand, leading to an increase in worldwide emissions

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

Going beyond own manufacturing efficiency:

Chemicals are essential for many abatement technologies!

2030



- ~27 Gton CO_2e below 40 EUR/ton (-46% vs. BAU)
- ~7 Gton of negative and zero cost opportunities
- Fragmentation of opportunities

www.vattenfall.com/climatemap

Cefic Impact Analysis

Direct costs

These costs relate to the direct process related CO2 emissions of the chemical industry.

Assuming a CO2 price of 40 euro, based on 2006 chemical industry emissions, this would result in a direct cost of about 6 Euro bn per annum, or 3.3 % of the gross added value of the industry.

This amount per annum is twice the figure quoted as the total direct cost in the Commission's impact assessment of REACH.

Cefic Impact Analysis

Direct costs

A study by A.T. Kearney regarding the French chemical industry assessed that in order to realise a reduction of about 20% (which is close to the theoretical maximum), investments of Euro 250 million would be required.

Even if this figure cannot simply be extrapolated to the European chemical industry as a whole, it is clear that an investment of more than 1 billion Euro would be required to achieve a similar reduction at European level.

Industry will end up paying CO2 auctioning costs plus having to make investments.

Cefic Impact Analysis

Indirect costs

On the basis of 2006 chemical industry electricity consumption the total yearly indirect costs increase for the sector would amount to Euro bn 5.1, of which 19% for the Chlor-Alkali industry.

It is therefore essential to take the indirect emissions of this latter sector into account by granting it equal treatment as sectors exposed to carbon leakage, in the form of a compensation for their higher energy costs.

Cefic Impact Analysis

Total costs

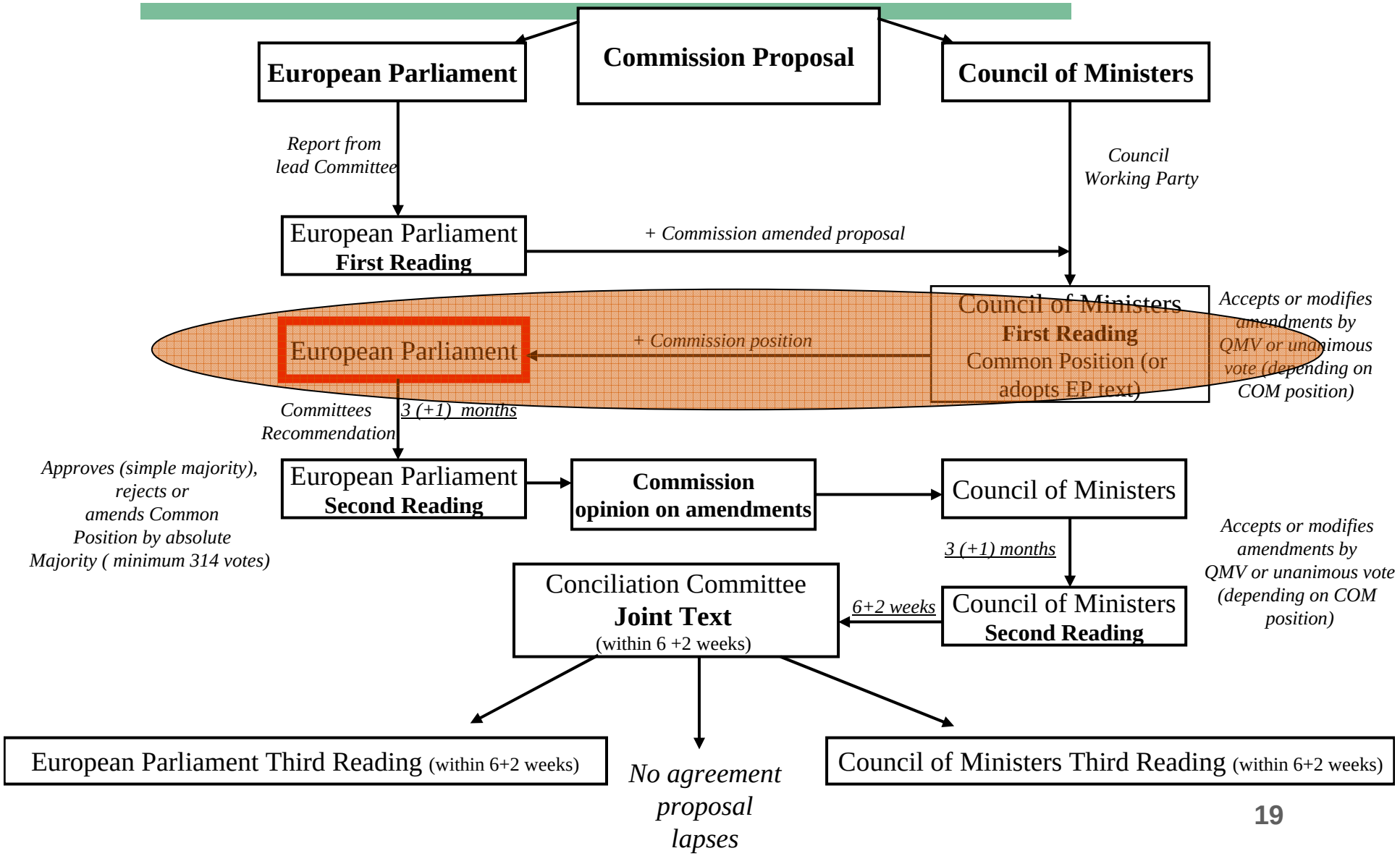
Total yearly costs for the industry in the case of full auctioning would thus amount to Euro bn 11.1 per annum or about 6 % of the chemical industry's gross added value.

Given the international trade exposure of the industry, in most cases it will be difficult to pass on these costs, certainly on third markets.

Employment

Until 2020 in a worst case scenario 135,000 jobs in the chemical industry are at risk, which would roughly affect twice that number in downstream industries (in total 400,000 people).

Where we are…

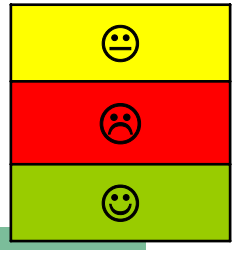

European Parliament
Commission Proposal
Council of Ministers
Report from lead Committee
Council Working Party
European Parliament First Reading
+ Commission amended proposal
Council of Ministers First Reading Common Position (or adopts EP text)
Accepts or modifies amendments by QMV or unanimous vote (depending on COM position)
European Parliament
+ Commission position
Committees Recommendation
3 (+1) months
Approves (simple majority), rejects or amends Common Position by absolute Majority (minimum 314 votes)
European Parliament Second Reading
Commission opinion on amendments
Council of Ministers
3 (+1) months
Accepts or modifies amendments by QMV or unanimous vote (depending on COM position)
Conciliation Committee Joint Text (within 6 +2 weeks)
6+2 weeks
Council of Ministers Second Reading
European Parliament Third Reading (within 6+2 weeks)
No agreement proposal lapses
Council of Ministers Third Reading (within 6+2 weeks)

Timeline

- 1-12 Dec COP 14 in Poznan
- 3-4 Dec EP debate
- 4-5 Dec ENVI Council: «Political agreement»?
- 6 Dec Sarkozy in Warsaw
- 8-9 Dec Energy Council
- 11-12 Dec EU Summit « Details » (e.g. decision on carbon leakage thresholds?)
- 15 Dec: Trilogue discusses EU Summit conclusions
- 17 Dec: EP Plenary vote on package

ETS in the Council

Member states' overall positions



	Overall position	Details
AT		In line with the current Presidency proposal. No defined position
BE		Little consideration for its chemical industry. Government unable to speak with one voice.
BU		In favour of a less steep phasing out of free allocation for non exposed sectors
CY		
CZ		It is concerned for the power sector, less for manufacturing sector. Government needs support of Greens in the Parl.
DE		It pushes for one criterion and stronger measures for carbon leakage. 80% flat rate free allocation for non exposed
DK		On carbon leakage: If measures should be taken, then only after Copenhagen. and after further analysis
EE		Concerned about carbon leakage but don't have a strong position. Would follow the Polish.
EL		Green position
ES		Environment minister is against setting criteria before Copenhagen, Industry minister doesn't agree
FI		Could follow Germany. They don't agree on Cefic criterion (paper industry) and indirect emitters. Ok for the rest
FR		2 criteria (increase in costs, trade intensity), threshold in the Directive. Non exposed 80% to ?%. Shift to 30% reduction in codecision. CHP free allocation with limitations. CION to intervene to stop excessive volatility prices
HU		The government shares the industry's concerns. Doubts on availability of data on GVA. Wants change on year base
IE		
IT		It wants to block the process. Could agree in exchange of concessions for renewables and CO2 for cars.
LT		
LU		
LV		
MA		Are concerns with their power sector (desalination of water). Would go with the majority.
NL		Green government, still uncertain on whether to follow Germany or not. Concerned for indirect emitters
PL		It leads the new MS's block, asks for protection of the industry. Appears a bit extreme and risk to be isolated
PT		
RO		It hesitates whether to define a threshold in the directive for criteria or leave it for comitology
SE		It prefers to wait for Copenhagen to tackle carbon leakage.
SI		
SK		
UK		It is little worried for the manufacturing sector, foresees gains from permissions trading.

Emission Trading Scheme Directive Review

Improvements emerging from 1st Reading:

- Benchmarking is there, but starting point is 10% best!
- Indirect emissions are recognized, but ‘financial compensation’ is wooly and left up to member states!
  - Based on BAT!?
- Industry advantage through CHP is endangered: No free allowances for electricity, only for heat?!
- Vague criteria for exposed sectors, unclear basis for assessment
- Sectors can be removed by EC from ‘exposed’ list every year!
- …

Still a lot of open issues…

Formation of Alliances

- Chemical industries' workers' unions (EMCEF)
- Business Europe
  - Alignment effort
- Alliance of Energy-Intensive Industries
  - Cooperation; drafting common paper
- Alliance of Competitive EU Industries
  - Meeting in Cefic on 21 November

Thank you for your attention!

Cefic Messages

- A definition of the **sectors exposed to carbon leakage** should be inserted immediately into the text to end legal uncertainty and be based on **clear criteria**. We propose a ratio of average GHG intensity higher than

  1kg CO2 / 1Euro gross value added

- **Indirect emissions** of electro intensive industries as defined in art 2, § 4 of the EU Energy Taxation Directive 2003/96/EC should be taken into account and receive an equal treatment, in form of a compensation for their higher energy costs.

- **Cogeneration of heat and power** plants are the most efficient means to generate heat and electricity achieving significant CO2 emission reductions. The EU ETS must encourage CHP by providing free allowances for the production of heat and electricity for their industrial consumption

Cefic Messages (cont.)

- Sectoral objectives of reduction of emissions (**benchmarks**) rewarding the better performances with 100% free allowances are the most proportionate and cost-efficient measure to meet the objectives of the legislation and should be confirmed in the text.

- **Small emitters** should be exempted from the bureaucratic burden of ETS.

Cefic's Criterion on carbon leakage (1)

Kg of CO2 equivalent / € Gross Value Added

- "Kg of CO2 equivalent" measures the quantity of direct and indirect Green House Gases (GHG) emitted in the production phase.
- "Gross Value Added" is basically all the factors on which you do not pay Value Added Tax, but other forms of tax, eg profit tax. A good approximation is Gross operating income plus Personnel cost.

- Detailed definition:
  Gross value added is the value of gross output less the cost of material and other intermediate inputs.
  Intermediate inputs consists of the value of the goods and services consumed as inputs by a process of production, excluding fixed assets whose consumption is recorded as consumption of fixed captital. The goods or services may be either transformed or used up by the production process.

Coreper status

- **Benchmarking: Community-wide ex ante benchmarks for allocation of transitional free allowances of emission rights will be determined in a way to incentivise greenhouse gas emission reductions. The most efficient techniques will be 'rewarded'. A reference to CHP has been inserted.**

- **Exclusion of small installations: Installations of less than 25 000 tonnes of carbon dioxide equivalent and a rated thermal input below 35 MW may be excluded from ETS. Hospitals may also be excluded if they undertake equivalent measures.**

Coreper status (cont.)

- **<u>CDM/JI</u>: Council proposes quality proofing in comitology at the request of Member States. Parliament agreed on the principle, but asked for clear criteria to be defined in the directive to provide guidance for the comitology procedure. The Presidency will come forward with a proposal on the wording for a recital. Parliament delegation and Presidency agreed on the quantity of credits used (not exceeding 50% of the EU-wide reductions).**

- **<u>CHP and waste gases:</u>**

  - Free allocation will be granted for heating and cooling and for electricity generated from waste gases.

Coreper status (cont.)

Furthermore, Parliament and Council agreed on including

- a provision to ensure that the market for emission allowances is protected from insider dealing and market manipulation

- a provision related to the disclosure of information and professional secrecy

- a recital encouraging neighbouring countries to join the EU ETS.

Coreper status (cont.)

- **<u>Free allocation for electricity generated through CHP</u>: This has been pushed by the Presidency, but there is no support from any Member State delegation. Concerns about possible distortions of competition in the electricity market prevail. The argument seems valid, given that 16% of EU electricity is produced by CHP, and even more in some Member States.**

- **<u>Auctioning in the power sector:</u> A presidency proposal is on the table, providing for time-limited derogations for certain Member States, based on clearly defined criteria and conditions, such as connectivity to international grids and the share of coal in the energy mix.**

Coreper status (cont.)

- **Auctioning levels for "normal" industry: Start with 20% auctioning, gradual increase to [70 - 100%].**

- **Carbon leakage: A presidency proposal is under discussion in Coreper. The Commission is working on a methodology to identify carbon leakage sectors based on certain criteria (additional costs induced by ETS and non-EU trade intensity) and to set up thresholds for three different categories of industries (high risk of exposure to carbon leakage/moderate to high risk/low to moderate risk). A proposal on how to deal with indirect emissions is under preparation.**

- **Establishing a list of carbon leakage sectors: Coreper has not established a final position yet. Parliament and Commission share the view that a list should only be available after Copenhagen.**

Coreper status (cont.)

- **CCS: The presidency has presented a text which reduces the number of allowances (from 500 million to 100 - 200 million), includes co-financing provisions and refers also to other renewable energy technologies. The proposal is still under discussion in Council.**

- **International agreement and trigger from minus 20% to minus 30 %: Presidency proposes to stick to the commitment made by Heads of State and Government in March 2007. Following conclusion of an international agreement, the Commission will assess the implications and, based on this assessment, submit a legislative proposal to revise the directive in line with the new commitments. Discussion in Coreper is ongoing.**