POSITION PAPER

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Cefic position on the Commission proposal to step up Europe's 2030 climate ambition

Cefic supports the EU's ambition to become climate-neutral by 2050. Climate-neutrality by 2050 means going through a deep transformation within just one or two investment cycles. The EU chemical industry intends to grasp the opportunities arising from the transition to a climate-neutral and circular economy.

We acknowledge the EU's desire to significantly accelerate the transition, in order to ensure timely action and meet the climate-neutrality objective by 2050. Increasing the 2030 EU GHG target should provide a balanced reduction pathway towards 2050 and redistribute in time the transition effort towards climate-neutrality. In that context, it is important to refine the current analysis on technology readiness and to understand the length of investment cycles in each sector of the economy. This is why Cefic is asking for a sectorial strategy providing more details on how the Commission expects different sectors of the economy (industry, power, buildings, transport, agriculture) to contribute to the overall objectives until 2030 and beyond (taking into account GHG emission reductions so far) and how it will approach "hard to abate" sectors. It should also include regular check points regarding progress on the enabling conditions for the transition of each sector, the expected rate of deployment of breakthrough technologies, availability of resources and private finance.

Innovation in industry is not linear but it needs to rely on a long-term vision

Demonstration of key breakthrough technologies on an industrial scale will take a decade and industry often has long investment cycles. This is why it is important to create the enabling conditions for their successful deployment: we welcome the strong emphasis on the decarbonisation of the power sector but wish to emphasise again the importance of abundant and reliable electricity at competitive prices, next to other low-carbon energy sources, to achieve deep GHG emission reductions in our sector.

The Commission's impact assessment foresees an average annual investment in industry of approximately 20 Billion € until 2030, mostly directed at energy efficiency (waste heat recovery). While recognizing the importance of continuous improvement into efficiency of current processes, we doubt that incremental improvements alone will be sufficient to deliver on long-term GHG emission reductions targets. Investments will need to be compatible with long-term targets to ensure optimum use of resources and to avoid stranded assets.. The energy intensity of the chemical industry today is already 55% lower than in 1991 and it becomes more and more difficult to find economically viable energy efficiency projects.

The additional effort towards 2030 needs to be shared in a fair manner to secure industry's buy in

The Commission draft Climate Law states that the transition to climate-neutrality requires "a **collective effort of all sectors of the economy and society**". The European Parliament is even more explicit, stating that: "All sectors, whether or not covered by the system for greenhouse gas emission allowance trading within the Union (EU ETS) should undertake **comparable efforts** to deliver on the Union's climate-neutrality objective". We are therefore calling for an ambitious revision of the Effort-Sharing Regulation, which will help effort-sharing sectors to catch up with the EU ETS sectors. Burden-sharing between ETS and non-ETS

European Chemical Industry Council - Cefic aisbl
Rue Belliard 40 b.15 B-1040 Brussels Belgium
Tel. +32.2.436.93.00 mail@cefic.be **www.cefic.org**
EU Transparency Register n° 64879142323-90

sectors should be rebalanced and the share of the ETS-sector in the EU ambition should be reduced as industry is exposed to global competition.
Unfortunately, the Commission's 2030 impact assessment shows that the additional effort would fall disproportionately on the shoulders of ETS sectors. In the MIX scenario for example:

- ETS sectors would have to increase emission reductions versus 2005 by 22 p.p. (from -43% to -65%)
- ESR sectors would have to increase emission reductions versus 2005 by only 9 p.p. (from -30% to -39%)

Implications of the ETS and ESR targets post-2030 need to be clarified. If the Linear Reduction factor to meet the – 65% target versus 2005 for ETS stationary installations[1] starts to apply in 2026, the annual reduction rate will have to increase from 2.2% today to 6.9%. This means that the ETS cap would reach zero as early as 2035 and that industry would have just a few years left after 2030 to phase out all of its remaining emissions i.e. 483 Mt of CO_2-eq[2], which is highly unlikely and would be potentially damaging for the whole EU economy.

Furthermore, using a "baseline scenario" as point of comparison rather than the current EU ETS level of ambition under-represents the impact of a much lower cap and a higher Linear Reduction Factor compared to today. The assumptions on which the baseline scenario is founded need to be more transparent. We do not understand the basis on which, the Commission has used an extrapolation of the delta between the nominal cap and actual emissions as a proxy.

A reform of the EU ETS

The EU ETS should remain a core policy instrument to establish a carbon signal that incentivizes CO2 abatement at the lowest practicable cost.

Adjustment of the ETS cap for 2030 should still allow sufficient free allocation to effectively mitigating the carbon leakage risk: to achieve this, the current approach, which links the available volume for free allocation to the overall cap needs to be revised. The overall cap is defined based on the estimated potential for reduction in both the energy-intensive and the power sector. Since the power sector has a higher abatement potential[3], the level of available carbon leakage protection decreases much more rapidly than the emissions reductions, which industry can deliver. The level of free allocation must be sufficient to ensure effective carbon leakage protection throughout the transition, allowing incumbents to mitigate the extra collateral costs of GHG abatement technologies.

Applying a one-off reduction of the amount of free allocation appears disproportionate, removing any flexibility from industry. As an alternative to a one-off reduction, Cefic proposes to increase the outflow rate of the Market Stability Reserve (MSR), in order to make the ETS better fit for economic cycles. Allowances not used from the New Entrants Reserve (NER) should be used to avoid a cross-sectoral correction factor in the next allocation period.

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[1] See table 26 on page 98 of the impact assessment accompanying the Commission's Communication on 2030 target plans

[2] Table 39 on page 48 of the impact assessment accompanying the Commission's Communication on 2030 target plans – Part 2 fixes industrial emissions in 2005 at 835 Mt of CO_2-eq and 493 Mt of CO_2-eq in 2030 i.e. a reduction of 59%. The remaining 41% would have to be abated in just five years if the cap (assuming there is no net absorptions in the power sector).

[3] See table 6 on page 52 of the impact assessment accompanying the Commission's Communication on 2030 target plans. Versus 2015, the MIX scenario foresees a GHG reduction of 70.8% in power generation and 22.4% in industry.

As the share of electricity-related emissions under the total cap is going down (from 55% today to 47% in 2030), the cap on free allocation needs to be updated (upwards) to reflect this development.

Furthermore, auction revenues should be recycled to support investments into technologies that can put industry on the path to climate-neutrality, while maintaining its competitiveness.

Protecting industry against carbon leakage during the transition

Decision-makers should take due account of the international dimension and the negative impact of fragmented action on a global level. An increase of the 2030 ambition must be accompanied by reinforced protection against the risk of carbon leakage addressing direct and indirect carbon costs, imports and exports, and considering impacts on entire value chains.

The chemicals industry is already at high risk of a carbon leakage today due to high trade and carbon intensities. We expect this exposure to increase over the ETS IV period as carbon costs go up and free allowances go down. The industry net trade balance has deteriorated since 2012: imports increased (+3.6% per year) and exports decreased (-0.5%). Free allowances help mitigating carbon leakage risks including for EU exports to 3rd countries, reducing the carbon costs gap with key competitors.

A simple Carbon Border Adjustment Mechanism (CBAM) addressing only imports, without free allowances or comparable measures to address the additional cost for exports, will not be sufficient to secure competitiveness along the value chains and avoid consequent economic and social loss.

A CBAM would have to take account of all embodied emissions along the value chain both direct and indirect. Otherwise it may lead to imports of cheaper downstream products, contrary to the policy objective, and damage upstream capacity.

For these reasons, CEFIC is also considering two additional design options for carbon leakage protection (in addition to the four Commission consultation proposals), to address export and value chain carbon leakage risks:

- A climate contribution that would be paid by consumers for emissions up to benchmark
- The combination of an imports contribution (with a continuing ETS price) and free allowances for EU producers

Along with addressing both import and export related carbon leakage, the climate contribution, could provide additional resources for EU policies, while providing stability and predictability for investments in decarbonization and end markets. In all circumstances, additional incentives will be needed for investment in low CO_2-production technologies to unfold their potential for achieving greenhouse gas neutrality.

A much broader EU ETS will result in cross-subsidies between sectors and may not drive changes in sectors with high abatement costs

Cefic does not support introducing the transport or buildings sectors under the EU ETS (i.e. under a common cap). Marginal costs of abatement in transport (and buildings) are likely to be significantly higher and price elasticity much lower than in the industrial sector (subject to carbon leakage). Inclusion will simply entail a higher CO2 price risk to industry.

Furthermore, the EU ETS already has many emission sources at the moment. Including millions of additional small emission sources in the EU ETS would also require a completely different MRV approach, probably upstream, which could disrupt the functioning of the current EU ETS.

Accounting for avoided or negative emissions

The introduction of sinks as means to balance emissions is a valid, long-term perspective and we therefore welcome the proposed formulation of the increased 2030 ambition as a net target.

Climate-friendly hydrogen, bio-based materials and chemicals, sustainable biofuels and synthetic fuels, have been identified as potential contributors to GHG emission abatement in manufacturing but currently lack an adequate policy framework or economic incentives.. These and other technology options should be considered and accounted for based on their GHG merit in a technology-neutral way. Transfer of CO_2 between sectors, for example via recycling of CO2 which could result in emissions absorptions by the chemical sector also needs to be considered and supported by a credible accounting system.

Land-Use Land Use Change and Forestry (LULUCF)

The introduction of sinks will require the establishment of a solid accounting system, including in the LULUCF sector. We believe that industry (i.e. ETS sectors) should also have access to natural sinks as a way to mitigate their emissions, especially in the longer-term, when remaining emissions will become increasingly harder to abate.

The future legislative framework will need to balance between the LULUCF objectives and progress in the bioeconomy: it is important that removals do not happen at the expenses of sustainable material use of renewable feedstocks grown on land and forests. Otherwise, it will lead to displacements in the form of imports of feedstocks grown elsewhere and possibly even drive land use change (ILUC) in other countries ready to meet the European demand for raw materials.

Cefic therefore takes a cautious approach towards “carbon farming”, notably if it would also apply to forestry, as it would reward a “passive” management approach versus an active management enhancing the multiple benefits that land and forestry can deliver to society. We fear that imposing a penalty beyond a certain level of harvesting (e.g. for each ton or cubic meter of biomass put on the market) will come at the expense of the bioeconomy that will lose competitiveness.

LULUCF policy aims at enhancing carbon sequestration, hence incentivising a longer rotation or even no-harvest management approach. The review of LULUCF can only make sense if it goes hand in hand with a thorough reconsideration of the renewable energy policy of the EU: while the EU has a strong track record in promoting renewable energy, very few incentives exist regarding the promotion of renewables for the deployment of bio-based products that can store carbon for longer periods of time.

A coherent and holistic approach to climate and energy target setting

Cefic would welcome a more coherent and holistic approach to climate and energy target setting. We believe that all three climate and energy targets should be part of a “package agreement” (as in 2020 with the 20-20-20 target). Today, it seems the GHG target on one hand and the RES/EE targets on the other hand are constantly catching up with one another, creating unpredictability and overlapping policies. Energy efficiency and renewable energy targets should be supportive of the GHG objective. Given the major

challenge Europe faces in decarbonising the energy sector, all forms of low-carbon energy sources should be stimulated. The EED should pursue a performance-related approach rather than imposing an energy consumption reduction on industry.

Energy Intensive Industries such as the EU chemical industry will need access to abundant, competitive, reliable low-carbon energy as key enabler for industrial transformation (see also VUB study, COM Masterplan). Such a development is dependent on innovation, demand for low-carbon products and market functioning. Top-down targets like the absolute energy consumption cap under the EED risks diverting industry from cost-efficient abatement solutions.

We also lack coherence on hydrogen as the 2030 impact assessment and the Hydrogen strategy do not seem to match. The impact assessment[4] mentions that: "By 2030, the installed electrolyser capacity - measured in terms of electricity going into the electrolyser - is projected to reach 1.5 GW in the baseline scenario and between 12-13 GW in the policy scenarios". This is significantly below the 2x40 GW electrolyser capacity foreseen the Hydrogen Strategy. The Commission should therefore clarify its approach as soon as possible.

Transport policy

Carbon pricing in road transport and taxation systems need to be investigated carefully, as long as reliable and efficient alternatives are not sufficiently available. For example, the European rail freight system is suffering from low reliability, lack of capacity, insufficient interoperability and low digitalization to attract more volumes from road.

Multimodal freight transport choices are based on multiple criteria such as reliability, cost, speed and sustainability, depending on goods and customer requirements. A dedicated strategy and action plan for EU freight transport is needed to clarify how it can support the climate neutrality ambitions, taking into account its specific characteristics compared to passenger transport, such as longer distances, heavier loads, specific infrastructural needs, specific procedures and legislative environment.

Focus until 2030 should therefore be on providing availability, reliability and cost-efficiency of the low emission alternatives like renewable and low-carbon fuels, low emission road vehicles, reliable and efficient rail and barge supported by the corresponding infrastructure, digitalisation and automation.

For more information please contact:
Florie Gonsolin, Manager Energy & Climate, Cefic,
+32.2.436.94.01 or fgo@cefic.be

About Cefic
Cefic, the European Chemical Industry Council, founded in 1972, is the voice of large, medium and small chemical companies across Europe, which provide 1.2 million jobs and account for 16% of world chemicals production.

[4]See Page 60 of the impact assessment accompanying the Commission's Communication on 2030 target plans - Part 2