

Cefic ideas for an updated EU Industrial Strategy

Cefic welcomed the publication, in March 2020, of the EU Industrial Strategy. One year later, we support an update of the strategy to bring it more in line with the objectives of the EU Green Deal and the aftermath of the Covid crisis.

An effective EU Industrial Strategy valuing the chemical industry's solutions as center piece of strategic ecosystems, reaching out to hundreds of thousands of SMEs will be critical to deliver on the Green Deal's promises. The EU Industrial Strategy should enable us and all the strategic value chains and ecosystems we supply, to drive an unprecedented economic transformation whilst competing in a global economy.

In order to enable others to transform in the coming decades to 2050, the EU chemical industry will have to undergo a thorough transformation itself. The Industrial Strategy offers the opportunity to put in place the right framework conditions:

1. We call for a **sectoral coherent approach for Chemicals** with a roadmap with clear priorities and realistic timelines, which would help building investor confidence in Europe at precisely the time when major transformational investments are needed as quickly as possible. We stand ready to engage in a sectoral dialogue to develop the conditions to accelerate the chemical industry's transformation.
2. We ask for **better coordination of the EU and national funding programs**, for example through a "single window" approach, and of policies (competition policy, state aid, sustainable finance) to ensure that industry can access the required finance to enable the transition.
3. We ask that **all Green Deal policies are "Single Market proof"** – i.e. avoiding predictable Single Market fragmentation in the implementation phase (particularly of EU environmental legislation, which allows "gold-plating"), which can slow down industrial transformation and negates the competitive advantage the Single Market confers on the scalability of Green Deal solutions.
4. We call on EU authorities **to monitor current and future availability of crucial factors enabling or limiting industrial transformation**, including access to competitively priced CO₂-neutral energy, and map these against demand implied by current and planned EU legislation. This should enable the authorities to make a better assessment of any future supply shortages and drive appropriate remedial policy action including a global perspective.
5. We call for the **close monitoring of (cumulative) regulatory costs** in order to allow policy making in full consideration of the trade-offs, notably to ensure continued public support of the transformation.

I. THE CHEMICAL INDUSTRY & THE GREEN DEAL: CONTRIBUTIONS AND CHALLENGES

In many ways, the European chemical industry is highly successful. We stand for industrial progress: state of the art chemical processes and technologies, environmental leadership (best proven technologies), world-leading standards of safe chemicals management, novel product applications responding to societal demand, including for the achievement of the transition towards a circular, climate neutral and, whenever possible, bio-based economy.

In the context of the Covid crisis, the chemical industry was officially designated as indispensable, essential, critical or crucial because it supplies numerous strategic value chains in and beyond Europe, including in medical supplies but also in areas that are essential for the delivery of the EU Green Deal. For example, chemicals are key components of materials used in wind turbines, solar panels, electric batteries and building insulation in addition to playing a vital role in digital communications hardware. Chemicals contribute to ensuring the EU's resilience to future crises/shocks that cannot be predicted today.

The chemical industry has gone through significant transformations in its history and embraces the challenge to transform Europe towards climate neutrality by 2050. We offer an explanation of "where we are coming from" in Annex 1 to this document.

The chemical industry makes major essential contributions to almost all strategic ecosystems; it could be seen as the "foundation" of these ecosystems. Given the diversity of these ecosystems, a coherent approach to the chemical industry is required to ensure it can play its role as an enabler for all other ecosystems. At the same time the chemical industry is an indispensable sector for the achievement of the Green Deal objectives. Concrete examples of how chemical substances are used in some important products and technologies across various sectors and directly contribute to achieving Green Deal objectives can be found in Annex 2.

The chemical industry's ability to play this central role in the transformation process is highly dependent on the recognition by the policy environment of its real operational challenges. Today, energy-intensive base chemicals are under pressure in Europe. Without measures addressing the loss of competitiveness relative to other countries arising from high policy ambition, rising European carbon costs, decreasing free allowances and heavy transition investment needs, the EU chemical as well as other EU industrial sectors will see accelerating carbon leakage, with serious consequences for the industrial transformation. These challenges are further outlined in Annex 3.

II. CHEMICAL INDUSTRY GREEN DEAL SPECIFICS

The chemical industry is probably affected by a larger number of Green Deal and related policy initiatives than any other sector, with the following elements being of significant relevance:

1. Circular Economy Action Plan 2.0
2. Chemicals Strategy for Sustainability
3. Zero Pollution Ambition
4. "Fit for 55" package

Particularly for the chemical industry, the coherence of these policies with each other will be a crucial factor to ensure the ability of the industry to progress its own industrial transformation and maintain its transformed manufacturing activity in Europe (as described above). Failure to ensure that all elements of

the Green Deal deliver a coherent outcome for the chemical industry will ultimately risk resulting in outsourcing development and production of new Green Deal technologies to other parts of the world.

A sectoral coordinated policy under the Green Deal should consider climate policy, industry and innovation policy, environmental policy and chemical policy in a coordinated manner. The following elements need to be part of the Sectoral Green Deal for the Chemical Industry:

1. EU institutional governance to put competitiveness center stage

The genuine challenge of attaining the objective of turning Europe into a circular and low-carbon economy within a desired timeframe must be met with a clearer strategic direction from the European institutions and improved coordination with industry across Commission DGs. The Green Deal bears this promise but apparent discrepancies concerning timelines, resource needs and economic feasibilities between Commission impact assessment analyses and industry roadmaps make it obvious that a much closer communication and alignment between Commission DGs, Council formations and Parliament committees and industry is required to achieve a genuine safeguarding of industrial competitiveness at home and abroad as a key enabler of the transition.

2. EU policy design coherent with international developments and rules

As the world's standard-setter, the EU plays an important global leadership role. This also brings with it the responsibility to ensure that EU policy is of the highest possible quality, considering all available evidence that sets the right incentives. Specific actions should include:

- **Ensure that all policy is “Single Market proof”** – i.e. avoiding predictable Single Market fragmentation in the implementation phase, which can slow down industrial transformation.
- **Ensure all policy is in line with the principles of a market economy**, sometimes adjusting but not replacing market mechanisms and competition by central planning: EU should remain an international role model: open, liberal and value based.
- **Monitoring by the authorities of current and future availability of crucial factors enabling or limiting industrial transformation**, including CO₂-neutral energy, and map these against demand implied by current and planned EU legislation. This should enable the authorities to make a better assessment of any future supply shortages and drive appropriate remedial action with a view on global developments and opportunities.
- **Objective monitoring of regulatory costs and benefits**, in order to allow policy making in full transparency of the trade-offs, notably to ensure continued public support of the transformation.
- **Design policies for dynamic ecosystems and value chains considering global market trends and consumer demand** rather than individual sectors and ‘EU only’ approaches to ensure policies are flexible and adaptable enough, designed for added value and overall benefit and avoid unintended consequences.
- **Design policies so that they can be implemented in practice without disadvantaging European producers** domestically or in their export markets. Impact assessments should check the enforceability of proposed legislation and legislative measures should be strictly enforced to avoid that the objective pursued is not achieved while domestic producers are disadvantaged.
- **Investment leakage check**: EU Green Deal measures should consider the consolidated international effect on carbon emissions. Reducing EU emissions through decreasing (re-) investments in production would undermine global climate goals and reduce EU's potential of providing enabling products and technologies.

- **Assess the impact of all Green Deal strategies** in their entirety and not just of individual policy proposals, so that the interlinkages between them are fully taken into account and unintended consequences that could slow down implementation are avoided.

3. Policies fostering chemicals' potentials

The Single Market, an open-minded approach to new technologies and the presence of strong industry clusters are key for the success of Europe's industry, but some policy gaps continue to exist. Important action includes:

- **Prioritise competitive energy pricing:** The large carbon reduction potential offered by the use of carbon neutral energy by the energy intensive sectors requires a complete overhaul of the energy market, including consideration of Single Market impacts in national policymaking. It must be ensured that the carbon neutral energy required for the decarbonisation of industry is available in sufficient quantities and at an affordable cost. The observatory proposed above is an important instrument to support this policy action and to ensure a global view on energy and resource sourcing leading to a cost efficient climate strategy for industry.
- **Ensure the full potential of industry's contribution to innovation** is realised through Horizon Europe research funding. For example, chemical recycling offers a huge opportunity for the chemical industry to progress the circular economy.
- **Wider use of IPCEIs** to spur the development of new technologies.
- **Open markets for EU chemical exports and vigilant enforcement of EU rules:** The EU is highly dependent on open trade and should continue to pursue reform of the multilateral trading system. Access to key growth markets should be pursued via the establishment of Free Trade Agreements with third countries. Especially the Chemical Strategy for Sustainability will have huge consequences for many downstream products. The strategy needs to be properly implemented and needs to be both enforceable and enforced with respect to imported articles as well.
- **Fostering EU's resilience by supporting up to date infrastructures** in the fields of digitization, energy, transport and finance.

ANNEX 1

BACKGROUND: WHERE WE ARE COMING FROM

As economic operators, delivering on the Green Deal means, first and foremost, investment – in research, innovation and – eventually – in significant capital stock upgrades.

It therefore should not come as a surprise that our prime focus in relation to the Green Deal is that the **EU's attractiveness as an investment location should be reinforced in order to enable the business case for the transformation of European chemical industry production in line with the Green Deal transformation**. Companies will consider such investment cases in comparison to alternative investment locations and their associated business cases and can only justify investment in Europe if the investment case is viable. We also refer to this as “competitiveness” – investments in the EU will only happen if they compare favourably to investment cases in other parts of the world.

We also look at the level playing field from the perspective of the industry's ability to compete on export markets. In many ways, the European chemical industry is highly successful. Traditionally, it has been a world leader in chemicals production – as shown by a consistent export surplus which reached €45 bn in 2019. EU chemicals sales in 2019 amounted to €543 bn. However, the continued success in absolute terms obscures a major shift in relative terms when looked at globally: while European chemical sales have continued to grow, Europe's share of global sales over the same period has declined from about 26% in 2001 to 15% in 2019. This decrease is primarily due to declining competitiveness in absence of a level playing field. The same trend can be observed with respect to export competitiveness: exports have increased in absolute terms, but the relative share of the EU has decreased due to declined competitiveness.

This **loss in global market share** represents a significant opportunity cost of foregone jobs and economic activity that could have been created in Europe. It is evidence of the EU's apparent inability to attract significant new investment at global scale over the recent decade or so. Investments in new production capacity increasingly flow to other parts of the world, in part because **the business case for investing in Europe is becoming difficult to make**.

This leads to the risk of investment leakage in the EU chemicals industry. Nowadays chemicals are produced all around the world, and a larger number of regions is competing for investment. We have provided evidence of this for many years (in Cefic's Facts & Figures <https://cefic.org/our-industry/a-pillar-of-the-european-economy/facts-and-figures-of-the-european-chemical-industry/>) and pointed to the possible negative consequences for Europe's ability to transform in line with climate and circularity objectives, as well as Europe's strategic autonomy as entire value chains become increasingly dependent on (more competitive) imports from other regions. The situation with regards to the supply of active pharmaceutical ingredients from India and China is a case in point.

There are several potential causes for Europe's loss of global market share, but most of this decrease is due to **declining competitiveness**. **Energy and feedstock prices** are a critical factor for the competitiveness of the chemical industry. This is boosting profits abroad and attracting investment, including from European chemical companies: as at February 2019 announced chemical industry investments in the USA amount to US\$204bn (with 70% from non-US based companies). Likewise, in 2018, €87.1 bn was invested in China. In comparison, EU investment stood at €22.8 bn in the same year, one-fourth of the Chinese figure. Therefore, we continue to call for competitive energy costs, including of climate-friendly electricity.

At the same time, the EU chemical industry is **undergoing a transformation process** to help realise climate neutrality by 2050, deliver a more Circular Economy, and contribute to all other objectives of the EU Green Deal. The Chemicals Strategy for Sustainability will also have a transformative impact on the industry.

The global chemical industry can and will provide solutions for the societal challenges of our times, but – despite the fact that the EU is clearly playing a leadership role in adapting its regulatory framework in these areas – the question is whether these solutions will be developed in Europe or in other parts of the world and imported into Europe, with the associated loss of growth and employment opportunities here. However, **to meet the EU policy objectives, significant investments are required in Europe**¹. In a context of increasing competition from other regions, **the EU regulatory framework needs to ensure that the desired industrial transformation process can be successfully achieved** – this underpins our call for a level playing field.

It is important to realise that there is additional pressure coming from inside the European Union.

Chemical companies often refer to the **complex and heavy regulatory burden as a factor negatively impacting their competitiveness**. In the past fifteen years, the industry has come under increased competitive pressure. At the same time much regulation has been adopted. It is worth noting that frequent and numerous reviews and updates, more than once in areas where EU legislation had just been passed and not even been given the time to be implemented, have appreciably increased a sense of unpredictability in the investment community. Simply put, **an investment case becomes more difficult to make if there is an expectation that existing regulation will change frequently even before just adopted rules have started to be implemented**.

Possibly even more worrying, **we are noticing an increased tolerance of national legislation that fragments the EU Single Market**. This is most often the case in the areas of environmental or public health policy, where EU rules allow for additional national legislation. However, these “frontrunner” initiatives have the effect of fragmenting the Single Market and make the scaling-up of new technologies more difficult. By negating the Single Market’s advantage of allowing companies to benefit from economies of scale, in principle supposed to make investment cases easier, this **increasing market fragmentation makes investments in industrial transformation more difficult**.

A cumulative cost assessment conducted for the Commission in 2016 provided evidence that **Europe’s complex regulatory framework poses a significant burden on EU chemical companies**, amounting to **about 10 billion euro** per year between 2004 and 2014. Regulatory costs are in the same magnitude than total **R&D expenditures** of the Chemical industry and thus represent a **significant factor shaping the profitability** of the EU chemical industry.

There is no discussion about the fact that stricter regulation has also generated benefits; however, these benefits accrue over a different timescale and for broader parts of society. There is also no discussion that regulatory costs have also increased in other chemicals producing regions, although this has generally been less than in the EU. However, non-EU manufacturers of articles can use substances banned in the EU in their process and export the final article to the EU market, in many cases without any constraints.

To be clear, **the chemical industry does not dispute the need and benefits of sound, transparent EU regulation**. In the context of a level playing field, we are asking that there be an objective assessment of the regulatory burden caused by regulation, and that it is better understood that this burden reduces the competitiveness of the EU industry, tilting the level playing in our disfavour and affecting our ability to

¹ The 2020 call for the ETS Innovation Fund provides evidence for this: the call for projects for industrial transformation was endowed with EUR 1 billion; the projects submitted totaled more than EUR 21 billion.

deliver the desired industrial transformation. The consequence of this does not need to be “less regulation” overall, however there is a need for efficient regulation and – where necessary - counterbalancing measures that help restore the level playing field. Any new regulation introduced should be checked on enforceability and be effectively enforced in practice.

ANNEX 3

CHALLENGES FOR THE CHEMICAL INDUSTRY AS A MAJOR EUROPEAN EXPORTER

Traditionally, the European industry has been a world leader in chemicals production – as shown by a consistent export surplus which reached €45 billion in 2019. EU chemicals sales in 2019 amounted to €543 bn. Demand for chemicals comes from practically all ecosystems in the European economy and abroad. However, the continued success in absolute terms obscures a major shift in relative terms when looked at globally: while European chemical sales have continued to grow over the past 20 years, Europe's share of global sales over the same period has declined from about 26% to 15%.

Today, energy-intensive base chemicals are under pressure in Europe (exports shrinking, imports on the rise) due to cost disadvantages resulting from the EU's limited natural resources and ambitious policy objectives. The chemical industry is already at high risk of carbon and investment leakage today due to high trade and carbon intensity. The leakage impact will worsen over the ETS IV trading period (to 2030) as carbon costs increase and carbon leakage provisions (i.e. free allowances and indirect compensation) decline. The chemical industry net trade balance has already deteriorated since 2012: while imports increased since 2012 (+3.6% per year), exports decreased by -0.5% per year.

Carbon leakage risks due to reduced exports are also significant. Continued free allowances would to some extent limit carbon leakage for EU exports to third party countries by reducing the carbon cost gap with key competitors.

Without measures addressing the loss of competitiveness relative to other countries arising from high policy ambition, rising European carbon costs, decreasing free allowances and heavy transition investment needs, the EU chemical as well as other EU industrial sectors will see accelerating carbon leakage, with serious consequences for employment and prosperity.

As sector benefitting from active, multilateral trade relations, we do not seek the answer to this challenge in protectionist policies. The European chemical industry is a global industry, exporting about 177 bn euro or one third of its production to non-EU27 countries. Open and fair trade are the lifeblood of our industry. The business model of the industry is transforming feedstock – organic, inorganic, biobased – into higher value-added products (specialty and fine chemicals, consumer chemicals) for domestic use or export. Undistorted access to energy and raw material imports is key for the sector. Imports amount to some 132 bn euro, a minor part of it is subject to anti-dumping measures. As long as trade is conducted fairly, the sector is wary of protectionism for fear this will backfire against its exports. Europe should seek alignment with its trading partners and also remain open to foreign direct investment with limited government intervention.