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CONTRIBUTION TO THE PUBLIC CONSULTATION ON DRAFT ETS STATE AID GUIDELINES

The Association of Lithuanian Chemical Industry Association provides contribution to the Public consultation on draft ETS State aid Guidelines. The association is representing the main branches of the chemical industry in the country, manufacture of fertilizers as well as manufacturer of primary plastics (in particular Polyethylene terephthalate, PET). Our contribution concerns Aid to undertakings in sectors deemed to be exposed to a genuine risk of carbon leakage due to significant indirect costs that are actually incurred from greenhouse gas emission costs passed on in electricity prices (aid for indirect emission costs) (*Article 10a(6) of Directive 2003/87/EC*).

Unfortunately both sectors, Manufacture of fertilisers and nitrogen compounds (NACE 20.15) (**the Fertilizers**) and Manufacture of plastics in primary forms sector (NACE 20.16) (**the Primary plastics**) are not included within the list of the *sectors deemed to be exposed to a genuine risk of carbon leakage due to indirect emission costs (Annex 1 to the Communication from the Commission Guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post 2021)*.

*Final report of Combined retrospective evaluation and prospective impact assessment support study on Emission Trading System (ETS) State Aid Guidelines (Final report)* revealed that indirect carbon leakage indicator (**ICLI**) for the Primary plastics is equal to 0.246. As the value is above established threshold of 0.2, the Sector is considered as exposed to the risk of indirect carbon leakage. All RAG ratings (RAG rating, RAG rating under high carbon scenario and RAG rating before fuel and electricity substitutability) indicate medium risk. As the risk is real and considerable further assessment should be done very carefully and in depth. Although assessment provided at Final report, made in accordance with official EU methodology, indicates it as exposed to the risk, the Sector hasn't been included within the list and we are not aware on the details why it is excluded. Still we strongly believe the Sector (or at least manufacture of PET), as we have knowledge and expertise on this subsector) should be included into the list considering following factors:

1. Plastics are comparably valuable material and it is possible economically effectively to supply major part of EU by marine or combined transport means from many other parts of the world. Moreover, plastics are raw material of commodity type and one manufacturer can be easily replaced by another. Thus, EU plastics market is very vulnerable to the import.
2. Import figures of PET together with expiring safeguard measures are growing at huge speed. Import figures since 2012 more than doubled, when EU producers' sales increased just approx. 15% over that period. If we look at 2019 specifically, we would see even more drastic figures when EU producers sales reduced by approximately 5% and imports increased by 41%, which was mainly driven by huge increase in imports from China since

antidumping duties expiry and new factories startup in Asia (Vietnam, China) or restart in Africa (Egypt). It is anticipated the share of import will increase in later years due to established trade routes, growing PET manufacturing capacities at the rest of the world (especially China) and potential increase in costs of EU producers due to Green Deal, Plastics strategy (such as SUP directive) and other initiatives which would put additional burden to EU producers to get their product more green and circular.

3. As EU plastics market is vulnerable to the import, EU producers can't pass increased electricity costs to the customers, as they compete with foreign manufacturers that don't have such costs.
4. Considering the assessment provided in Final report is based on earlier figures it is necessary to reevaluate *Trade intensity* factor for the Sector by taking current data and make forecast for the next period. This would confirm actual Trade intensity for the Sector is even higher, then provided within Final report.
5. It should be taken into consideration that huge part of Trade intensity, at least for PET as per our knowledge, derives from the import (2019 – 1026 th.t.), while export figures are quite low (2019 – 118 th.t.). That means EU manufacturers of the Sector is under intense competition from third countries, while ability of EU manufacturers to compete in rest of the world are poor due to high costs of production. Considering electricity costs forms considerable part of total costs, the risk of indirect carbon leakage is high.
6. Import of PET flows from India, China, Vietnam, Egypt, Indonesia, and other import countries that don't have similar costs in their electricity prices.
7. It is estimated overall EU demand of PET packaging will grow 5,2% per year (CAGR) until 2024 (market research company MarketsandMarkets 2020 data). However, most probably the gain in demand won't help to increase utilization rate for EU manufacturers (on the contrary in 2019 EU manufacturers utilization rate reduced by 7%), because of intense competition with import from third countries. Finally, low utilization rate and growing competition with importers will and already has stopped investments projects to increase capacities of the Sector. On contrary, in the rest of the world, and particular nearby EU, the capacities are expanding having EU as one of the target market (like Turkey, Egypt, Vietnam). New capacities in China alone will grow by approx. 1,5 mln tones in 2020, when already today they have unutilized capacities and are exporting 3 mln tones of PET or over 35% of total production. New capacities will just increase the pressure to export more and EU with expired antidumping duties in 2018 will be one of priority markets as other non-EU countries are more and more closing doors with new antidumping investigations against China.
8. The Sector at EU faces major change driven by Plastic strategy and Green Deal. Implementation of circular plastic economy principles requires to invent new technologies for reuse, collecting, sorting, recycling and manufacturing. Later, these inventions should be implemented. All this cause significant financial contribution for the business. E.g. anticipated breakthrough technology in utilizing major part of collected plastic waste, that are difficult/impossible to recycle due to contamination - chemical recycling technology for PET is still not commercially viable despite several years of development and huge amounts invested. Implementation of this technology would require even more investment with estimated value of over 500 mln EUR in EU. Recycling of other types of Plastics and efficient usage (without downgrading) of such recycled material is far behind.

All such investments should be financed through profit margin of business operators. Decrease margins and market share of the Sector may cause not only carbon leakage, but can ruin implementation of Plastics strategy, as major part of plastic waste collected at EU won't return to the circle economy and shall contaminate our environment.

9. Competition with import and EU policy driven requirements has already forced local manufacturers to audit their energy efficiency and invest into it. So, most investments are already completed. Further considerable enhancement is not possible. Also, there are no potential in developing of current manufacturing technologies, which are already mature.
10. Profit margins of EU PET producers are positive last few years, but very low and going down as of 2019 therefore not sufficient for reinvestments therefore local PET demand growth is mainly taken over by imports from new capacities outside EU.

We strongly oppose the statement the Fertilizer sector is not sufficiently exposed to indirect carbon leakage risk and not to qualify for state aid as per initial quantitative assessment. The 3, 4, 9 of the list provided above are valid also for fertilizers. The following has to be taken into addition as well. The example of the company which emits about 2 million tons of CO<sub>2</sub> per year from 2 large scale ammonia installations based on steam methane reforming process can be taken. The lack of about 500 000 European Union Allowances (EUA) per year occurs from ammonia production facilities and creates significant cost. There are no commercialized technologies to avoid carbon dioxide during ammonia production process. No evidences of invention of competitive decarbonized technologies in short term is foreseen. According to the study of the Navigant Company "Ecofys" made in the end of 2014 the fertilizers sector (NACE 20.15) has a nevertheless negative balance of EUA, while other some other sectors eligible for state aid have surplus till 2030. This clearly confirms the need of more precise differentiation among the industry sectors. Based on what is said above we strongly insist do not change existing targets for 2030 for fertilizers sector.

We propose:

11. To use transparent, structured approach, as this was the case in the phase III.
12. To take into account availability and costs of the exchangeability fuel/electricity.
13. To apply qualitative assessment to the borderline sectors: trade intensity x emission intensity > 0,15 could be an option.
14. To take into account that electrification requires great quantities of electricity and significant process changes. This is possible with the state aid only.

Considering all the arguments provided above we suggest to include Manufacture of fertilisers and nitrogen compounds and the Manufacture of plastics in primary forms sector to the list of the *sectors deemed to be exposed to a genuine risk of carbon leakage due to indirect emission costs*.

Executive director

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