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ECVM contribution to the public consultation on State Aid: EU ETS Indirect Compensation

EU-ETS Indirect Cost Compensation for PVC value chain is vital

ECVM urges the Commission to consider, in its review of the EU ETS State Aid Guidelines, the qualitative assessment of NACE 20.14¹ (among others: production of EDC and VCM), as well as NACE 20.16² (among others: production of PVC), for eligibility for indirect cost compensation. These sectors remain at risk of carbon leakage due to indirect emissions costs during phase IV of the EU ETS.

Currently a PRODCOM subsets of NACE 20.14 and NACE 20.16 are eligible in phase III and as the carbon leakage risk has not decreased, it is our maintained sectors viewpoint that organic basic chemicals and plastics need to remain eligible also during 2021-2030 and this at the entire NACE 20.14 and NACE 20.16 levels.

The indirect emission compensation aims to maintain the global competitiveness and survivability of key industries such as the chemical and life sciences industry in Europe. The compensation serves to counter existing competition distortion arising from the situation that installations in countries not participating in the ETS do not have to pay the same costs for combating climate change. Accordingly, these installations have a considerable and, as ETS price is rising, increasing comparative cost advantage compared to European installations. Compensation is therefore needed and remains necessary as long as the unilateral EU ETS is not mirrored in climate related initiatives with similar scope and burden in other regions.

In the draft guidelines the commission sets the criteria to determine which sectors are eligible for indirect emission cost compensation. Concerns exist relating to the data used for this assessment, therefore a qualitative assessment should be opened for borderline cases, using similar criteria as used in the determination of the carbon leakage list (TI x EI > 0,15).

The guidelines stipulate further that the CO₂ emission factor shall reflect the production mix of the fossil fuels in the given geographic area. The Central Western European (CWE) region is not considered as a geographic area despite the Day-Ahead market

¹ Manufacture of other organic basic chemicals

² Manufacture of plastics in primary forms

coupling that exists between the countries of CWE. Therefore, the CWE-region should also be considered as a geographic area, meaning one CO₂ emission factor should be used within this area. The CO₂ emission factor should also reflect the marginal running unit (in the merit order) as this is determining the CO₂ cost per MWh. If not, countries within CWE, paying a similar price for electricity would be treated in a discriminative manner. Similarly, Norway must remain part of the “Nordic” market area as is currently the case.

Eligibility – Explanatory note does not provide a sufficient base

For a correct carbon leakage list, complete and correct data are essential. Incorrect or incomplete data can result in erroneously removal of a sector from the carbon leakage list.

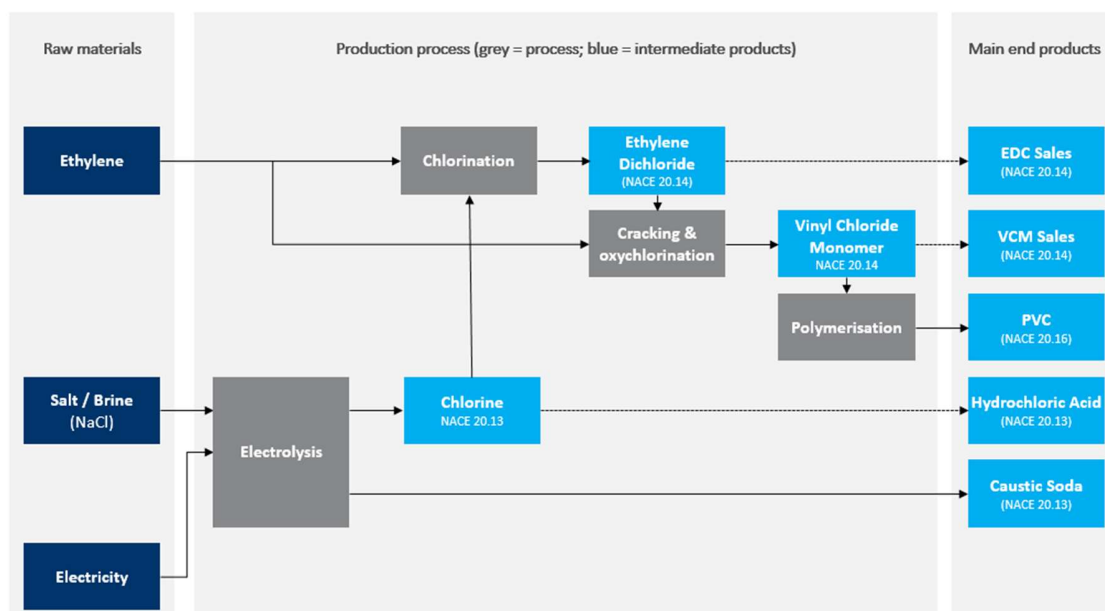
In the Explanatory Note accompanying the draft ETS Guidelines, a qualitative assessment is considered provided the sectors concerned have at least an indirect carbon leakage indicator of 0.2 and that their carbon leakage risk, as evaluated by the consultant in the study, is at least medium. However, we have several remarks on the consultancy report.

- The report does not communicate in a transparent way about the used data. Moreover, some data are partially unrepresentative and, as such, do not appropriately reflect the sector's business realities and market pressures.
- The report states “some sectors with high trade intensity can be net exporters of their products from EU to extra-EU countries and therefore have a limited risk of carbon leakage related to international competitiveness.”
 - Sectors with a high trade intensity who are net exporters of their products are definitely also exposed to carbon leakage as they also have to compete with products produced in extra-EU countries (where there is no such indirect carbon cost) but now on the extra-EU market, instead of the EU market as in the case of import. Therefore, trade-intensive sectors will suffer clear competitive impacts on both imports and exports from indirect EU carbon costs and should thus be considered in a qualitative assessment.
 - As there is a high trade intensity in NACE 20.14 and NACE 20.16, there is a low absorbability of additional EU indirect carbon cost ('cost pass through'). Higher indirect carbon costs will affect the competitiveness of value chains and products, especially where competitive technological pathways do not exist. Market characteristics provide no grounds for the NACE 20.14 & NACE 20.16 to pass on EU carbon costs to their customers.
- The report is static and does not take into account future electrification:
 - The chemical industry could shift more from a direct cost base to an indirect cost base in comparison with current energy supplies. The next 10 years (time period of the State Aid Guidelines) are crucial for enabling

the scaling of such an industrial transformation. Breakthrough technologies necessary for the chemical industry to contribute to the EU Green Deal all rely on a massive increase of electricity consumption.

- Key prerequisite for the development and roll-out of such new process technologies in a low carbon scenario is the availability of low carbon electricity in large and reliable volumes at competitive costs to enable industrial transformation.
- The EIB 2018 report (*Industrial Value Chain -A bridge to a carbon-neutral Europe*) warns that the indirect costs under the EU ETS are, or can become, a serious deterrent towards investments in (new) processes that require these high amounts of electricity.
- The report does not take into account value chains of highly integrated chemical industry:
 - Europe, today, benefits from a highly integrated chemical industry, which is encompassing activities ranging from NACE 20.13 (e.g. chlorine production for later use in EDC), NACE 20.14 (e.g. EDC and VCM as prime building blocks for PVC), to NACE 20.16 for the manufacturing of polymers such as PVC.
 - This value chain is vital between companies but also within companies producing products of the above mentioned sectors along the PVC value chain.

Drawing below: The PVC value chain, including NACE 20.13, 20.14 and 20.16



In this highly integrated structure, it is vital, that the main customers of an exposed sector like 20.13 are also accepted as exposed sectors.

Eligibility – Proposal Qualitative Assessment

We suggest that the assessment for eligibility for indirect compensation should be in accordance with the approach used in Phase III EU ETS, with new criteria used in phase IV.

The quantitative assessment identified sectors as eligible for Indirect Electricity Compensation (Annex I) where all three of the following criteria are fulfilled:

- $TI \times \text{emission Intensity (EI)}$, measured in kg CO₂/ GVA (euro) > 0,2
- $EI > 1$
- $TI > 20$ (%)

Accordingly, a qualitative assessment should be open for sectors or subsectors, including Borderline sectors such as NACE-4 sectors with $TI \times EI > 0,15$ (*in line with direct emission allocation*).

In the qualitative assessment, consideration should be given for eligibility for indirect emission compensation list where at least two out of three of the following criteria are fulfilled:

- $EI > 0,5$ (0.5 times the value used in the criteria in the quantitative assessment)
- $TI > 25\%$
- Fuel and electricity exchangeability for products in the sector

The above logic is coherent and corresponds to the Commission's methodology described in the relevant Staff Working Document (phase III: two of the adopted eligibility criteria needed to be fulfilled).

We estimate that 20.14 and 20.16, amongst others, would be eligible by these thresholds.

The proposal would most probably increase the number of eligible sectors, however, as the EF will be reduced the total amount of compensation could remain stable (relative to the total auctioning volume).

About ECVM

The European Council of Vinyl Manufacturers (ECVM) represents the six leading PVC resin producers in Europe, accounting for around 75% of the PVC resin manufactured in Europe. ECVM is a division of PlasticsEurope, the trade association representing the plastic manufacturers in Europe. A founding member of VinylPlus®, ECVM is committed to sustainable development, and to address and promote health safety and environmental best practices over the PVC life cycle.