Position paper on the draft of the EU ETS State Aid Guidelines 2021-2030

Confederation of Industry of the Czech Republic

EU ETS State Aid Guidelines will continue to play crucial role in carbon leakage protection which is becoming even more important in the context of increasing EU climate ambition while at the same time no similar steps are taken in other parts of the world. Such role is even more important due to the higher carbon price compared to phase 3 and in view of the development and uptake of low carbon technologies that will increase substantially the (direct and/or indirect) electricity consumption in many sectors. However, the presence of the State Aid itself (next to the free allocation of EU ETS allowances) is not sufficient, as its effectiveness is clearly dependent on how it will be set, including its individual parameters, and how appropriately it will complement other carbon leakage measures. As the Czech Republic has decided not to continue implementing the system of free allocation of EU ETS allowances for electricity generators in the 4th EU ETS trading period, the following comments will only be focused on the draft rules for compensation of indirect carbon costs post 2021.

Generally, we welcome that the Commission proposal stems from experiences and some methodologies used during the 3rd EU ETS trading period. Nevertheless, despite there are aspects of the proposal that we deem appropriate, we see urgent need to amend several parameters of the Commission proposal so that the compensation of indirect costs can become fit for purpose, i.e. will help to ensure sufficient protection of competitiveness of EU industrial sectors at risk of carbon leakage (and thus prevent carbon leakage), while, at the same time, not jeopardizing the motivation of beneficiaries to further invest in relevant environmental measures.

The following text contains our main concerns in terms of individual compensation parameters proposed by the Commission. All these points and recommendations need to be perceived in mutual relations.

1) Sectoral eligibility

In comparison with the current trading period, the number of sectors (NACE) eligible for compensation is proposed to be reduced almost by a half. However, to make the compensation effective, the industrial value chain of eligible sectors proposed must be taken into account both in terms of supplying sectors (e.g. raw material or energy inputs such as industrial gases which will be also very important for long term transformation of some sectors) and downstream processes/sectors that are at risk of carbon leakage due to electricity prices (e.g. the seamless tubes, etc.). Without this and due to further reduction of compensation proposed by the Commission (in aid intensity and benchmarks, see point 2 and 4 below), the compensation even for some sectors already proposed to be eligible for aid could cover less than 50 % of the actual indirect costs borne by the companies. This undermines significantly the effectiveness of the provisions to prevent the risk of carbon leakage. The downstream processes or subsectors at risk of carbon leakage will also face increased costs of carbon, energy and material inputs which further reduces their competitiveness.

Furthermore, the proposed possibility for member states to exclude eligible sectors (paragraph 21) creates major legal uncertainty and may lead to unintended effects and distortions within the EU. Thus, it should not be retained in the final text.
Please also pay attention to Annex I.

2) Maximum level of aid intensity

We welcome that the Commission is proposing to keep the State Aid intensity factor stable over the whole 4th trading period. However, there are several reasons why we are convinced that the percentual figure should be higher than 75 % (concretely 100 % of the benchmark) as a basic rule, instead of the proposed possibility for individual member states to compensate by intensity higher than 75 % in individual cases (see point 3).

The eligible sectors are facing high exposure of carbon leakage linked to indirect costs and are unable to pass through unilateral regulatory costs without genuine risk of losing market shares. This risk is even more relevant in the context of much higher carbon prices compared to those experienced in the recent past.

Furthermore, affordable and competitive electricity prices are essential to facilitate the transition to breakthrough technologies which will require even larger amounts of electricity.

Thus, the aid intensity factor needs to be set at 100 % of the benchmark because any factor reduction undermines the effectiveness of the carbon leakage provisions as long as there is no comparable climate legislation in competing countries. No one can say that this intensity would mean full compensation of indirect costs, as the aid will still be capped by the very strict benchmarks which are to be even updated in the middle of the period. It is clear that energy efficiency improvements are a must for industries with high energy costs in order to remain competitive.
For example, in case of using fall back benchmarks, the compensation will be reduced by 20 % compared to the baseline electricity consumption. If the 75% aid intensity level would be set, the installations in fall back may receive compensation only for maximum of 60 % of their indirect costs (75 % of 80 %). This is absolutely not consistent with the aim to ensure sufficient carbon leakage protection.

3) Possibility of MSs to compensate beyond the 75 % intensity

As stated in point 2, we are convinced that the aid intensity must be kept at the level of 100 % of the benchmarks to make the compensation fit for purpose.

Nevertheless, if the default aid intensity is not increased to such level, introducing the possibility for member states to grant additional compensation beyond the default value is an important step to reduce indirect costs to eligible sectors. Then, the additional compensation should be set so that indirect costs are capped at no more than 0.5 % of the GVA (adequacy of using GVA is commented below). At the same time, this possibility should be open to all eligible sectors and not limited only to some of them.
Example: in the steel sector this top up possibility should be accessible to both the electric arc furnace (EAF), which has very high electro-intensity because it uses large amount of

electricity to melt and recycle scrap, and the integrated route, which consumes electricity produced from the combustion of recovered waste gases generated unavoidably by the steel making process. Financial compensation for this case is explicitly mentioned in recital 13 of the post 2020 EU ETS Directive in order to preserve the incentive to recover waste gases, since free allocation is granted only partially for waste gases' emissions. In fact, financial compensation of indirect costs related to waste gases' electricity consumption is not only linked to the electro-intensity of the process but mainly to the objective of balance the lack of free allocation that the steel producer bears for its waste gases.

Finally, it should be noted that undertaking specific assessment needs to consider the actual specificities of the sites. The GVA of companies is highly dependent on their structure, including the configuration of the production steps where the higher share of value added is generated. Hence, a site assessment would also be necessary where appropriate.
Furthermore, company-specific assessment on electricity consumption should not lead to unintended results in case energy efficiency measures that have already been implemented.

4) Update of the fall back benchmarks

The draft guidelines do not indicate the default value of the fall back benchmark. In phase 3, this was 80 % of the reference electricity consumption. Since this represents a major reduction of aid, it should not be reduced further, otherwise the state aid would be insufficient to achieve its objective of avoiding the risk of carbon leakage.

It should also be noted that the reference fall back benchmark in the free allocation rules for direct emissions is the process emissions benchmark, which is much higher than the electricity fall back benchmark (97% of historical process emissions) and most importantly has not been further reduced between phase 3 and phase 4.

5) Regional emission factors

As a matter of principle, the CO_2 emission factor must reflect the full indirect CO_2 burden, i.e. the actual CO_2 cost passed through into prices. The approach of using historical empirical data on the fossil emission factor in the relevant regional market should be maintained in order to ensure a consistent and stable framework. The calculation of the factors should be based on reliable and transparent sources in order to reflect the real costs faced by the industry.

6) Conditionality

Generally, there is an urgent need to respect the essence of the "compensation" measure. Therefore, the aid should not be conditional upon additional requirements as it aims at reimbursing the energy consuming sectors for the indirect costs passed on in their energy bill. The proposed conditionality on additional measures to be taken by the beneficiaries (i.e. investments in energy efficiency or emission reductions and carbon free power purchase agreement) requires additional expenditures and this would cause that the purpose of the compensation which is to reimburse incurred costs is lost as well as the proper carbon leakage protection effect.

As the eligible sectors are acknowledged as being at risk of carbon leakage (on the basis of market characteristics, profit margins and abatement potential), any missed reimbursement would create further conditions for the materialisation of such risk, leading to, inter alia, an increase in global emissions. The beneficiaries must have a right to invest their capital, including the money received through the compensation, to measures according to their actual needs as possibilities, and they should not be obliged by any rules to do some concrete steps. In this context, it is also necessary to add that energy efficiency improvements are a must for industries with high energy costs in order to remain competitive. Compensation of indirect costs does not distort incentives for energy efficiency investments because it is still based on very strict benchmarks reflecting the best performance in the sector. Furthermore, the "incentive effect" is also preserved by the fact that the benchmarks will be updated during the phase 4, so that companies have further interest in improving performance, where technically possible.

Moreover, the proposed conditionality requirements are actually linked to the implementation and enforcement of other pieces of legislation (notably the Energy Efficiency Directive and the Renewable Energy Directive). However, member states retain the possibility of adopting different instruments to promote energy efficiency and renewables in order to achieve the targets set in such legislation. Therefore, the conditionality requirements would overlap and possibly collide with different national measures.

Finally, the three proposed conditionality requirements present specific crucial limitations:

a) The energy efficiency investments with a payback period of 5 years do not reflect the reality of business decisions (e.g. in the steel sector), which are bound to a significantly shorter period. Furthermore, the draft text does not take into account early actions such as recent energy efficiency investments. We strongly disagree with any conditionality. If there is no political will to delete it, the only and possibly acceptable requirement in this sense would be that the beneficiaries should strive, according to their possibilities, to follow recommendations of the energy audits (i.e. without payback time requirement).

b) The requirement to install an onsite renewable energy generation facility covering at least 50 % of the electricity needs absolutely does not match with the very large energy consumption of industrial sites and the physical limits of such on-site generation. Furthermore, the RES can never match with the typical non-stop production nature of the sites, as they are not able to ensure stable and permanent supply of enough energy needed. And moreover, in many plants it would not be possible to build up the required RES capacities due to their land capacities and requirements. This conditionality requirement is therefore not technically nor financially feasible, hence it cannot be achieved realistically by the eligible sectors.

c) The requirement to invest at least 80 % of the received state aid into investments to reduce direct emissions of the installation is not consistent with the scope of the Guidelines which are targeting indirect costs. This requirement completely undermines the purpose of the compensation. Furthermore, the condition to ensure that the investment must lead to emission reduction well below the benchmark values does not

take into account neither existence and availability of the technologies, nor the fact that investment in such technologies would require far more financial sources, including private sources, of which the 80 % of compensation would be negligible.

Annex I – Eligibility of further sectors

In this Annex we would like to express reasons why other sectors should be eligible for compensation of indirect costs.

Steel sector

The steel sector uses significant amounts of industrial gases (NACE code 2011) for unavoidable purposes such as oxygen which have an important electricity consumption embedded. On the basis of the data from the Best Available Techniques Reference document (BREF), the embedded electricity consumption is estimated at 24 kWh/t crude steel in the EAF route and 92 kWh/t in the BF/BOF route (which is around 20-25% of the total electricity consumption in BF/BOF route). The lack of compensation for the indirect costs linked to industrial gases further exposes the steel sector to carbon leakage risk. Therefore, similarly to the allocation of free allowances to the heat consumer under the rules on free allocation for the direct emissions, the consumption of industrial gases should also be considered as eligible for financial compensation when it occurs in a sector that is exposed to indirect carbon leakage such as steel and state aid should be granted to the exposed sector. Such treatment would be important in the context of the medium to long term transformation of the sector, whose breakthrough technologies will need large consumption of industrial gases like hydrogen.

Furthermore, in the EU ETS phase 3 seamless steel pipes were also included in the list of eligible sectors as they are closely linked to the steel sector because they represent a very electro-intensive process similar to other hot/cold rolling processes. Therefore, they should remain eligible.

Chemical sector

NACE 20.14, NACE 20.16

ETS State aid Guidelines – position paper

Association of Chemical Industry of the Czech Republic fully supports current emission reduction targets of European Union, recognizing great importance of EU ETS as a tool in transition of European industry to carbon neutrality. It is essential to ensure that this unprecedented, common effort of entire European economy is appropriately distributed among sectors and supported by financial measures, letting European industry as the most exposed sector to keep its competitiveness in the global market. Compensation of indirect costs of electricity, together with the free allowances allocations are indispensable tools for minimizing carbon leakage risk of industry sector. It remains crucial to distinguish between direct and indirect risk of carbon leakage. However, whereas it is possible to easily quantify direct effect of the emission costs on production and industry competitiveness, there are methodological challenges in case of sectors with serious indirect risk of carbon leakage resulting from interdependencies between particular value chains across all the industry.

The new, quantitative criteria of indirect electricity costs compensation appear to be reasonable. Quantitative assessment assures structured policy approach towards all the industry sectors exposed to higher prices of electricity stemming from the EU ETS. At the same time, it is crucial to underline necessity of individual approach to qualitative eligibility criteria in reference to sectors exposed to indirect carbon costs with effects reaching far beyond the situation of particular sector.

Petrochemical-related sectors are not on the list in draft Guidelines, but substantially affect many other sectors in the strategic high-end value chains. Despite the fact that those sectors do not meet quantitative criteria proposed by the European Commission, they should be eligible under qualitative assessment as their absence on the list may result in far reaching negative consequences for low-carbon transformation of European industry at large. Sectors that fits into this group are those directly related to petrochemical production: **NACE 20.14: manufacture of other organic basic chemicals and NACE 20.16: production of plastics in primary forms which is strictly interdependent with petrochemical sector.**

Referring to explanatory note of European Commission accompanying the proposal of the new guidelines[1], Association of the Chemical Industry would like to share its evaluation of these chemical sectors in the context of carbon leakage risk.

QUALITATIVE ASSESSMENT OF CARBON LEAKAGE RISK IN PETROCHEMICAL INDUSTRY				
NACE	Sector name	ICLI[2]	Consultant's carbon leakage risk evaluation	Unipetrol's carbon leakage risk evaluation
20.14	Manufacture of other organic basic chemicals	0,191	LOW	HIGH
20.16.1050	Production of High-density polyethylene (HDPE)	0,246	MEDIUM	HIGH
20.16.5130	Production of Polypropylene (PP)		MEDIUM	HIGH
20.16.3010	Production of Polyvinyl chloride (PVC)		MEDIUM	HIGH

According to the new methodology Indirect Carbon Leakage Indicator value moves NACE 20.14 sector to the borderline category. Moreover, due to the specificity of NACE 20.14, there are some considerable doubts if the values used in quantitative assessments reflect real situation of the sector.

Dependent on the company structure, reported GVA contributions for NACE 20.14 can contain data from many different products and processes as well as non-production personal and R&D costs or income from participations and investments. Due to the reporting phenomenon specific for NACE 20.14[3], the reported GVA could be overstated (Eurostat allows that GVA of a site with multiple products can be reported under one NACE code). For many chemical sites 20.14 is the most important sector, as it is the biggest subsector of the chemical industry. As a consequence real Indirect Carbon Leakage Indicator in all likelihood exceeds 0,2.

At the same time Indirect Carbon Leakage Indicator for 20.16 is 0,246 higher than postulated > 0,2.

[1] DG COM Explanatory Memorandum

[2] Combined retrospective evaluation and prospective impact assessment support study on Emission Trading System (ETS) State Aid Guidelines. Final Report.

[3] Eurostat GVA for NACE 20.14 is in any case not a fixed and stable figure but instead subject to retroactive statistical changes over time. Depending on the observed point in time and the nature and spread of margins of reported activities, the actual GVA value is changing and then leads to a different score of direct and indirect emission intensity in kg CO2/€ GVA making NACE 20.14 a borderline case that should be subject to a qualitative assessment.

Objective risk of carbon leakage risk for all these codes have to be evaluated as high. The key arguments that constitutes this situation:

- Unlike majority of the sectors exposed to carbon leakage risks not included in the proposal, petrochemicals are present in value chains of many other industry sectors. They serve as a raw material or semi-finished product used within the same company or in other entities from other industry sectors. The length of the products value chain and the degree of processing required may vary depending on particular product, nevertheless weakening of competitiveness of European petrochemical production will subsequently affect all related sectors. The main groups of high-volume organic compounds are: aliphatic compounds (ethylene, propylene), aromas (benzene, toluene, xylene), and oxygen compounds such as ethylene oxide, ethylene glycol, formaldehyde and methanol. Derivatives of these products can be found in clothing, household goods, car components, airplanes, computers, paints, solvents, cosmetics and pharmaceuticals. Many of these products enable the reduction of greenhouse gases in other sectors of the economy, e.g. insulation materials in construction, production of renewable energy installations, improvements of the energy efficiency in transport (composites that reduce the weight of vehicles).
- One of the biggest advantages of European petrochemical industry is high integration of crackers in the chemical value chains. Weakening this source of synergies decreases European petrochemical industry competitiveness and real GVA stemming from the manufacturing process.
- Petrochemical industry in Europe accounts for around half of ETS chemical industry emissions, so presents great potential of further electrification of its manufacturing processes. Electrification is a cornerstone in the long-term process of transformation of energy intensive industries in compliance with carbon neutrality goal. Higher prices of electricity will deter European industry from investments in electrification.
- Currently existing electrified manufacture facilities will become disadvantaged – while direct emission will be still receiving free allowances, indirect costs of electricity will not be compensated in any way.
- Excluding petrochemicals from Member States' indirect cost compensation will negatively affect competitiveness of the sector on global market due to higher costs of production. This argument becomes even stronger when we take into account recent big investments of petrochemical companies from other regions of the world including China and Arab Peninsula.
- Abovementioned tendency is also very actual for production of plastics in primary forms – along with big increase of world manufacturing capacity in last years, retaining current market share of European companies would be difficult even without EU ETS impact.

NACE 20.60 The European man-made fibres

The European man-made fibres industry: general background

- The man-made fibre sector includes a very wide range of fibres (also called chemical fibres), all having their own and very specific technology, different polymerization, and different spinning processes. This includes, among others **viscose, polyester, polyamide** (often called nylon), **acrylic, polypropylene, polyethylene**, the segmented **polyurethanes** -elastic fibres

known as elastanes (or spandex)-, **carbon fibres**, **speciality high-tenacity fibres** such as the high-performance **aramids** and Ultra High Molecular weight **polyethylene**.

- In the global textile world, around 100 million tonnes of fibres are produced annually, out of which two-thirds are man-made, synthetic and cellulosic. This represents more than twice as much as the annual cotton production -the largest natural fibre- and much more than wool (ca. 1 million tonnes) or other smaller natural fibres such as silk, flax, hemp, sisal, bamboo and others together (less than 0.5 million tonnes). Polyester is by far the most produced fibre worldwide

- The European man-made fibres industry is the **third-largest producer** in the world, after China and India. It is located at the start of the production value chain and provides essential raw materials for **end-uses** such as clothing, carpets, household textiles and a wide range of technical applications in transport, protective clothing, hygiene and medicine, sports, construction and many more. Without man-made fibres many of the (high tech) applications used to save on energy would simply be impossible. Examples are numerous and can be found in areas such as tyres, conveyor belts, fillings for sleeping bags and cold-weather clothing, filters for improving the quality of air and water in the environment, fire-resistant materials, ballistics applications, precursor and carbon fibre for reinforcement in composites used for advanced aircraft or car production, and many more. Man-made fibres are precisely engineered to give the right combination of qualities required for the end-use in question: appearance, handle, strength, durability, stretch, stability, warmth, protection, easy care, breathability, moisture absorption, etc., all resulting in value for money. In many of these applications, man-made fibres help saving much more energy in the use phase than it is needed for the fibre production itself. They are also used in blends with natural fibres such as cotton and wool.

- The **EU man-made fibre industry** is a very **innovative** global leader with production processes leading to high-quality goods. New fibres resulting in better performing applications (environment, energy saving etc.) are being invented every day. Man-made fibres are at the heart of the innovation in the textile value chain. Not only are **man-made fibres** relevant themselves but also in so far as they **contribute to help downstream products to remain manufactured in Europe:** the possibility for the European textile industry to be able to maintain a manufacturing base in Europe is also linked to the innovation in fibres. Without new man-made fibres, no innovative textiles and no other innovations would occur further downstream.

- In 2018, the man-made fibre industry in wider Europe had an output of 4.6 million tonnes (including spun melt), with **sales of € 10.5 billion**[4] and **exported outside the EU goods worth € 2.5 billion**. The man-made fibres industry employs no less than **20,000 people** and has production facilities in almost every European country. **Innovation spending and investment was ca. € 1 billion** over the last five years.

- The man-made fibres industry forms part of the European textile and clothing supply chain, which, according to the European Apparel and Textile Confederation (EURATEX) estimates, represented a **turnover of € 178 billion** and **investments of € 4.9 billion** in the EU 28 in 2018.

[4] The European man-made fibres are predominantly sold in Europe, as prices in the Far-East are in general at lower levels. Transport costs are thus relatively low for man-made fibres.

Thanks to a revival of EU activity, **the 171,000 textile and clothing companies** still employ over 1.7 million workers[5].

- The man-made fibre and polymer production industry are **capital intensive**. Investment levels differ considerably depending on the man-made fibre. Man-made fibre investments are **long-term investments**, which should be profitable and sustainable on the long run. Indeed, investment in such a chemically-based industry, mean investment will last for **at least 20 years**. When an investment decision has been deliberately taken, it is therefore not intended to be changed several years later.

- Regarding the "**substitutability" of EU by non-EU products,** from the point of view of the clients, for commodity-applications fibres may be substituted. However, for high-tech applications, automotive applications, medical applications, safety applications (automotive and aerospace) and other speciality applications the substitutability is much more difficult, as in those fields delivery contracts are often linked to specifications/accreditations or special licences. Therefore changing a supplier for a high-tech application is very difficult as it is in many cases also coupled to a high risk.

The European man-made fibres industry = a greener sector

The man-made fibres sector performance mirrors the chemical sector's one. Statistics collected through the European Chemical Industry Council (CEFIC) showed that greenhouse gas (GHG) intensity has plummeted 76% in the period 1991-2017 and that total greenhouse gas (GHG) emissions have felt nearly 60% since 1990 until 2017. **This means that almost 190 million tonnes of CO2 equivalent <u>were prevented of being released</u> to the atmosphere in that period. This achievement is even more remarkable if one notices that chemicals production has increased by 81% between 1991 and 2017 (figures needed for MMF).**

The European man-made fibres sector is subject to fierce global competition

- Man-made fibres and textile markets are **global** and **very competitive**. Over time, European producers have therefore specialized, moving from commodity-type to speciality-type products. Today, the European man-made fibres industry is one of the most efficient in the world. However, it remains exposed to **distorted import competition**, mainly from Asia in general and from China in particular where huge **overcapacities** continue to be built up for a number of man-made fibres (as shown in the tables below), mainly through subsidies and other government-oriented measures. Asian countries export these overcapacities which leads the EU market to be saturated with low-priced and very often dumped imports. This consequent and widespread dumping in Europe results in loss of market shares and ultimately the disappearance of companies and jobs.
  Furthermore, intellectual property rights are regularly infringed, and as product quality of imported goods is improving quickly, this unfair trade makes it difficult to stay ahead of competition.

<u>Production capacities versus demand in third Asian countries – example: polyester (main dominant fibre produced worldwide)</u>

[5] https://euratex.eu/key-figures/

Production Capacity ('000 tonnes)

	2000	2010	2012	2013	2014	2015	2016	2018	2019	2030
China*	7,214	30,478	36,216	41,532	44,660	46,720	49,186	56,892	59,600	67,333
India	1,485	4,195	5,025	5,635	6,128	6,478	6,815	7,421	7,827	10,310
Taiwan	3,080	2,387	2,568	2,571	2,591	2,584	2,481	2,395	2,395	2,217
Europe	**1,610**	**1,228**	**1,213**	**1,256**	**1,268**	**1,299**	**1,344**	**1,389**	**1,409**	**1,385**

*Hong Kong included

Source: PCI Fibres – World Synthetic Fibres Supply/Demand Report 2010 & Wood Mackenzie - Fibres Global Supply Demand Report 2018

Demand ('000 tonnes)

	2000	2010	2012	2013	2014	2015	2016	2018	2019	2030
China*	6,391	22,960	28,144	29,230	28,879	30,415	31,722	36,442	37,560	52,957
India	1,375	2,715	2,968	3,276	3,706	3,918	4,150	4,372	4,530	8,218
Taiwan	1,341	895	646	620	808	832	769	736	717	653
Europe	**1,812**	**1,741**	**1,782**	**1,789**	**1,998**	**2,031**	**2,143**	**2,332**	**2,384**	**2,830**

*Hong Kong included

Source: PCI Fibres – World Synthetic Fibres Supply/Demand Report 2010 & Wood Mackenzie - Fibres Global Supply Demand Report 2018

Availability for export ('000 tonnes)

	2000	2010	2012	2013	2014	2015	2016	2018	2019	2030
China*	823	7,518	8,072	12,302	15,781	16,305	17464	20,450	22,040	14,376
India	110	1,480	2,057	2,359	2,422	2,560	2,665	3,049	3,297	2,092
Taiwan	1,739	1,492	1,922	1,951	1,783	1,752	1,712	1,659	1,678	1,564
Europe	**-202**	**-513**	**-569**	**-533**	**-730**	**-732**	**-799**	**-943**	**-975**	**-1445**

*Hong Kong included

Source: PCI Fibres – World Synthetic Fibres Supply/Demand Report 2010 & Wood Mackenzie - Fibres Global Supply Demand Report 2018

- These figures clearly indicate that since these countries are still building up new production capacities, there will always continue to be a **huge excess capacity to export to the EU**.

- WTO customs data show that, generally speaking, the **tariff duties** imposed by the EU for imports into its market for man-made fibres are the lowest in the world while European exporters of man-made fibres have to pay much higher rates of tariff duties when accessing third countries' markets (e.g. Mercosur, US). Asian countries in general, China and India in particular, and others like Brazil, Turkey and the US are winning and continue to win market share in detriment of goods manufactured in the EU which have lost and are still losing ground. This is also true for man-made fibres.
  Additionally, these countries have been very active in taking regular **trade defence actions** while the EU man-made sector has only anti-dumping duties in place for high tenacity yarns of polyester. Moreover, the latter are 5% in average while in the US trade defence duties can reach up to… 473%!. These trade defence actions and the duties that result from them concretely shield their internal markets and exports tend to land in the worldwide-only free access market: the EU. EU man-made fibre producers are extremely concerned by the negative impact of these actions on the EU market which put additional pressure on their production and sales levels.

- The patterns of trade can be further seriously affected (lower exports and/or higher imports) if countries such as Vietnam or Indonesia continue to gain market shares by benefitting from the growing Chinese investment in the man-made fibres sector which is spreading around Asia.

- This intense global competition has been detrimental to the EU man-made fibres industry which **profit margins** are **constantly under pressure**.

- We can illustrate a concrete first example of levels of profits in the man-made fibres industry by referring to the specific subsector of **polyester staple fibres**. In the anti-subsidy proceeding following a complaint lodged on November 2013 by CIRFS[6], the European Commission found that **profitability of sales** were -5.4% in 2010, 1% in 2011, -0.8% in 2012 and 0.2% in the investigation period (October 2012 to September 2013) and that **return of investments** was -25.1%, 5.5%, -4.5% and 1.5% for the same periods as above, respectively. Also, the confidential complaint showed that the profit average was merely 2.1% throughout the 2010-April 2013 period.
  Profit margins at such low levels do barely allow EU polyester staple fibre producers to keep the needed investment levels to properly compete in the polyester staple fibre business. In fact, higher profit levels are needed so as to achieve those levels of investments and thus assure the industry survival and avoid job losses.

- A second example of a subsector where profits are not being delivered/achieved is the **high tenacity yarns of polyesters** sector as shown in the anti-dumping case on imports of those yarns from China launched by CIRFS on August 2015[7]. In such case, the European Commission

[6] Commission Implementing Decision 2014/918/EU of 16 December 2014 terminating the anti-subsidy proceeding concerning the imports of polyester staple fibres originating in the People's Republic of China, India and Vietnam, Official Journal of the European Union L 360/65 of 17 December 2014. The complaint was submitted on behalf of seven EU producers which represented more than 70 % of the total EU production of polyester staple fibres.

[7] Commission Implementing Regulation (EU) 2017/325 of 24 February 2017 imposing a definitive anti-dumping duty on imports of high tenacity yarns of polyesters originating in the People's Republic of China following an expiry review pursuant to Article 11(2) of Regulation (EU) 2016/1036 of the European Parliament and of the

noticed that **profitability of sales** were -4.7% in 2012, -5.3% in 2013, -1.4% in 2014 and -1.1% in the review investigation period (October 2014 to September 2015) while the **return on investments** was -4.3%, -4.2%, -2% and -1.4% for the same periods as above, respectively.

- Generally speaking and when we relate to polyester, the technology is widely and readily available, to the point that it has become a commodity product of which prices are referenced globally and particularly by China. **The EU man-made fibre industry is thus a price-taker, leaving very few or no room for premiums**. As earlier said, although the EU industry continues to concentrate on specialities, there is a need, in order to cover fixed costs, to keep producing a certain part of commodities due to production, technical reasons (critical mass) and markets' requirements and needs. Any increase of the cost may lead commodity and thereby speciality production to become unprofitable and to disappear.

- The EU man-made fibres' sector is an **energy user**, sometimes even **energy-intensive**. Due in part of insufficiently liberalized energy markets in the EU, and new energy efficiency guidelines, the sector has to face energy prices in the EU which are not only proportionally higher than in other industrialized non-EU regions but also rising as only part of the cost increase is being compensated. In average, energy costs are, after raw materials, a cost element of the same order of magnitude as labour cost. **The man-made fibre industry is and has been constantly striving to minimize its energy use (savings) and thereby its cost in order to stay competitive** but a certain amount of energy usage is an unavoidable part of its production processes.
  Again, the results of the man-made fibres industry are very similar to the results realised by the chemical industry in general. The chemical industry has reported, on the one hand, **reductions in energy consumption[8] which vary from -58% to -13% depending on the type of energy with an average for all products of -24% between 1990 and 2017**. Moreover, **energy intensity halved during the 1991-2017 period** and **the chemical sector has consistently performed better than the overall industry** (-54% compared to -40%). On the other hand, **renewable and biofuels energies consumption have more than doubled since 2000**).

  Innovation into new technologies and implementation of these should further help to increase energy efficiencies which is and will remain a top priority. However, resources for such projects are already limited and should not be further eaten up by additional costs due to ETS.

  Moreover and although being the cleanest and the most sustainable in the world, the **European man-made fibre industry is exposed to additional cost burdens linked to the compliance with stringent European environmental legislation passed over the past years** and which goes far beyond legislation in non-European countries, e.g. REACH.

  ETS, as a second example, and despite the current carbon leakage provisions, has already a substantial impact on the competitiveness of energy-intensive industries, due to EU-specific direct costs (purchase of ETS allowances) and indirect costs (CO2 as element of electricity price).

Council, Official Journal of the European Union L 49/6 of 25 February 2017. The complaint was introduced on behalf of four EU producers which represented around 97 % of the EU production of high tenacity yarns of polyesters.

[8] According to CEFIC, gas and electricity account for nearly 2/3 of total energy consumption in 2017 (latest figures).

Unlike the power sector, **carbon costs in energy-intensive industries cannot be passed through** over the value chain **to consumers without losing market share to their non-EU competitors**. Companies that already meet the highest standards cannot make drastic improvements or technology shifts.

The cost increase due to ETS should compensation for carbon leakage be stopped hardly being compensated is expected: - to absorb the already low profit margin, - to stop investments in Europe (€1 billion over the last five years), - to leave no money available for innovation, also for energy savings, essential for survival of the sector in Europe, - to result in reduced competitiveness, loss of market share, job losses, - to result in carbon leakage, - to lead to the demise of European fibre production, which will mean that all fibres will have to be imported, resulting in a textile industry which will be completely dependent on Asia for its raw materials and, most likely, in higher CO2 emissions (due also to additional transport).

The risk of "carbon leakage" in the man-made fibres industry

- The European **man-made fibres** sector has so far qualified and been determined as a **sector deemed to be at risk of carbon leakage** and the sector *manufacture of man-made fibres* also meets the criteria for being eligible for state aid measures within the context of the guidelines. Indeed, not only *manufacture of man-made fibres* (NACE 24.70, now NACE 20.60), but also *polymerization* (NACE 2416, now NACE 2016), which is very often part of the process, and several fibre and textile after-treatment activities are being exposed to carbon leakage.

- The criteria of being exposed to a serious risk of carbon leakage due to costs relating to ETS 2021 have been fixed, and the industrial sectors being at risk have been defined and have been published in the EU's Official Journal on 8 May 2020[9]. The carbon leakage risk and the need of compensation have been recognized by the European Commission, based on the criteria set by the European Commission itself. Given the above, we believe that the **suppression of electricity compensation** for MMF is **unjustified**.

- The cost structure is one aspect. Being able to keep a business profitable and sustainable in combination with social responsibility criteria is another. If this is impossible, or when the uncertainty for long-term investments is very high due to e.g. ambiguity about future compensation, **the production in the EU will be reduced and relocated to other countries**. Businesses indeed move to countries where an attractive and sustainable production climate is expected. Once polymerization and/or production of man-made fibres is closed down, and the business has moved outside Europe, this manufacturing operation will not return (and loss of knowhow, R&D). This reduction of production in Europe would certainly lead to a **large rise in imports from Asia, and China in particular**, unless these countries make commitments equivalent to those taken by the EU under the ETS. For the time being no such commitments

[9] Commission Delegated Decision (EU) 2019/708 of 15 February 2019 - L 120/20.

have been given by the main non-European man-made fibre producing countries. **The carbon emissions per tonne of output** (due to carbon intensive energy sources and lack of treatment of emissions) **in most of these countries are substantially higher than in Europe** which could result in an increase in global carbon emissions.

- Long term investments in the EU, typically needed for a high capital intensive industry, have been made too risky **and thus less attractive from an economic point of view** because of variations (mainly increases) in the CO2 price, the uncertainty about keeping the carbon leakage status and the compensation, the current threat of a CO2 tax called Border Carbon Adjustment as well as other energy efficiency or tax increases. This has an adverse impact on jobs and growth prospects and thus in wealth and prosperity in the EU. It makes also non-EU countries a more attractive place to invest since there is the certainty that any how costs related to energy and CO2 emissions will be lower. A global equal level playing field must be realized to make it attractive to also invest into Europe.

- If no man-made fibres production in the EU would remain, **the whole textile and clothing chain will suffer**. Certainly, the current physical proximity of EU man-made fibre producers is critical for the competitiveness of downstream users as it improves the availability of products and flexibility for the whole textile supply chain and reduces input costs. Furthermore, proximity facilitates the development of new products and increases innovation as it is much easier, and at the end even more efficient, to develop a new product with another company or a research institute nearby, just because the communication channels are much shorter. However, proximity and the services which the man-made fibres industry provides to its customers are, ultimately, not as prominent as a competitive price.

- We feel that if the European man-made fibres continue to get compensation the market in Europe will continue to grow as **technical textiles** (sector with a huge potential) used in transportation, building, renewable energy production and medicine will become more and more the guarantors for our economic wealth. It is very important that the sector can manufacture products under competitive conditions as otherwise, advanced developing countries will benefit from the global growth trend in fibres needed for these technical textiles. Europe must continue to rely on its specialized expertise and innovation capacities where it has clearly a competitive edge compared to the rest of the world. It must be the place to be to invest into a sustainable business.

Numerical elements for assessment

CIRFS wants to stress that the criteria for being exposed have been set on the cost increase of direct and indirect cost, as well as on trade intensity criteria. Reference to only indirect cost increases is not correct, and is not in line with the Directive.

Direct emissions for the man-made fibre sector are: 554.046 tonnes CO2, average of the years 2013-2015.

With 0.295 kg CO2 direct emission/€ GVA we calculated the GVA as applied by the European Commission:

554.046 x 1000/0.295/1000000 = € 1,878 million = € 1.878 bn

With the GVA, 0.638 kg CO2 indirect emission/€ GVA and 0.376 tonne CO2/MWh we calculated the TWh as used by the European Commission:

0.638 x € 1,878 million / 0.376 / 1000 = 3.187 TWh, or 3187 GWh or 3,186,813 MWh.

Thus the indirect emissions are for a check: 3,186,813 x 0,376 = 1,198,241 ton CO2.

Then 1,198,241 ton CO2 x 1000 (to get kg) / (1,878 x 1,000,000) = 0.638 kg CO2 indirect emission/€ GVA. (Q.E.D.)

The Trade Intensity of NACE 20.60 is 44.1%. The trade intensity is one of the criteria for defining the exposed sectors list. It is undisputable that the man-made fibres industry is exposed to carbon leakage based on the trade criteria (> 10%).

Indirect emissions in the man-made fibres sector score 0.638 kg CO2/€ GVA indirect; thus too low in so far the criteria set (> 1 kg CO2/€ GVA).

Due to the fact that a sector satisfies the formula *kg CO2 direct + indirect emission x Trade Intensity > 0.20* it qualifies to be exposed to the risk of carbon leakage to be used for the allocation of allowances based on the direct emissions only (as NACE 20.60 clearly is), we therefore believe that, should a sector fulfil the formula *kg CO2 indirect emission x Trade Intensity > 0.20* it should also qualify for the indirect emission financial compensation.

The NACE 20.60 score for indirect emission is: 0.638 x 44.1% = 0.281, thus comfortably above 0.20.

GIVEN ALL THE ANALYSIS AND ARGUMENTS PRESENTED ABOVE, CIRFS REQUESTS YOU HENCE NOT TO EXCLUDE THE MANUFACTURE OF MAN-MADE FIBRES FROM THE INDUSTRIAL SECTORS DEEMED TO RECEIVE ELECTRICITY PRICE COMPENSATION UNDER THE DRAFT REVISED EU ETS STATE AID GUIDELINES.