Cerame-Unie The European Ceramic Industry Association

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Post 2020 Climate and Energy Legislation
How to streamline industrial competitiveness in the EU ETS

The recent initiatives instigated by the European Commission (Market Stability Reserve, 2030 framework, post 2020 carbon leakage) provide an ideal opportunity for a holistic debate on EU post-2020 climate and energy policies that extends beyond marginal adjustments to existing policy instruments. Since 2007, when the 2020 package was defined, major developments (at both European and international level) have dramatically modified the context within which the framework will be defined, such as a severe recession in the EU economy, access to new energy sources in the USA, increased divergence in international energy prices and slow progress towards an international climate agreement.

Unilateral climate and energy policies create costs for European industry thereby leading to a risk of relocation to countries with less ambitious (or no) climate policy. The resulting loss of manufacturing not only costs EU jobs but can also give rise to an increase in global energy use and emissions through the use of inferior production processes, more carbon-intensive electricity and greater transportation of goods. In the absence of a binding international agreement (with truly comparable effort from competing countries) it is essential that mitigation measures for industry are forthcoming.

Manufacturing and SME-driven sectors like ceramic production are the backbone of the European economy and key drivers of growth and jobs. However, high energy and carbon costs resulting from a unilateral climate policy represent critical challenges to their international competitiveness and exposure to carbon leakage[1]. The EU ETS as the cornerstone of the current EU regulatory framework covers more than **1,200 ceramic installations**, representing around 10% of the total number of installations, but less than 1% of the emissions.

It is imperative that post 2020 climate and energy policies preserve the competitiveness of European industry in order to foster the growth of industry, avoid carbon and investment leakage and favour the development of breakthrough technologies in order to support the transition to a low-carbon economy. The current one-size-fits-all approach on manufacturing and power sectors under the ETS should also be reassessed in the context of the debate on a 2030 framework.

As demonstrated in the **Ceramic Industry Roadmap to 2050**, our industry is committed to fairly contributing to the EU's long-term climate goals provided that a stable, effective and predictable legal framework is in place that combines both climate ambition and industrial competitiveness. The right 2030 package is essential to stimulate cost-efficient, low carbon investments.

Cerame-Unie, the European Ceramic Industry Association, has developed the following policy recommendations:

- **Set effective measures to prevent the risk of carbon and investment leakage**
- **Implement a structural bottom-up reform instead of a piecemeal approach**
- **Reduce regulatory burdens and set simplifications**
- **Promote the development of low carbon technologies**
- **Explore possible alternative instruments to support climate protection**

[1] The European Commission's report on energy prices published in January showed that natural gas prices for our industry have increased on average by 30% between 2010 and 2012 and are three to four times higher than competing countries like USA and Russia. The full report and a summary with the main findings for the ceramic industry are available on Cerame-Unie's website here.

➢ **Effective measures to prevent the risk of carbon and investment leakage**

In line with the conclusions of the March 2014 European Council, post 2020 climate and energy policies should be subject to a genuine **competitiveness test**. Following this principle, an increased level of ambition towards 2030 should be accompanied with an increased level of protection against carbon leakage.

Yet, according to the current ETS Directive, provisions on carbon leakage are due to be phased out by 2027. This would result in an overwhelming shortage of free allowances entailing an additional **€ 4bn in direct carbon costs** for the European ceramic industry between 2021 and 2030. However, even if the current rules remain in place without change, the **cross sectoral correction factor** would increase to around 40% by 2030 resulting in direct costs in excess of € 1bn over this period. Therefore, the development of effective measures to prevent the risk of carbon and investment leakage should represent the main element of the post 2020 climate and energy legislation.

Such provisions should ensure that installations from sectors at risk of carbon leakage receive **free allocation corresponding to 100% of technically and economically achievable benchmarks**, based on the most recent production levels and with **no cross-sectoral reduction factor** applied. We propose that the backloaded allowances should be used for this purpose to eliminate the need for the cross-sectoral reduction factor. Furthermore, **indirect carbon costs** passed through in electricity prices should be offset for all sectors at risk of carbon leakage by a harmonised EU-wide support scheme.

In order to ensure the necessary regulatory certainty for long term investments, all energy-intensive sectors should be recognised as exposed to the risk of carbon leakage. A selective carbon leakage list could distort fair competition on the EU internal market between sectors on the list and sectors not on the list (for example between competing construction products), paradoxically favouring the most carbon emitting sectors. As a next-best alternative, carbon and trade intensity should be used as the **eligibility criteria**. However, **Gross Operating Surplus** (GOS) should replace **Gross Value Added** (GVA) in the carbon intensity assessment, as the former does not include labour costs and hence provides a better indication of the real impact of carbon costs on the profitability of the sector[2].

➢ **A structural bottom-up reform instead of a piecemeal approach**

In the absence of equivalent contributions from major competing countries, decarbonisation of the EU is in effect a strategy of economic policy rather than a pure environmental choice. Therefore, it has to be implemented in combination with a comprehensive industrial policy that safeguards the competiveness of Europe's energy-intensive industries. Consequently, the EU commitment to emission reduction must take into account both **the outcome of the Climate Conference in Paris,** together with a **bottom-up approach based on technical feasibility and cost efficiency for each sector**. This should also entail a greater focus on **the untapped potential in non-ETS sectors**, such as buildings.

More generally, a consistent legislative framework should avoid overlapping policy measures and targets, as is the case for the current 2020 package. Each legislative proposal should be considered as part of **a structural reform rather than as a piecemeal adjustment**. Following on from this, the

[2] On average, labour costs represent up to 70% of the GVA for some ceramic sectors. Therefore, the ratio carbon cost/GOS is much higher than the ratio carbon costs/GVA.

proposed **Market Stability Reserve** should be carefully assessed to ascertain whether it is consistent with the objectives of curbing emissions at the lowest cost and preventing the risk of carbon leakage.

➢ **Promoting the development of low carbon technologies**

As demonstrated in the Ceramic Industry Roadmap 2050, the contribution of the sector to ambitious long-term climate objectives also relies on the availability of technologies that increase industrial energy and carbon efficiency at affordable prices. Therefore, it is essential that the post 2020 climate and energy legislation includes tangible measures to promote the use of existing funding schemes (such as Horizon 2020 or future successor programmes) as well as possible, new funding sources (such as the use of **auction revenues**). It will boost innovation and help industry quickly develop and deploy **best available and breakthrough technologies**.

However, the introduction of such support scheme should not be done at the expense of free allocation for industry or by arbitrarily manipulating the carbon price through policy interventions. Furthermore, it should also be noted that no technologies in short or medium term are envisaged within the sector to reduce **process emissions**, which are determined by composition and local geology of the raw materials used (such as the decomposition of carbonates and the oxidation of organic content). These process emissions are a natural by-product of the firing process in ceramic production, cannot be avoided and hence should not be considered for future emission reduction obligations.

➢ **Reducing regulatory burden and further simplification**

EU ETS introduces administrative costs for business. While some rules are needed to ensure that the system operates fairly and consistently, a balance must be struck between fairness, cost-efficiency and simplicity. A simpler EU ETS could still achieve its objectives, but do so in a less administratively burdensome way. Greater simplification could be achieved by ensuring that small emissions sources are treated more proportionately in phase IV. Furthermore, a framework is required to ensure that all **small emitting installations** (including many from the ceramic sector) benefit from additional simplification measures.

➢ **Exploring possible alternative instruments**

The debate on post 2020 climate and energy legislation gives the opportunity for a deep re-assessment of existing policy measures and for exploring possible alternatives when appropriate. The main objective of such an exercise should be to ensure industry's competitiveness and level the global playing field.

Due to the different signals associated with the carbon price, **separate policy instruments for industrial operators and the power generation sector** should be carefully explored. The **inclusion of imports** in the trading scheme also deserves an in-depth assessment.

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