Cerame-Unie The European Ceramic Industry Association

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Ceramic industry position on post 2020 EU ETS review

On July 15th 2015 the European Commission presented their legislative proposal for revision of the EU ETS Directive, setting out the rules for the fourth ETS trading period (2021-2030). The proposal maintains an ambitious decarbonisation target as agreed by the European Council in October 2014. However, the European Council conclusions also stress the need to **preserve international competitiveness of European industry**. We believe post-2020 carbon leakage mitigation must be in line with the adopted level of climate ambition. In the context of more stringent climate targets, a steeper emission reduction pathway, the existence of the Market Stability Reserve and foreseeably higher energy, carbon and environmental costs, it is essential that the legislative framework **prevents an increase in carbon, investment and job leakage risks in SME-driven, manufacturing sectors, such as ceramics.** Such issues are of primary concern to our industry, since ETS covers more than 1,200 ceramic installations, representing around 10% of the total number of installations, but less than 1% of the industrial emissions. Ceramic sectors in the scheme include manufacturers of bricks, roof tiles, wall and floor tiles, refractories, sanitaryware, clay pipes and other ceramic products.

Against this background, we put forward the following policy recommendations:

1. **Energy-intensive industries like ceramics should remain on the list of sectors deemed to be at risk of carbon leakage. There should be no differentiation/tiering introduced between various sectors exposed to the risk of carbon leakage.**
2. **The number of free allowances available to industrial participants should be increased in order to preserve the international competitiveness of EU industry.**
3. **Qualitative assessment of the carbon leakage risks must be maintained since it allows a more comprehensive analysis. This approach should be open to all sectors and sub-sectors, regardless of the quantitative assessment outcome. Consequently, the threshold of 0,18 should be removed. In addition, the possibility to annually add sectors/subsectors onto the carbon leakage list must be maintained.**
4. **Free allocation should be based on most recent and representative production levels and on technically and economically achievable benchmarks that reflect real industry performance. Fall-back benchmarks must be maintained for sectors with a large range of heterogonous products.**
5. **Installations in carbon leakage sectors should receive free allocation corresponding to 100% of realistic benchmarks.**
6. **Eligibility for financial compensation for indirect costs should be based on total electro-intensity as in the Environmental and Energy State Aid Guidelines (EEAG).**
7. **Process emissions should either be excluded or granted full free allocation due to the inability to reduce them.**
8. **Member States shall implement equivalent national measures to allow small emitter installations to opt-out of EU ETS. Opt-out possibility shall be extended to installations with emissions below 50,000 tonnes in order to reduce the administrative burden for SMEs.**
9. **The legislative framework and appropriate financial support should enable the deployment of best available technologies (like cogeneration) and breakthrough innovation.**
10. **Differentiated and tailored-made systems for manufacturing and power sectors need to be developed according to their specific requirements.**

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Background information

- **The rationale of carbon leakage provisions**

Unilateral climate and energy policies create costs for European industry thereby leading to an increased risk of relocation to countries with less ambitious (or no) climate policy. The resulting loss of manufacturing not only costs EU jobs but could also give rise to an increase in global emissions through the use of inferior production processes, more carbon-intensive energy sources and greater transportation of goods. In the absence of a binding international agreement (with truly comparable efforts from competing industries in third countries) it is essential that adequate mitigation measures for manufacturing industry are forthcoming. Post 2020 carbon leakage mitigation has to be in line with the adopted level of ambition.

- **Quantitative and qualitative carbon leakage assessment**

Under the Commission's proposal, manufacturers face an increasingly dwindling share of free allowances and escalating compliance costs (on account of an increased rate of annual cap reduction coupled with the fixed share of allowances attributed to free allocation). In order to maintain international competitiveness, a greater number of free allowances for industrial participants is urgently needed. This could be achieved by decreasing the share of auctioned allowances or by utilising allowances provisionally earmarked for the Market Stability Reserve.

The proposal of the European Commission takes the correct approach by ensuring measures to support energy-intensive industries at risk of carbon leakage and limiting the outcome of the carbon leakage assessment to two eventualities: namely those at risk and those not at risk. **We believe that introducing differentiation into various groups would lead to incomplete carbon leakage protection for many industrial sectors at risk.** In addition, the resultant unequal levels of protection would also distort the level playing field in the EU market.

The carbon leakage assessment must be available for all sectors and subsectors, as in the current ETS phase. Also the option of the qualitative assessment to carbon leakage risk must be maintained in the Directive**.** Quantitative criteria are too narrow and do not take into account all the factors that can contribute to the risk of carbon leakage. As such, they do not enable a comprehensive picture of the complex market situation for a given sector to be established. For instance, they do not take into account the technological limits of the sector, its ability to pass-through carbon costs or of profit margins which can act as a potential indicator of investment capacity. Furthermore, quantitative assessments are solely backward looking, whereas qualitative analysis can add the necessary forward looking elements, such as trade and investment trends. The Commission's proposal indicates that qualitative assessments should evaluate three criteria: a) extent to which it is possible for individual installations to reduce emission levels / electricity consumption, b) current / projected market characteristics and c) profit margins as a potential indicator of long-term investment or relocation decisions. For a comprehensive assessment, all indicators must be evaluated simultaneously, with no hierarchy between the three components.

For some time, Cerame-Unie have been asserting that Gross Value Added (GVA) is not an appropriate indicator to reflect the impact of carbon costs on the competitiveness of a sector, since it consists of both labour costs and the Gross Operating Surplus (GOS). Average labour cost can represent up to 70% of the GVA for some ceramic sectors and therefore using GVA underestimates that impact. A more representative indication can be obtained by replacing GVA with GOS in the carbon intensity

assessment. Like GVA, GOS data can be readily obtained from Eurostat. At the very least, we call for GOS to be used in the qualitative assessments.

We are concerned about the introduction of a threshold of 0,18 to qualify for a qualitative assessment. The issue is of particular concern to brick, roof tile and clay pipes sectors, which have been included on the current carbon leakage list on the basis of a qualitative assessment. The qualitative assessment better reflects the characteristics of this sector, which is the second most energy intensive manufacturing sector in Europe, highly labour – intensive and mainly driven by SMEs. The proposal, in its current shape, decreases to large extent investment predictability in these sectors. According to the 2009-2011 data used to determine the second carbon leakage list, these sectors are on the borderline of the proposed threshold. The closeness of these sectors to the proposed thresholds means there is a very high degree of uncertainty on the outcome. If carbon leakage status is lost, this would have a serious impact on business survival after 2020, let alone the impacts on growth, investment and the competitive distortion in the EU internal market between sectors on / not on the list. The retention of full carbon leakage status for brick, roof tile and pipe sectors is a business-critical issue.

We consider the qualification threshold of 0,18 for qualitative assessment to be unnecessary and we advocate the removal of the 0,18 threshold. The inclusion in the group of sectors at risk of carbon leakage must be possible on the basis of a qualitative assessment regardless the quantitative assessment outcome, at least for sectors and subsectors which have been included onto the carbon leakage list on this basis in the past. Furthermore, the ability to annually add sectors onto the carbon leakage list should also be maintained in the Directive to reflect changing market characteristics for borderline sectors. Moreover, subsectors should continue to be assessed at the appropriate level of disaggregation, so as not to discriminate against smaller subsectors that are currently assessed at a higher level of disaggregation (i.e. 6 or 8 digit code levels).

- **Realistic benchmarks and activity levels**

Benchmarks must be set at a level that is technically and economically achievable for installations based in the EU, so as to reflect real industry performance. Current rules are already very restrictive, as benchmarks are based on the average performance of the top 10% most carbon-efficient installations.

The benchmark revision should take place not more than once in the trading period in order to ensure legal certainty and limit the administrative burden, in particular for sectors with a high number of installations like ceramics. More frequent revision is not appropriate because major breakthrough technologies are not expected to be widely deployed by the end of the fourth trading period.

We believe that the Commission's proposal should mention the fall-back approach to free allocation. Due to heterogeneity of ceramic products, the fall-back benchmarks were applied to many of them in the past (for example: clay blocks, wall & floor tiles, refractory, sanitaryware, clay pipes, etc). Such an approach is particularly adapted to sectors with a wide range of products, large number of SMEs and small emitters. **Therefore we believe it is essential to ensure in the ETS review proposal that the fall-back approach is maintained for the 4th trading period.** An inappropriate treatment will dramatically raise the risk of carbon leakage.

Free allocation should be based on the most recent and representative production data available as it must reflect economic reality. We welcome the European Commission proposal to move in that

direction by allowing the use of five-yearly production data. Particularly, we note the Commission's proposal allows installations to obtain additional free allocation for increases in production without adding new capacity. Whilst supporting this principle, we anticipate little benefit since a minimum production increase of 50% would be required. In order to deliver genuine benefits to industry, a lower minimum threshold should be considered.

- **Cross Sectoral Correction Factor (CSCF)**

The current application of the CSCF to free allocation is at odds with the aim of guarding against carbon leakage. The current system acknowledges that sectors at risk of carbon leakage require 100% free allocation of the benchmark to remain internationally competitive. However, the allocation is then reduced by the CSCF, which is 5.73% in 2013 and increases linearly to 17.56% in 2020. The application of the CSCF reduces free allocation such that even the best performers in the sector cannot achieve the benchmark level. If continued in ETS phase 4, it would strongly jeopardise the effectiveness of carbon leakage provisions. Therefore it should be avoided, for example through the use of additional allowances currently earmarked for the Market Stability Reserve.

- **Indirect Compensation**

In the third trading period, Member States can provide financial mitigation to a very limited number of sectors / sub-sectors defined in Annex II of the EU ETS State Aid Guidelines. However, the Annex II list, which is based on trade and indirect carbon intensity, does not include any ceramic sectors. Yet, the impact of carbon and other environmental costs on electricity prices will escalate dramatically over next years, as power generation sector decarbonises. Therefore, we propose that eligibility for financial compensation for indirect costs should be based on total electro-intensity as in the Environmental and Energy State Aid Guidelines (EEAG) in order to extend the list to all sectors and installations sensitive to electricity price increases.

- **Process Emissions**

In the ceramic sector, a notable proportion of direct emissions are associated with process emissions caused by the decomposition of carbonates and oxidation of organic content in the raw materials. The exact amount varies significantly in the heavy clay sector depending on the geology and chemical composition of locally available minerals. As process emissions are inherent in the raw materials and are unabatable, they are a natural by-product of the firing process which cannot be avoided. Therefore, process emissions should either be excluded or granted full free allocation. According to this principle no cross sectoral reduction factor should be applied for these.

- **Small Emitter Installations**

In the fourth phase, Member States shall implement equivalent national measures to allow small emitter installations to opt out of EU ETS, in order to reduce administrative burdens for industrial operators. The best experiences of those, who are already making use of this possibility in the third trading period should be used. In line with the new Commission's objective of reducing EU bureaucracy, **the opt-out possibility should be extended to installations with annual emissions up to 50.000.** According to 2013 data, around 13,540 installations reported emissions below this threshold. They represented around 84% of the total number of ETS installations but only 5% of total emissions. Therefore, extending the opt-out possibility to such installations would give the opportunity to reduce significantly the administrative burden (in particular for SMEs) without undermining the overall

environmental objective. Effective and simplified monitoring, notification and verification rules should be clearly defined.

- **Support to energy efficiency and innovation**

As demonstrated in the Ceramic Industry Roadmap 2050, the contribution of the ceramic sector to ambitious long-term climate objectives is dependent on the availability of technologies that increase industrial energy and carbon efficiency at affordable prices.

Firstly, the legislative framework should promote the deployment of existing best available technologies like cogeneration. For instance, investments in this technology have been deterred by continuous changes to national rules and the current treatment under EU ETS, where no free allocation is granted for emissions related to electricity produced through cogeneration. On the contrary, high efficiency cogeneration should be promoted given the benefits with regard to primary energy saving, reduction of network losses and emissions. In addition, efficient use of energy by cogeneration contributes positively to the security of energy supply.

Secondly, tangible financial support to incentivise more-difficult technological breakthroughs will be essential, including funding (or co-funding) for industrial research, development and demonstration of pre-commercial technologies. There is a need for breakthrough technologies to come to market given the need to attain long-term decarbonisation targets, coupled with the long lifetime of ceramic plants (typically 40 years). We support the extension of the NER400 programme to cover low-carbon innovation in industrial sectors. For industrial innovation, the NER400 fund should be technology-neutral and should stretch beyond industrial carbon capture. In addition to NER400 programme, Member States should make use of auctioning revenues to support the low carbon transition of industry, including SMEs.

- **Exploring alternative instruments**

The debate on post 2020 climate and energy legislation gives the opportunity for a fundamental re-assessment of existing policy measures and for exploring possible alternatives when appropriate. In manufacturing sectors, low carbon prices are needed to reduce the risk of carbon leakage and loss of competitiveness, whereas in the power generation sector, higher carbon prices are required to induce low-carbon investments. Furthermore, the two sectors differ significantly with regards to technological abatement potential and ability to pass through carbon costs. In particular, the manufacturing sector is exposed to international competition and cannot achieve the ambitious long-term climate objectives without the development of breakthrough technologies. Due to these differences, differentiated and tailored-made systems for manufacturing and power sectors need to be developed according to their specific requirements. Furthermore, climate policy needs a broader approach which also takes into account embedded emissions in imported products. Therefore, the inclusion of imports in the trading scheme also deserves an in-depth assessment in order to ensure that the EU is not simply decarbonising by deindustrialising.

The European ceramic industry covers a wide range of products including abrasives, bricks & roof tiles, clay pipes, wall & floor tiles, refractories, sanitaryware, table- & ornamentalware, technical ceramics and porcelain enamel. The industry generates over 200,000 direct jobs and a production value of €27 billion within the EU.

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