ERT

# European Industrial Competitiveness facing an existential crisis

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# Alarming decline in Europe's competitiveness

Soaring energy prices are currently precipitating an alarming decline in the competitiveness of Europe's industrial energy consumers. The high energy prices and strained supply chains of raw materials are rapidly removing the basis for Europe's industry's global competitiveness and its ability to achieve bold decarbonisation targets.

The combination of high energy prices, and high CO2 costs (for all industries which are not compensated), is currently resulting in carbon leakage. A significant spike in curtailments and closures is taking place in the EU, in the sectors of fertilisers, steel, zinc and aluminium and other basic materials. At the same time, imports from countries such as China, India and Turkey are increasing, and investments in facilities outside the EU, often with less ambitious decarbonisation agendas, are on the rise.

To the detriment of the EU's objective of achieving more "open strategic autonomy", the case for investing in these sectors in the EU is nowadays much harder to make than outside of the EU. It is urgent not to increase our import dependency and to avoid production shifting away.

## Energy-intensive industry in the EU is facing an existential crisis

Energy-intensive industry in the EU is facing an existential crisis. If European political leaders and policy-makers do not take drastic actions in the coming weeks and months to reduce the cost of energy for energy-intensive companies, the damage will be irreparable and will result in a significant loss of jobs in Europe. In addition, the crisis will hit companies in several supply chains where shortages will arise, including in the food and agricultural sector.

The European Round Table for Industry (ERT) is supportive of an ambitious net-zero agenda for Europe, including the EU Green Deal and the "Fit for 55" and "REPower EU" policy packages. Moreover, companies led by the 60 CEOs & Chairs in ERT have already been making extensive efforts in decarbonising their businesses and developing new solutions to save energy, in line with the UN sustainability goals.

## EU Green Deal needs to foster new investments

The Green Deal as the new growth strategy of Europe will only be successful if industry is part of this transformation, and if its international competitiveness is not undermined. The "RePower EU" package aims to accelerate decarbonisation, but is not focused enough at preserving the EU's competitiveness. In the short term, the EU needs to adapt its strategy to support decarbonisation in a way that also strengthens and protects its industrial competitiveness.

If industrial competitors outside the EU do not pursue the same ambitious decarbonisation agenda or face the same costs, policy measures under the Green Deal need to be designed in such a way that they would foster new green investments into the EU. Policy measures should also maintain carbon leakage protection and provide incentives for other countries to decarbonise their production.

# Recommendations on preserving industrial competitiveness

## A. Short-term emergency

- The European Commission should rapidly develop a plan to "REInvest in Industry" to preserve the EU's industrial and technological fabric.
- The current industrial emergency requires urgent measures. Emergency measures in the form of adequate state aid will partially offset the losses of energy-intensive industries. However, these must be applied at the level of installations and not at a company level, to ensure the support is efficient and targeted.
- Furthermore, the requirement for an undertaking to show operating losses (i.e., a negative EBITDA) unjustifiably restricts the number of facilities eligible for state aid. This should be changed.

## B. Mid- to long-term recommendations

### 1. ACCESS TO AFFORDABLE ENERGY

- **Renewable energy & Power Purchase Agreements (PPAs):** For power-intensive sectors, a key decarbonisation potential relies on a clean power mix. Industry needs a fully functioning liquid energy market with a larger scale and faster deployment of renewable energy and the removal of administrative and system barriers to PPAs.
- Actively and decisively support the use of non-recyclable residual waste in industrial sectors (e.g., chemicals, cement) that allows rapid and large-scale fossil fuels substitution (a process known as co-processing), by recognising it as a measure responding to REPowerEU and the wider EU Green Deal objectives.

### 2. FOSTERING INVESTMENTS

- **Carbon Contracts for Difference (CCfD)** for hard-to-abate industries should play an important role to accelerate investments into low-carbon production processes.
- **Carbon Capture & Storage (CCS) and Direct Air Capture & Storage (DACCS):**
  - Appropriate funding and a regulatory framework which incentivises both the development and industrialisation of carbon capture and storage as well as direct air capture and storage (CCS and DACCS) are essential. Market-based solutions need to be designed for the pricing of carbon removals, including how carbon removals will be accounted for inside the EU ETS.
  - To enable the development of CCUS hubs in Europe to decarbonise hard-to-abate industries, cross-border cooperation on CCS infrastructure and transport needs to be strengthened to ensure accounting coherence across value chains. CCUS hubs also offer the opportunity to integrate technical carbon removal solutions.
  - The EU ETS should be revised to suit investments in carbon removals, such as direct air capture with CCS (DACCS) and Bioenergy with carbon capture and storage (BECCS).
- **Biofuels, low-carbon and (renewable) Hydrogen** will be needed in hard-to-abate sectors. Feedstock flexibility and long-term clarity are essential.
- **Investment in digital infrastructure** is a useful enabler of the Green Deal. The "Fit for 55" package should foster private investment and accelerate the deployment of high-capacity networks. Beyond the immediate crisis, digitalisation is an essential lever for more efficient energy networks across Europe.

### 3. CARBON MARKETS

- **EU ETS: ERT supports the reinforcement of the EU-ETS market,** as an efficient way of pricing CO2 and as a key instrument for

investment in decarbonised energy capacity. ERT believes that the EU-ETS with effective carbon leakage measures – including indirect CO2 cost compensation measures for the electro-intensive industry – should remain a central pillar of a successful transformation towards climate neutrality, while at the same time maintaining the competitiveness of European industry.

- **Carbon Border Adjustment Mechanism (CBAM):**
  - **For certain sectors or value chains, a well-designed CBAM could be an effective instrument against carbon leakage** and for incentivising other countries exporting to the EU to adopt ambitious climate policies.
  - While it is welcome that current CBAM proposals put carbon leakage protection of industry at the top of the EU climate agenda, it is very problematic that the ETS free allowance allocation is due to be gradually withdrawn while CBAM would still be an unproven tool, not incorporating downstream value chains and not offering a solution to maintain competitiveness for exporting products outside of Europe.
  - Likewise, in addition to its focus on basic materials, CBAM must incorporate a value-chain approach to avoid distortions of markets for downstream products
  - A 'one size fits all' approach for CBAM runs counter to the main objective of protecting industry from carbon leakage. The European Commission should take the necessary steps to assess its impact on competitiveness in the different sectors and sub-sectors before CBAM comes into effect.
- **Climate clubs:** Creating a global climate club for alignment of Global Carbon Pricing with the rest of the world could be a useful complement to CBAM. The G7 can be a starting point, but all countries – including developing countries – must be included in due course in setting the regulations. Bringing the USA on board would be a crucial success factor.

# Annex I : Facts & figures on challenges regarding competitiveness

The ongoing crisis is only partly reflected in statistics, as companies are applying survival strategies, and foregoing long-term competitiveness. The real extent of the damage will be visible over the coming years. Yet, the situation is nowadays already very critical for:

a. **Aluminium:** Production of 1 out of 4 Megaton in the EU/EEA has closed in less than a year (including 50% of capacity in the EU itself!), and the same capacity has started up outside of Europe, resulting in much higher emissions. For example, Chinese aluminium has a carbon footprint 3 times higher than the average European aluminium.[1] Europe has now an import dependency of close to 50%. Recently, another European aluminium production capacity, namely the Slovalco aluminium plant in Slovakia, had to close.[2]

b. **Steel:** Many electro-based steel productions are under severe pressure from the high electricity prices. Aside from the shutdown of the Aperam facility in Genk, Belgium, ArcelorMittal has announced the temporary closure of 5 blast furnaces.[3] Moreover, the only existing direct reduced iron (DRI) production plant in the EU, in Hamburg D, is closed as well. This is symbolic as all future decarbonised steel will have to transform to this type, from carbon- to energy intensive. Lately, many electric arc furnaces (EAFs) are on a stop-and-go modus. In addition, the prospect of the combined effects of the decreasing free allocation and CBAM would entail that the EU-based production and jobs linked with exports will largely have to close. The steel market will shrink as not all downstream activities would be covered by CBAM. This could result in significant additional inflation due to increased steel prices. Furthermore, new market entrants from outside of the EU will sell their (carbon-intensive) steel on the EU market as CBAM could be circumvented or absorbed by many importers.

c. **Ammonia:** The production of ammonia for the fertiliser sector is rapidly declining. Already in the spring, Yara started curtailing its production in France and Italy.[4] In addition, around 20% of EU-based ammonia production is used to produce intermediate chemicals, many of which are exported. If ammonia is covered under a CBAM, these products would be losing their carbon leakage protection, which was given by the free allocation of certificates to ammonia in the past. Carbon leakage is shifted into the value chain, putting additional costs on downstream products. Unless a new compensation mechanism is introduced, this will result in real carbon leakage.

d. **Cement:** Current electricity prices have tripled the costs of producing cement in the EU.[5] Combined with significantly increased prices for other energy carriers, this poses a direct threat to cement operations in Europe. Unless urgent actions are taken at both the EU and national levels, plant closures across the EU are inevitable, exacerbating an ongoing erosion of European production: indeed, EU cement imports have increased by 300% in five years, a trend that has accelerated in the first three months of 2022 (+47% y-o-y).

e. **Glass:** The production of glass is intensive in gas consumption and the only possible substitute is heavy fuel which has more environmental consequences. An industrial effort to lower emissions has been made in the past years by switching from fuel to gas. Since March,[6] the glass industry has been warning about the high gas prices, and the cost of glass production in Europe is now 3 to 5 times more expensive than in neighbouring countries (Algeria, Egypt, Belarus). The first company, Duralex, announced that it will stop its production next winter due to the cost of energy. It takes a long time to re-open a production once it had to close. There is a high risk of definitive plant closures in the EU.

**1** More info in this paper by European Aluminium. Aluminium is needed for the green transition, and the biggest medium- to long-term challenge for the aluminium industry in Europe is the extra CO2 cost that comes from the electricity bill. This extra cost cannot be passed on because aluminium is globally priced. Addressing the issue at EU-level poses a particular challenge due to the institutional complexity as various DGs have responsibilities: DG Ener on electricity market, DG Competition on state aid for compensating industries at risk of carbon leakage, DG Taxud on CBAM (which is aiming at phasing out essential and functional compensation schemes) whilst DG Clima has tools to reduce emissions in Europe (but not globally).

**2** More info in Bloomberg: "Metal Plants Feeding Europe's Factories Face an Existential Crisis" (04/09/2022). The long-term power contracts are ending, and, due to lacking competitive compensation of the indirect CO2 cost, the renewal of power contracts has not been possible. With the extreme power prices in Europe, the cost of power would be so high that continuing production would result in very significant losses. CBAM represents a threat to the aluminium industry if compensation is removed and free allocations are phased out before alternatives have proven to be sufficient.

**3** More info: https://steelnews.biz/european-stainless-steel-mills-shut-down/

**4** More info in this corporate press release.

**5** More info in this statement by Cembureau, the European Cement Association.

**6** More info in this article of the Wall Street Journal "Europe's Energy Crisis Threatens Glass Production" (1 September 2022)

# Annex II : Key principles to address the high costs of energy

- Political leaders should **look beyond the national context and short-term emergency measures as it could take several winters** (3 or more) before energy markets would re-balance and prices may decrease.

- **Fundamental solutions** for the current energy challenges and price levels are to **increase alternative energy supplies and reduce energy demand.**

- **Political leaders can in the short-term induce calmness in the markets** and **help to reduce the price of energy by advocating for energy-saving measures and announcing new investments into infrastructure and energy production.** Such actions will increase liquidity, avoid shortages in energy and improve energy connectivity in the EU (of gas and electricity grids).

- The **Energy Union should be considered as one integrated market,** not 27 national markets.

- It is essential to invest more into **improving energy infrastructure across Europe.** This means investing more into the electricity grid, interconnections between countries and grid flexibility. A new EU-wide plan for investments until 2030 should be developed. This is fundamental for the Green Deal. Investing in the electricity grid would also boost the development of the hydrogen economy.

- **Energy demand should be reduced across the EU.** This should be achieved by lowering the consumption of energy and improving energy efficiency, not by curtailments and closures of European industrial production.

- **Governments should play a much more proactive role in encouraging changing behaviour** that lowers the use of energy (and possibly penalise the non-proper use). Energy efficiency at a large scale should be increased and savings in the consumption of electricity and gas should be incentivised (e.g., urban renovation and refitting buildings).

- It is important to **protect vulnerable households with targeted measures.** The EU should also make sure to support its energy-intensive companies and the SMEs which play a crucial role in the European industrial ecosystems.

The European Round Table for Industry (ERT) is a forum that brings together around 60 Chief Executives and Chairmen of major multinational companies of European parentage, covering a wide range of industrial and technological sectors. ERT strives for a strong, open and competitive Europe as a driver for inclusive growth and sustainable prosperity. Companies of ERT Members are situated throughout Europe, with combined revenues exceeding €2 trillion, providing around 5 million direct jobs worldwide - of which half are in Europe - and sustaining millions of indirect jobs. They invest more than €60 billion annually in R&D, largely in Europe.

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