



Brussels, 14 March 2008
ENTR/G2

**Subject: Joint meeting with the chemical and refinery industry associations - Cefic, VCI, BASF, Europia
DG ENTR, 11 March 2008**

The **purpose of the summary report** is to inform all concerned parties in DG ENTR, including other sectoral units, about the situation in the chemicals industry with regard to early identification of potential Energy Intensive Industries in the progress of the Task Force – EII.

Participants

DG ENTR: [REDACTED] (G.2), [REDACTED] (G.2), [REDACTED]
(G.2), [REDACTED] (G.2)

Cefic: Joachim Krueger, [REDACTED], Peter Botschek, [REDACTED], Arseen
Seys (Eurochlor)

Europia: [REDACTED] Chris Beddoes

BASF: Wolfgang Weber

VCI: Jörg Rothermel

The **reason for the joint meeting** with the chemical and refining industrial representatives is the way how EII are categorized in ECFIN study. The latter has dealt with both sectors in one section. The two sectors can be perceived as technically close to each other and therefore it is considered most appropriate to treat refining together with the production of base chemicals.

The **aim of the meeting** was to clarify and bridge the gaps between the available data and the data required in the ECFIN methodology and to provide a solution for final identification of proposals for a future EII list in the chemicals and refineries subsectors on the basis of a uniform yardstick.

The basic guideline for the discussion was the Work Programme of the DG ENTR Task Force on Energy Intensive Industries.

The Commission highlighted the extremely important need to work with the criteria set in the proposal for ETS review. From a practical viewpoint it is crucial to stay as close as possible to the ECFIN study due to other sectors' work on this issue. If some particularities need to be addressed, a reasoning why it is impossible to comply with the general methodology needs to be delivered.

The main concerns from the chemicals industry side which, in comparison with other industrial sectors, result in belated progress are:

1. Complexity of the value chain

The problem in some subsectors is that CO₂ intensity of some downstream products is relatively low compared to other levels in the fully integrated value chain. Therefore the question is whether to monitor only a particular step in the value chain or examine the entire value chain. Since the two approaches may give divergent results, it was felt that the second one is more correct. In case of numerous cracker products, following the first methodology would lead to 'encyclopaedia' outcome (dozens of products are produced in the same process). This is the reason why the industry calls for a more "pragmatic" approach than the one proposed from the Commission in the ETS proposal and in some parts of the ECFIN study.

2. Definition of the chemical sectors and subsectors in the ECFIN study

The industry expressed concern about the perceived inconsistency between aggregation in the ECFIN study and in the proposal for the ETS review. It would like to have the scope of the methodological exercise more aligned to their investigation. Cefic has already proposed 8 subsectors¹ whose processes represent 80-90% of emissions in the chemicals industry. In comparison between ECFIN approach and the 8 proposed chemical processes, i.e. the building blocks clearly exposed to international competition, the industry would like to see them further extended in order to reach compliance with the future criteria for free allocation. However, the chemicals industry (reluctantly) accepted the use of the ECFIN classification and approach as a basis in the current exercise.

3. Categorization of each product, high integration and inter-connection inside the sector

Taking into account categorization of the products in BREF documents, the industry cautioned against additional categorization and screening of each sub process as the sector is characterised by extreme complexity, integration and inter-connection of processes. Many products are inter-dependent, using each other synergies, therefore the industry would like to see the complexity addressed in a correct way. Moreover, as regards inter-connection, it is necessary to consider the links between the products. For example, if chlorine leaves Europe, many related products leave it as well. Chlorine itself is not a product widely traded while PVC, its main downstream product, clearly is.

4. Availability of the data

Diversity in positions on climate change and the need for transparency indispensably requires authorities to work with publicly available data. This does not disqualify the data from various consultants. However, the Commission tends to work primarily with publicly available sources such as EUROSTAT data.

[REDACTED]

¹ Ammonia, Ethylene and Cracker Products, Methanol, Soda Ash, Carbon Black, Nitric and Adipic Acid, Energy installations integrated in chemical processes (CHP, boilers, power stations...), Chloralkali.

² [REDACTED]

5. Exposure to international competition

Although much of the data indicated in chapter 3.1.1 of the Work Programme for the Task Force is available in one or another way, strong reservations were raised whether the approach was practicable and would allow drawing correct conclusions. In the chemical sector there are many customs code entries. International trade is very intensive and producers compete on an international level. Nevertheless, chemical products face very different levels of exposure to trade. Some of them are not globally transported on a large scale due to high transport hazards and transport costs. It is important to look into the technical reasons for the difference in exposure while taking into account the importance of value chains. When analysing exposure to international trade, it is impossible to examine all the 'thousands' of products. This is why the industry has been invited to propose which product is the best indicator for each subsector. If the leading "indicator products" qualify against the indicators, all the others would qualify as well. This approach is widely practiced in all economic analyses of the chemical and refinery sector.

6. Short term fluctuations in prices

Another concern is the reference period chosen for the definition of EII which may lead to misleading conclusions if the results are extrapolated to the future. [REDACTED]

Furthermore, for petrochemicals there are frequent sharp price fluctuations on a regional and on a global level which need to be eliminated in an econometric analysis of long term trends (often these are caused by regional outages, accidents etc). A technical/methodological problem has to be found to address this sort of problems appropriately.

7. Possibility to pass-costs-through

It depends on the market situation whether it is possible for demand in the EU (and global demand) to move to the suppliers outside Europe. In case of high global demand, every company is able to sell its production even if it has much higher costs than its competitor as there is no spare capacity. The situation is the opposite at the bottom of an economic cycle. As the length of cycles varies and opinions about the future vary widely as well, the solution is very complex.³

The Commission representatives proposed to work on a product group approach, oriented to the future, with cases identifying a number of key indicator products. When looking into the margin in comparison to competitors, in the situation of low demand and introduction of CO₂ cost, the prices would drop and thus the economic operators would not be able to pass costs through.

8. Price elasticity in the EU with regard to CO₂ cost

This information is not directly available although it would be of highest importance to assess the impact on the markets and on employment. The best proxy for price elasticity of demand could be to examine the existence of world market prices for main products and the differences between major regions of the world. In case of a world market price and closely linked regional

³ The base chemical industry is characterised by a rather regular build up of excess capacities and rather sharp corrections in the down cycle. At present we observe a very massive increase in the production capacities for some important products. Whether this will lead to major problems will largely depend on the global economic development and in particular in the big emerging countries in Asia which could absorb this additional production, or otherwise.

prices, transport costs would be decisive. However, in most cases the transport costs are modest and this could be used as an indication of high opening to global competition.

9. Profitability margins

Several chemical products identified in the ECFIN study show low CO₂-costs in relation to their price. However, this shows rather the influence of much increased feedstock prices than the importance of CO₂ costs for competitiveness of the European industry in comparison to other regions. Consequently, the margins are a more useful indicator than CO₂ costs in relation to end product prices. However, even the high margins at present are of limited credibility as they do not remain stable over the business cycle. In some extreme cases there is a totally global market with low margins and low CO₂/end product price relations. If there is no possibility to qualify the products as energy intensive it would have severe consequences. Another dilemma is lack of reliable data on profitability margins.

10. Operating rates

The data is more or less available for the main products but the problem is extrapolation to the future as the progress in globalisation is rapidly changing market structures.

11. Openness to exports

The EU chemicals industry has always exported a significant part of its production. From 1996 till now, exports have grown from 19% to 25%. As the exports are a very important pillar of the EU chemicals industry, the question is how to retain the exports to third markets where the pass-costs-through ability should be even lower than for the domestic markets. [REDACTED]

[REDACTED]. This is another reason why the industry would like to move away from the methodological monitoring of separate chemical products while insisting on the examination of integrated product streams.

12. Refineries' position

Europia recalled that it represents only refining, i.e. manufacturing of the refinery products excluding the upstream and downstream activities. Europia has prepared the data, based on Nera competitiveness report, proving that 1) the refined product market is an international market, exposed to international trade, 2) CO₂ costs would represent a significant proportion of the refining margin and 3) are likely to exceed transport costs from other regions to the EU. The study is based on publicly available data and offers far most substantial information on profit margins which is hardly the case for other chemical subsectors. However, all profitability considerations relate primarily to short run implications and do not address the long term horizon and return on investment which is decisive for investment decisions.⁴

Refining activities form one sector and should therefore not be subdivided. Refineries share equal problems with petrochemicals where a number of non-traded products exist while it makes no sense to separate them due to entirely integrated (coupled) production.

⁴ It is understood that the Secretariat General will organise a special information session on this work after Easter.

Outcome

The chemicals industry representatives showed a certain reservation towards the approach of the Work Programme. In their view, some unclarity about the further orientation and use of the exercise still exists and DG ENTR is called upon to explain it. Some industry representatives expressed doubts about the feasibility of the approach and felt that some qualitative description would be preferable for the decisions to be taken at political level. Notwithstanding these questions, both industries expressed their preparedness to cooperate. In the same way as Europa, Cefic will submit additional material after the Easter holidays, explaining and commenting the complexity described above and proposing methodological solutions where appropriate and available. It was agreed that the ECFIN study (and the methodological note on the Work Programme) should form the basis. Deviations should be limited to the necessary and should be accompanied by clearly justified reasoning for non-compliance with the general methodology. Industry is invited to test the discussed approach using "indicator products" for the subsectors and to reflect about the most suitable and convincing products.

In doing so the following should be examined in particular:

- Availability of world market prices for the relevant basic commodities
- Data on trade volumes and intensities taking into account the specificities of the supply chain
- Transport costs and transport restrictions (not a general issue, most of the products can be transported without major problems)
- Availability of capacity utilization data
- Indications that the market situation will change because of cyclical developments

The Commission representatives recalled that all statements need to be substantiated by data from independent and accessible sources.

██████████

██████████