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DISCUSSION PAPER

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Chemicals Strategy for Sustainability

A Level Playing Field for the EU chemical industry

This note seeks to lay out the European chemical industry's views on how to define and ensure a level playing field for chemicals production in Europe compared to other regions in the world. We look at this from the perspective of the need to ensure that the **EU's attractiveness as an investment location is reinforced in order to enable the business case for the transformation of European chemical industry production in line with the Green Deal transformation**. Companies have to consider such investment cases in comparison to alternative investment locations and their associated business cases, and can only justify investment in Europe if the investment case is preferable. We also refer to this as "competitiveness" – investments in the EU will only happen if they compare favourably to investment cases in other parts of the world.
We also look at the level playing field from the perspective of the industry's ability to compete on export markets. In many ways, the European chemical industry is highly successful. Traditionally, it has been a world leader in chemicals production – as shown by a consistent export surplus which reached €45 billion in 2019. EU chemicals sales in 2018 amounted to €565 bn. However, the continued success in absolute terms obscures a major shift in relative terms when looked at globally: while European chemical sales have continued to grow over the past 20 years, Europe's share of global sales over the same period has declined from 33% to 17%. This decrease is primarily due to declining competitiveness in absence of a level playing field.

This **loss in global market share** represents a significant opportunity cost of foregone jobs and economic activity that could have been created in Europe. It is evidence of the EU's apparent inability to attract significant new investment at global scale over the recent decade or so. Investments in new production capacity increasingly flow to other parts of the world, in part because **the business case for investing in Europe is becoming difficult to make**.

This leads to the risk of "investment leakage" in the chemicals industry. Nowadays chemicals are produced all around the world, and a larger number of regions is competing for investment. Recognising the chemical industry's strategic importance for a successful industrial strategy, China, the Middle East and India have all made successful efforts to build up large and increasingly sophisticated production facilities and attract high investments by putting industry at the very top of their political agendas. The same applies to the USA where the shift towards 'America First' will inevitably have further strong impacts on US industrial policy. We have pointed for many years at the possible negative consequences for Europe's ability to transform in line with climate and circularity objectives, as well as Europe's strategic autonomy as entire value chains become increasingly dependent on (more competitive) imports from other regions. The situation with regards to the supply of active pharmaceutical ingredients from India and China is a case in point.

There are several potential causes for Europe's loss of global market share but the majority of this decrease is due to **declining competitiveness** as opposed to slow growing export destination markets. **Energy and feedstock prices** are a critical factor for the competitiveness of the chemical industry. The shale gas boom in the United States has reduced energy and feedstock costs greatly. Making ethylene in Europe is now about two times more expensive than in the US or the Middle East. This is boosting profits abroad and attracting investment, including from European chemical companies: as at February 2019

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announced chemical industry investments in the USA amount to US$204bn (with 70% from non-US based companies). Likewise, in 2018, €87.1 bn was invested in China. In comparison, EU investment stood at €22.8 bn in the same year. This is one-fourth of the Chinese figure.

At the same time, the EU chemical industry is **undergoing a transformation process** to respond to strong societal needs and regulatory requirements with respect to climate change, circularity, overall increased sustainability including safe chemicals management, clean energy and transport, new processing methods and alternative feedstock. The chemical industry can and will provide solutions for these societal challenges, but – despite the fact that the EU is clearly playing a leadership role in adapting its regulatory framework in these areas – the question is whether these solutions will be developed in Europe or in other parts of the world and imported into Europe, with the associated loss of growth and employment opportunities here. However, to **meet the EU policy objectives, significant investments are required in Europe**. In a context of increasing competition from other regions, the EU regulatory framework needs to ensure that this transformation process can be successfully achieved – this underpins our call for a level playing field.

In addition to these external trends, there is additional pressure coming from inside the European Union. There are many potential reasons for the EU's competitiveness decline, including high energy prices, lagging innovation, currency appreciation, high labour costs, regulatory and tax burdens, among others. This is the external dimension of competitiveness.

Chemical companies often refer to the **complex and heavy regulatory burden as a factor negatively impacting their competitiveness**. In the past fifteen years, the industry has come under increased competitive pressure. At the same time much regulation has been adopted. It is worth noting that frequent and numerous reviews and updates, more than once in areas where EU legislation had just been passed and not even been given the time to be properly implemented, have appreciably increased a sense of unpredictability in the investment community. Simply put, **an investment case becomes more difficult to make if there is an expectation that existing regulation will change frequently and can be based on criteria that are not always clearly understood**.

A cumulative cost assessment conducted for the Commission in 2016 showed that **Europe's complex regulatory framework poses a significant burden on EU chemical companies,** amounting to **about 10 billion euro** per year between 2004 and 2014. Regulatory costs are in the same magnitude than total **R&D expenditures** of the Chemical industry. The three **main drivers of regulatory** cost are the regulations on industrial emissions, generating 33% of the cost, chemicals, with 30% and worker safety, with 24%. The total cost of legislation that chemical companies from six sub-sectors bore between 2004 - 2014 amounts to **12% of the value added** of the EU chemical industry. Compared to Gross Operating Surplus, the additional cost reaches 30% – indicating that the cost of regulation is a **significant factor shaping the profitability** of the EU chemical industry.

There is no discussion about the fact that stricter regulation has also generated benefits; however, these benefits accrue over a different timescale and for broader parts of society. There is also no discussion that regulatory costs have also increased in other chemicals producing regions have also increased, but this has generally been less than in the EU. Moreover, non-EU manufacturers of articles can use substances banned in the EU in their process and export the final article to the EU market, in many cases without any constraints. Another example concerns the implementation of the Rotterdam Convention on Prior Informed Consent which has been implemented in a much stricter way by the EU than by other Parties (as regards export notification and application of explicit consent): we see that this leads to more (costly) administration for no apparent safety, health or environmental benefit.

To be clear, **the chemical industry does not dispute the need and benefits of EU regulation**. In the context of a level playing field, we are asking that there be an objective assessment of the regulatory burden caused by regulation, and that it is better understood that this burden reduces the competitiveness of the EU industry, tilting the level playing in our disfavour. The consequence of this does not need to be "less regulation" overall, however there is a need for counterbalancing measures that help restore the level playing field. As a starting point, we have therefore proposed an independent and objective assessment of regulatory costs, so that policy makers can take well-informed decisions and, if appropriate, also address the question of the level playing field. In that context, it should also be noted that regulatory costs and administrative burdens not only come from EU legislation, but also from national legislation (implementing EU legislation or standalone national rules). Notably, permitting processes are often so onerous that it is very difficult to construct new infrastructure, whether related to the climate and circular transition or not, further reducing the investment attractiveness compared to other regions of the world.

In summary:

- Other regions enjoying energy and feedstock advantage or market size compete for investment with the EU and on the world market;
- The cumulative cost of regulations in the EU has more than doubled in the past fifteen years, amounting on average to 10 billion euro per annum or equal to the entire annual R&D expenditure of the industry. As percentage of turnover, this cost is limited but not when expressed as percentage of value added or profits;
- Other countries have also introduced stricter legislation but often in a less costly or less burdensome way. While they have to comply with EU REACH when exporting to the EU, they are not constrained on markets outside the EU where EU manufacturers are constrained.
- Restrictions on use of chemical substances in the EU can lead to opportunity costs e.g. when this impedes certain value chains dependent on them;
- Access to renewable feedstock (bioethanol, sugar, palm oil,…) in the EU impedes development of biobased chemistry in Europe. Investment in that segment are going to countries that have access to such feedstock at competitive prices, again no level playing field for EU companies willing to invest in the EU;
- In the EU it has become nearly impossible to produce or construct anything anywhere near anybody without going to lengthy licensing or authorisation processes;
- New chemicals legislation will by definition increase costs for EU producers further, but these costs add to investments that have to be made to reduce CO2 emissions or pollution while at the same time competing in and outside the EU with producers that face less onerous legislative requirements;
- Cumulative costs and impact on competitiveness therefore need to be carefully monitored.