

Ceramic industry position on post 2020 EU ETS

The 2030 climate and energy framework agreed by the European Council in October identifies the ETS as the main instrument to achieve the decarbonisation target. According to the adopted text, sectors covered by the ETS will have to reduce their emissions by 43% compared with 2005. This represents a steep, unilateral acceleration in the level of climate ambition. At the same time, the European Council conclusions stress the need to preserve the international competitiveness of the European industry and provide political guidance on the most relevant elements in this regard, including carbon leakage, benchmarks, and indirect carbon costs.

A structural deficiency of the current legislative framework is that the power and manufacturing sectors are subject to a common system, while they differ significantly with regard to technological abatement potential and ability to pass through carbon costs. It is essential that in the next steps of the decision-making process the political agreement reached by Heads of state and government is translated in a predictable legislative framework that addresses this problem and defines concrete rules to prevent carbon, investment and jobs leakage in manufacturing and SMEs-driven sectors like ceramics. This is a crucial concern for our industry, as the ETS covers more than 1,200 ceramic installations, representing around 10% of the total number of installations, but less than 1% of the emissions. Ceramic installations under ETS are from the sectors of brick and roof tiles, wall and floor tiles, refractories, sanitaryware and pipes. Post 2020 ETS rules may have a major impact on the competitiveness of the sector, as the loss of the carbon leakage status would cost approximately €4 billion over the period 2021-2030¹ in direct emissions alone.

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

1. Energy-intensive industries like ceramics should remain in the list of sectors at risk of carbon leakage as long as necessary;
2. Installations in carbon leakage sectors should receive free allocation corresponding to 100% of benchmarks with no cross-sectoral reduction factor applied;
3. Free allocation should be based on most recent and representative production levels and on technically and economically achievable benchmarks that reflect the real industry performance;
4. Carbon leakage assessment should better reflect the impact of carbon costs on competitiveness using more appropriate indicators like Gross Operating Surplus (GOS);
5. Qualitative assessments must be maintained since they allow a more comprehensive analysis of the carbon leakage risk;
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 as they are linked to the chemical properties of locally available raw materials;
8. Opt-out possibility for small installations should be maintained after 2020 and extended to installations with emissions below 50,000 t 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 specificities.

¹ Assuming economic growth at 1% per year and carbon price at €30 / tonne.

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.

Quantitative and qualitative carbon leakage assessment

Post 2020 carbon leakage mitigation should be in line with the adopted level of ambition. Considering the ambitious decarbonisation targets for ETS sectors, we believe that the protection should not be reduced to fewer sectors. Consequently, all energy intensive sectors as defined in the Energy Taxation Directive should be considered as exposed to the carbon leakage risk. As an alternative, the carbon leakage assessment should be determined using trade and carbon intensity criteria.

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 costs can represent up to 70% of the GVA for some ceramic sectors and therefore using GVA results in misleading conclusions. A more representative indication of the impact of carbon costs on the profitability of a sector can be obtained by replacing GVA with GOS in the carbon intensity assessment. GOS data can be readily obtained from Eurostat.

It is vitally important that qualitative assessments are also maintained as the quantitative criteria are too narrow and do not take into account all the factors that can contribute to the risk of carbon leakage. 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. The rigid, three-step qualitative approach that has previously been proposed by Ecofys introduces an inappropriate hierarchy amongst the indicators because using a 'stage-gate' approach omits essential indicators. For a comprehensive assessment, an analysis using all indicators is required.

Realistic benchmarks and activity levels

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

The review of the benchmarks for the post-2020 period should be based on real industry data in Europe in order to reflect the actual progress. It should not result from an annual linear reduction as this would be arbitrary and would not be in line with the principle of technical feasibility.

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

Last but not least, free allocation should be based on the most recent and representative production data available as it must reflect economic reality. As a result, a dynamic system based on more recent years should be explored, taking into account also administrative complexity and confidentiality.

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 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 the current rules remain in place without change, the CSCF will increase to \approx 40% by 2030. This would jeopardise the effectiveness of carbon leakage provisions.

To eliminate the need for the CSCF, we propose to introduce an allocation supply reserve initially stocked with both the backloaded and any unused New Entrant Reserve allowances from phase III.

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

Small Installations

According to the current ETS Directive, member states may implement equivalent measures for small installations with annual emissions below 25,000 tons. In 2013 around 12,150 ETS installations reported emissions below this threshold (representing 75% of installations but only 2.5% of total emissions). Such possibility should definitely be continued and the best experiences of those member states making use of this possibility in the third trading period should be shared in order to extend them to other countries. In line with the new Commission's objective of reducing EU bureaucracy and focusing only on bigger priorities, the opt-out possibility should be extended to installations with annual emissions below 50,000 tons. 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 sector to ambitious long-term climate objectives also relies on the availability of technologies that increase industrial energy and carbon efficiency at affordable prices.

Firstly, the legislative framework should promote the deployment of 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, as 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. In addition to NER400 programme, member states should make use of auctioning revenues to support the low carbon transition in the industry, including SMEs.

Exploring 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. EU ETS faces a fundamental dilemma. 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 regard 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 that are currently unavailable. Due to these differences, differentiated and tailored-made systems for manufacturing and power sectors need to be developed according to their specificities.

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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