## I. State of affairs in the European Chemical industry in the face of the global economic crisis

### 1. World economy is facing one of the biggest crises since decades

Further to the Cefic position on the Economic Crisis issued in February 2009, this is the first report of the Cefic Competitiveness Taskforce analyzing the state of the affairs in the European Chemical Industry.

At the time of writing it is clear that the world economy has suffered a sharp and sudden drop and while the timing of the recovery remains uncertain, it is most likely to take place more slowly over a period of time before real GDP regains 2008 levels. All major institutions (OECD, IMF) and economists are in agreement that the world economy is facing one of the biggest crises since decades:

- the global economy went into recession in all regions at the same time;
- with dramatically worsening financial conditions and a non functioning banking system, especially leading to problems for companies to obtain credit;
- with important industrial sectors (e.g. automotive and construction) in trouble;
- with highly volatile raw material prices and increased deflationary pressures.

### 2. The economy was hit sharply and unexpectedly at the end of 2008:

- many companies were not expecting a sharp and profound recession;
- whole value chains pulled the brakes;
- many industry sectors “over-reacted”, major de-stocking took place and even confirmed orders were cancelled.

### 3. European manufacturing sector fell dramatically

In the 4th quarter 2008 the output of the European manufacturing sector fell dramatically. Entire value chains slowed down abruptly:

- The manufacturers of consumer durables (passenger cars, large electrical devices, furniture) were the first to be affected by the much slower demand. The banking crisis has intensified the demand slowdown;
- These manufacturers cancelled their orders, which resulted in a simultaneous demand slump for input-producing industries (e.g. steel and chemicals);
- Manufacturers of capital goods started to be impacted at the beginning of 2009. In particular, domestic and foreign orders practically collapsed in mechanical engineering and electronics industry. The crisis in the banking sector aggravated the situation;
- The situation was relatively stable only for fast-moving consumer goods (foods, beverages, etc).

**4. The chemical industry experienced a strong decline**

Many customers of chemical companies were among those who cancelled their orders to a considerable extent, so that the chemical industry noticeably lowered its output. In the 4th quarter 2008 the production of chemicals declined by 14.5 percent. Overall capacity utilization dropped to 70-75 percent, and even more in certain subsectors.

Several effects intensified the downward trend:

- In order to clear existing stocks and not to build up new ones, production was slashed vigorously;
- In basic chemistry it is difficult to stepwise adapt production capacities. Whole production units were shut down completely on a temporary basis, as it would not have been possible to operate them cost-effectively at a lower scale;
- This shutdown of production plants resulted in a shortage of by-products, which are used as raw materials in other production facilities. In consequence of this limited availability of raw materials, activities of those other production facilities had to be reduced, too.

Q1 2009 data shows that the above-described downward trend did not continue. The output for chemicals increased compared with the historical very low production level of December 2008. However, on average the 1st quarter 2009 output is still 2.5 percent below the average level of the 4th quarter 2008 and 16.5 percent lower than in Q1 2008.

The demand is still very weak. Prices decreased and the confidence remained in the recession mode: negative business expectations and negative assessment of the current situation.

**5. Different development in the chemicals sectors**

Basic chemicals have been most severely affected by the crisis. The negative development in both automotive and construction sectors was a key factor and contributed largely to the output drop in this sector. In Q4 the basic chemicals output dropped by 20 percent compared to Q3/2008. The sector hit the bottom in December 2008 with a production drop of more than 30 percent compared with the pre-crisis levels. Since January, the output grew from month to month, but in Q1/2009 basic chemicals output was still 18.5 percent lower than one year before. The situation is similar in all three basic segments: inorganics, petrochemicals and polymers.

Specialty chemicals producers have also faced a demand drop in Q4/2008 and have cut production by 8 percent compared to Q3. The output drop was less pronounced than in the basic chemicals sector. This can be explained in particular by the fact that specialty chemicals are sold to a much broader customer base However, as the crisis reached more and more industries in Q1/2009, the output of specialties declined further, and in Q1/2009 the output was 16 percent lower than one year before.

In Q4/2008 the output of consumer chemicals dropped by 3.5 percent compared to Q3. This decline was more moderate than in the other chemicals sectors. However, the downward trend continued in Q1/2009, with output being 9 percent lower than the first quarter of 2008.

## 6. Perspectives

In the 1st quarter 2009 both industrial production and overall economic performance once more dropped clearly below the levels of the previous year and of the previous quarter, respectively. This was observed in most industrialized nations. However, during the first quarter, solid ground was found in some countries and industries. It seems that the trough has been reached. Economic stimulus packages show effect in some instances. Expectations of market players for the coming months are improving. Oil prices and stock markets point to some sort of stabilization.

In the first months of 2009, chemical business did not deteriorate any further as compared with the situation in December 2008 – especially in the basic chemical sector. The output for chemicals increased slightly compared with the very low production level of December 2008. There are some signs of stabilisation of the situation. Inventories in many industry sectors are high, but declining. No further downward trend for prices for basic chemicals. The chemicals business might have reached the through. Further downturn is always possible over the coming months, but it is less probable. However, the demand is still very weak and production will remain very low compared with the pre-crisis level. No major improvement is expected before 2011, and there are still several downside risks. 2009 and 2010 will remain very difficult.

Chemical companies have reduced their production capacity, used technical unemployment (e.g. reduced working time, temporary redundancies) and postponed investments. Some companies are awaiting major restructuring decisions to be taken by parent companies. As regards plant closures we do not (yet) observe major definitive closures of chemical plants across the EU so far, with some exceptions (notably in the UK). When the crisis in the chemical industry draws out, reduced working time a temporary redundancies may turn to permanent unemployment. Employment drops in the chemical industry must be expected for 2009. More than 50,000 people will probably lose their job in the EU chemicals industry.

## II. Overview of measures taken in the context of the European Economic Recovery Plan, including actions for the chemicals industry

The national recovery plans of the Member States vary in focus. The UK measures were initially more oriented towards stimulation of consumption by lowering of the VAT rate, but very recently took some additional measures to stimulate the economy, including a scheme to scrap old cars. D, F, NL, SP and SK have taken more socio-economic related measures stimulating the construction and automotive sector. The chemical industry will benefit indirectly benefit from these latter measures, although increased car sales are typically taken out from stocks rather than new make. Several Member States have taken generic measures to improve the cash flow of companies and introduced schemes relating to temporary unemployment in combination with training. Only one Member State (I) introduced a specific funding scheme relating to REACH.

An overview of types of generic or specific measures identified thus far and which were suggested in the Cefic position (with indication of countries where this applies):

- Cash flow related

    - Faster payment of invoices by public authorities (B, UK)
    - Possibility for certain companies in difficulty to make a phased payment plan and to freeze/delay payment of VAT taxes (B, I); accelerated reimbursement of VAT (CSR, SK)
    - Support to relieve the cash flow constraints on companies (F, NL, SP, UK)
    - Accelerated reimbursement of taxes in 2009 due to losses in 2008 (NL, SP) or possibility to offset losses against tax bills due on profits from previous year (UK)
    - Delayed payment of taxes (UK)
    - Enterprise Loan Guarantee scheme for small businesses (UK)

- Socio-economic
    - Specific measures to stimulate the construction sector (e.g. B, lower VAT for certain kinds of housing renovation and new houses, F: renovation programme, new dwellings; NL: construction of schools and hospitals, SK: thermal insulation of houses )
    - Strategic Investment Fund to support advanced industrial projects of strategic importance (UK)

- Fiscal measures

    - Accelerated depreciation for new investments (F, CSR, UK)
    - Premium for the wreckage of old cars (F, D, NL, SK, UK)
    - Reduced VAT rate (UK)
    - Fiscal incentives for industrial research and energy efficiency constructions (I); increase of funds for applied research and development (SK)
    - Support for the trade credit insurance market (UK), support for exporting loans for SMEs (SK)

- Employment and training related

    - 75% exemption payroll withholding tax for scientific researchers, tax reduction for shift & night work (B)
    - Part-time unemployment arrangement combined with training and education, recruiting new graduates on training assignment, detaching idle high level professionals to universities (NL); in France an agreement on a training scheme was signed between the French chemical industry association (UIC) and the trade unions, effective from 1 May till the end of 2009. This scheme is endowed with a global amount of Euro 8 million to retain jobs and skilled employees, and is specifically directed at SMEs and employees who are the most impacted by the crisis (already in temporary redundancy, most exposed to restructuring plans, etc).

- Chemical industry specific

- Setting up of topical working group for the chemical industry at ministry level (CSR)
- Launching of an Integral Competitive Plan for the Spanish Chemical Industry. This plan proposes 29 measures to recovery the competitiveness of our industry in a short range period (2009-2010) and regarding 6 areas (Regulations, Transport, Energy, Sustainability, RDI and Finances
- Financial support (Euro 120 million) to programs of research & development for substitution or significant reduction of SVCH substances (I)

## III. Recommendations for measures that would directly or indirectly benefit the chemicals industry

In February 2009 Cefic already proposed a series of measures that would bring relief to European chemical companies. It is encouraging to see that a number of these suggestions have been taken in several of the national economic recovery plans. However, hitherto we see little uptake of the Cefic proposals made in regards of promotion of innovation.

Whilst the suggestions made in the February paper remain valid, we would like to focus attention on a few measures that appear to fall on relatively fertile ground in the Commission and/or the Member States and which merit further attention. Last but not least accelerated implementation of the recommendations of the HLG Chemicals would foster the long term competitiveness of the sector.

- Cash flow related

Companies continue to cite problems with access to credits. A normal functioning of the banking system is therefore imperative. Besides that Member States should be encouraged to relieve the cash flow of companies:

- Faster payment of invoices by public authorities
- Accelerated reimbursement of VAT or other taxes combined with a freeze/phased payment of due VAT or other taxes

- Fiscal related

- Accelerated depreciation for new investments
- Fiscal incentives for research and innovation

- REACH related

REACH is cited by many SMEs as a severe financial burden. Measures that the Commission/ECHA or the Member States can take to alleviate this burden which are:

- **Lowering of REACH fees**: The high number of pre-registrations (2.8 million) suggests that the REACH fees have been set too high. Several options exist to adjust the REACH fees while maintaining the income needed by ECHA to perform its tasks: for example, the reduction of the fee for the registrants of the same substance for the dossier submission could be set higher than the present 25%.

Whilst it may be too early to re-assess the effective income from registration, a phased payment of REACH fees (proposed below) would allow for a timely revision of the fees in three years' time in accordance with the fees regulation so that outstanding installments can be annulled. This could be done pursuant to Art 22 (2) of the fees regulation allowing a "continual review in the light of significant information becoming available in relation to the underlying assumptions for anticipated income and expenditure of the Agency";

- **Phased payment of REACH fees**: The budget estimates of ECHA show that the Agency would receive more funds than it needs at the time of the first registration deadline. Indeed the REACH fee will cover the Agency direct costs and the financing of the evaluation tasks carried out by Member States authorities; these costs will be spread over several years corresponding to the processing of registration dossiers and the upfront payment of the full fee at the time of registration is not consistent with the real financial needs. The budgetary documents presented to the Board of Management of ECHA confirm this analysis ("the ECHA foresees to cash in 106 M€ in 2010; 74 M€ will not be allocated to the 2010 budget but put in reserve for future expenditures"). Consequently the fee should be paid in three or four instalments as it makes no sense to accumulate funds in ECHA while companies are facing extremely severe cash management problems. Of the total REACH related costs, the registration fee forms indeed only a relatively small part. Yet it is a significant, symbolic measure that is entirely within the competence of the Commission/ECHA. It would be an important signal that the Commission has understood the difficult situation the chemical industry is currently facing and is willing to take its own action. Cefic very much insists that the Commission takes all needed actions to organise the phased payment of REACH fees finding practical solutions for some legal and technical aspects that can certainly be overcome;

- **Accelerated fiscal depreciation of REACH related costs**: REACH costs comprise much more than fees and direct cash-out costs. The bulk of the REACH related costs stem from personnel costs to manage the process, costs of studies & testing, consortia management, fees, etc. In fact these costs represent an investment cost to continue the marketing of these substances. If Member States' fiscal authorities were for example to accept this broad definition of REACH costs and consider such costs in the same way as R&D expenditure, and provide for the possibility of accelerated depreciation, then this would greatly reduce the financial burden on companies. Basically, companies should be left the choice whether they wish to fiscally depreciate REACH costs in one year or spread these over several years. For instance, if a company incurs high costs in 2010, it could balance the costs against profits made in earlier years and be eligible for lower taxes or accelerated reimbursement of excess taxes. At the same time the Commission could clarify to the International Accounting Standards Board what types of costs occur in the context of REACH in view of guidance regarding consolidated international accounts. For the chemical industry the tax accounting practice of the Member States is the first priority.

- **Granting of REACH loans to SMEs**: One possibility could be to modify the existing EIB scheme for SMEs adopted on 23 September 2008 by the EIB's Board of Directors. Accordingly, the EIB will earmark EUR 15bn over the period 2008-2009 for loans at reduced costs to small and medium-sized enterprises in

Europe granted via commercial banks, as part of an overall package of EUR 30bn by 2011. Restraints of this scheme are that it is limited to autonomous SMEs and that activities may not involve animal testing. Extending this scheme to SMEs which are part of a group and inclusion of REACH in the scope would be highly desirable. For more details of this scheme see http://www.eib.org/about/news/eib-loan-for-smes.htm. If these loans could be used to cover the broad definition of REACH related costs described above, this would enable companies to continue to invest in other activities.

- **Support for REACH related research:** e.g. the Italian scheme introducing a subsidy scheme of Euro 120 million for companies or institutes to fund research into substitutes for SVHC. Member States should be encouraged to look into possible copying of this scheme. A copy of the Italian decree is attached for information.

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• Employment/training related

- Introduction of schemes analogue to the initiatives taken in the NL, i.e. part-time unemployment arrangement combined with training and education, recruiting new graduates on training assignment, detaching idle high level professionals to universities (NL).

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