



Cefic views on the impact of the economic crisis and suggestions for the implementation of the European Economic Recovery Plan

In November 2008 Cefic expected a decline of 0.6% of chemicals output (excluding pharmaceuticals) in 2008 and of 1.3% in 2009. This forecast was based on the latest available data (August 2008). However, the downward trend of production and business climate experienced during the last quarter of 2008 was much more severe than expected. In the past weeks we have seen announcements of major chemical companies regarding temporary shut down of plants, massive redundancies or technical unemployment measures. The sectors most affected by the financial crisis are base chemicals, polymers and specialty chemicals. In some companies, sales dropped sharply as from November 2008. Therefore, inventories increased strongly and the companies had to stop production resulting in a drop of output volume by 30% to 60% for some products. The chemical industry is thus not experiencing the anticipated relatively soft landing but faces a hard landing with a sharp decline in Q4 2008. This note analyzes the situation in the appendix and provides guidance for the implementation of the European Economic Recovery Plan adopted by the European Council of 11-12 December 2008.

Cefic welcomes the **European Economic Recovery Plan** aimed at restoring consumer and business confidence by adopting a common approach with clear strategic aims. Given the scale of the crisis the European economy is facing, the concrete actions listed in this Recovery Plan will help improve the economic and business environment in which our companies are competing in the long term. We particularly endorse the links made with longer-term policy goals relating to combating climate change, improving infrastructure and stimulating R&D and innovation. It is, however, essential to focus on short term measures to minimise the severe impact the financial crisis is having on chemical companies, especially SME's.

The EU chemicals industry is at the beginning of the value chain and measures benefitting downstream user sectors such as construction and automotive will therefore have a direct positive effect on the chemical industry. The chemical industry sees in the Economic Recovery Package moreover a transient opportunity to not only enhance the future competitiveness of the industry - in line with the recommendations developed in the context of the High Level Group on the Competitiveness of the European Chemicals Industry - but also to fully enable it to play its role as enabler of sustainability. In this way the crisis can become an opportunity to accelerate the shift to a more sustainable economy.

Concretely we would like to highlight some measures, to be implemented through tax or financial incentives or regulatory tools, which will directly or indirectly benefit the chemical industry and the way our industry can contribute to the sustainability objectives set out in the European Economic Recovery Plan. These measures are mere examples and the list is by no means exhaustive.

Last but not least, the European Economic Recovery Plan focuses very much on the coordination of policies of the Member States. We believe that the Commission itself can also greatly contribute to alleviating burden for business by reshaping its own environmental policy as integral part of the Recovery Plan.

Cefic is recommending the following measures:

Immediate or short-term measures

1) Measures to enhance access to financing for business and to stimulate economic activity

What can the national authorities do?

The Economic Recovery Plan identifies the right measures to ensure companies have access to financing. Measures such as accelerated repayment of VAT taxes, tax credits for R&D or accelerated amortization of capital investments will decrease pressure on “working capital”. In case of failure of the market, governments should pick up the (export) credit insurance role.

As recommended in the European Economic Recovery Plan it is indeed important that public authorities pay invoices for supplies and services within the regular term of payment, i.e. without delays within thirty days, in order to ease liquidity constraints. This is especially important for the many of thousands of SME's in the chemical sector that are facing increased costs stemming from the implementation of REACH requirements. A possible solution to late payment and the consequences this entails for SME's could be the creation of a billing safeguard facility for SME's to guarantee the payment of invoices to avoid short-term cash-flow problems.

It is furthermore important that governments bring forward planned investments to ensure the motor of the economy keeps running and certainly do not postpone them. In cooperative innovative projects the authorities should play the role of “launching customer” when other partners do not play that role.

Since it is evident that there are a lot of problems on the demand side resulting from a lack of confidence on the consumers' side, it is essential to keep people in the job. Government sponsored training in the workplace for employees can instil the necessary confidence for workers that they will not face unemployment and can at the same time improve their skills.

Cefic also welcomes the improvement of the criteria for a better access and use and access to the European Globalisation Adjustment Fund which the Commission has recently proposed. The temporary extension of the scope of this Fund will enable it

to react more effectively in response to the crisis. We urge the Council of Ministers and European Parliament to quickly approve this proposal.

We welcome the Recovery Plans proposal to protect employment and promote entrepreneurship. We urge the EU and Member States to find ways that not just train people but to keep them or get them back into real jobs. The EU should keep a strong scientific community in Europe through fast and flexible programs and solid funding. It is important to have a cross fertilization and exchange of flow of scientists in both directions, that is not only preventing the migration of EU scientists out of Europe, but also actively encouraging their return and attracting talent from outside the EU and enabling their integration within the EU system. EU should consider flexibility of existing rules and develop instruments that enhance the ability to act. For example, the current discussions about the working time directive on the one hand are not helpful if on the other hand there are other rules that prevent the ability of enterprises to act in a flexible way.

What can the Commission do?

The economic crisis will exacerbate the effects of markets distortions resulting from dumping or export subsidies/taxes. The EC must be prepared to act firmly against countries maintaining such policies so as to avoid they take advantage from the crisis. The EC's Trade Defence Instruments must be used in a coherent and effective manner to address the effects of the causes of market distortions. At the same time the EC and Member States should strongly react on outright protectionist measures taken by third countries. The Commission must also ensure the correct application of state aid rules by the EU Member States to ensure a level playing field in Europe. For the chemical industry fair competition in Europe is essential.

2) Make environmental policy an integrated part of the European Economic Recovery Plan.

What can the Commission and Member States do?

There are a number of measures the Commission and Member States can take which would directly benefit the chemical industry and accelerate environmental gains, thus creating win-wins e.g. financial support or tax benefits for new environmental technologies and new production processes, which would reduce the financial burden for companies and accelerate environmental gains.

Other measures which can reduce the regulatory burden:

- We recommend that environmental policy strictly focuses on regulatory efforts that support the implementation of safety of chemicals (REACH) and in the area of climate change. Where advanced legislation already exists we urge the EU and Member States to not make this legislation more stringent at the current time (e.g. IPPC, waste, water) but on the contrary to introduce more cost effective implementation measures. In lower priority areas, existing projects and new policy proposals should be scrutinised against the impact on costs for industry and be eventually put at a standstill to avoid any additional financial burden on

companies that must restrict investment plans for the coming years to what is absolutely essential to keep business running and maintain jobs.

- Given the huge costs REACH will entail for the chemical industry, the Commission/ECHA/national authorities could relieve the burden by reducing the fees significantly. The actual huge number of pre-registrations suggests a higher financial income stream to ECHA than anticipated and the fees could be recalculated on the basis of the actual situation; the Commission should also consider maintaining its subsidy to ECHA over the next years to reduce the financial burden on companies and allow them to keep the pace on REACH compliance by focusing their expenditures on preparing the dossiers for registration rather than paying administrative fees. Furthermore to avoid an unnecessary accumulation of funds with ECHA favourable amortization rules for REACH-related costs and/or a possibility for phased payment of the registration costs instead of 'one-shot' fees should be allowed. The companies could also be supported by facilitating a "REACH loan" for the entire chemical industry by the European Investment Bank (EIB) as an upgrade of its recent programme for SME's (under which REACH-related activities may not be eligible due to the involvement of animal testing).
- Take steps to ensure that the implementation and fine tuning of the ETS directive is promoting and enabling installations to invest in energy- and climate efficient technologies and measures and thus enhancing their global competitiveness.

Other measures

3) Energy efficiency related measures

What can the national authorities do?

Energy Efficiency in Housing and construction

The Economic Recovery Plan rightly identifies the opportunities to enhance the energy-efficiency of the housing stock and public buildings as an opportunity area. The chemical industry can make great contributions in this area. Notably measures in respect of insulation will generate win-win-win situations: for the construction sector, for the consumer, for the chemical industry and for the environment. Incentives for the construction sector will not only benefit polymers manufacturers, but also specialty chemicals such as paints and adhesives. Polymer foams offer good insulation properties and reduce energy needs for heating or air conditioning, For lighter works, certain paints and coatings can be climate change friendly not only because they provide an adequate insulation but also because they require less resources for their production. High-tech glazed windows offer a huge energy saving potential.

The reduction of electricity consumption

Usage of improved products helps a lot to reduce electricity consumption, for example the OLED lamps and LCD screens. In an indirect way, some newly designed products using specific plastics can also contribute to energy saving.

Renewable energies

The best energy use is the energy efficiently used. That is the philosophy behind insulation. Renewable energy comes, for example, from bio energy, wind energy or solar cells. Chemistry contributes to practically all renewable energy and new storage technologies and helps to make renewable energy cost efficient in the future.

For wind energy, chemistry offers e.g. binders and adhesives, coatings, concrete additives or polymer foams. New photovoltaic cells are made possible thanks to innovative materials. More and more solar cells need less and less light to be cost efficient. Promotion of research of wind and solar projects will have a positive spin-off for the chemical industry.

4) 'Green cars'

As regards the green cars initiative, the chemical industry can provide a great contribution to reduce fuel consumption. Innovative plastics help reduce the weight of the car. The stronger and more resistant a car is, the less you need to repair it and to use additional materials. Nanotechnologies play an important role here in the search to reduce the weight. In short, chemical products help install less and less heavy parts. The reduction of fuel consumption also requires a more efficient propulsion system, either to replace the usual motor in hybrids system (Lithium ion batteries) or to improve the usual motor (clean diesel filters). Better tyres with lower rolling resistance achieved through highly dispersible silica technology as well as better inflated tyres also help reduce fuel consumption.

Governments can help stimulate demand for such cars by bringing forward the renewal of their own car park. We also urge the EU and National Governments to create the enabling policy frameworks to promote general market uptake for such cars through incentives.

5) Innovation

The European chemical industry is providing modern materials and enabling technical solutions in virtually all sectors of the European economy. Therefore it is a key for economic development and wealth. With 1.2 million staff and sales of 537 billion Euros € it is one of the biggest industrial sectors and an important source of direct and indirect employment in many regions of the European Union.

Translating the results of research and development in chemistry and other sciences into practical applications, the products of a modern sustainable chemical industry are indispensable to address some of the most pressing global issues such as supply of energy, food, water and health care for an increasing and rapidly aging population. At the same time the industry has an important responsibility to contribute to a sustainable use of natural resources including energy, to reduce pollution, waste, and last but not least for the safe use of chemical products.

As part of its industrial policy the European Commission installed a High Level Group involving a broad range of stakeholders which is commissioned to examine

the challenges to the competitive position of the European chemicals industry and to identify the factors causing rapid structural change. For the innovation area, Cefic fully supports the actions set out in the European Economic Recovery Plan, especially with regard “to take competitive advantage when growth returns by answering the needs for the future as outlined in the Lisbon strategy”.

Innovation, the bringing of new technologies and products into the market, is key to the future of the chemical industry in Europe in order to sustain the global competition. The joint challenge is to combine existing technologies in a faster and effective manner throughout the full value chain. New developments can complement this. This means pursuing the necessary structural reforms to ensure timely marketing of innovative technologies and products, supporting innovation (not only inventions and research) and building a knowledge-based economy. It must therefore be ensured that the current crisis does not deviate financial resources away from the necessary investments.

This has been recognised in the recent High Level Group report of the EU Commission on the competitiveness of the chemical industry in Europe.

Recommendations

- Financial support is needed to promote sustainable innovations through demonstration projects (pre-competitive). A better balance is required between research funding and pre-competitive demonstration towards society. A typical size for a demonstration project would be around 40-60 Mio Euro. Based on learnings of the recent projects, the public sector (EU + Member States) should increase their financial support to bring sustainable innovation to the market. This is especially important for multi-technology projects with the engagement of several industry sectors. Cefic therefore suggests, that in current and future research frameworks the selection criteria are adapted to allow for support of demonstration projects.
 - Moreover, in line with the priorities established by the EU Technology Platform SusChem, FP7 resources allocated to chemistry – either directly or indirectly through other programmes (such as new materials..) should be increased from 2009 onwards, in order to allow existing projects or pre-projects (e.g. Smart Energy home, F3 Factory, Biomass4Five) to be completed but also new projects to be launched, either independently or, when relevant, in cooperation with other EU Technology Platforms (e.g. the Integrated Water Cycle program under definition with WSSTP – Water, Sanitation and Supply Technology Platforms). Cefic is ready to discuss individual projects with the Commission to determine the funds needed for securing the continuation of these projects under the current financial circumstances.
- Structural reforms in the Member States and the EU have to be initiated to allow practical and effective use of the existing funding tools and programs to move research into sustainable markets to speed up time to market.

Concrete implementation means

- combined efforts and cooperation of interested EU Member states and EU Commission (joint funding) in the setting up and implementation of innovation projects
 - more joint actions and projects involving various EU Commission services together in support of demonstration projects
- Need for more stringent approaches similar to lead markets to a more effective and faster exploration of new sustainable markets. (i.e. in packaging, transport, energy, water).
- Once decisions on priority markets are made, incentives have to be developed to ensure matching of skills and availability of high quality human resources to promote sustainable innovation. Industry has to be involved in the suggested cooperation with social partners, public employment services and universities.
- Increase EU network for efficient collaboration, for example through quality input from innovation clusters (support from Member States and the EU) to enable work and technology transfer.

6) Improve access to renewable raw materials for the chemical industry

Improved access to renewable raw materials at world market level for the chemical industry and removing EC distorting policies would promote the use of renewable feedstock in the chemical industry thus contributing to long-term sustainable resource use and improve the competitiveness of the chemical companies using raw materials such as sugar, starch, bio-ethanol, tallow and palm oil.

7) Improvement of transport infrastructure and road transport

The Economic Recovery Plan rightly identifies the need to accelerate investments in infrastructure, supporting the construction sector and enhancing the longer-term sustainable growth of European industry. Beside of that, the EU should also accelerate private investments in infrastructure projects, e.g. pipelines. The following infrastructure projects would in particular help to improve the competitiveness of the chemical industry:

- Improving the infrastructure connections between ports and hinterland;
- Improving the infrastructure connections between chemical clusters;
- Closing of the missing links in the European Olefines pipeline network;
- Investment in dedicated rail freight lines;
- Investment in intermodal terminal capacity in ports and inland hubs;
- Investment in transalpine rail connections;

- Investment in missing 'last mile' connections of the rail network with the final delivery point;
- Investment in energy feedstock pipelines;
- Promoting industrial CCS large scale demonstration projects;
- Increase of overhead clearance of inland waterway bridges.

As regards road transport, industry would welcome an increase and harmonisation of allowable vehicle weight at European level to 44 tonnes for road vehicles and to 48-50 tonnes for intermodal transport. Such a higher, harmonised weight would reduce congestion, emissions and the losses stemming from underuse of vehicles.

8) Elimination of chemical import duties in the context of the Doha Round

Within the Doha negotiations, we urge the EU Commission to strongly advocate for a chemical sectoral tariff elimination agreement which would encompass all major chemical producer countries (over \$3 bn in production) including China, Brazil and India; and that would reduce chemical tariffs to zero over a defined time period. As chemicals are used in many sectors, such reduction would have a very positive effect on the economies as a whole of developed and developing countries alike.

Appendix

Global economic environment

The world is facing the greatest international financial and economic crisis for many decades. The world economic activity and the global business climate have worsened considerably over the past few weeks. The expectation for the coming months is still downward. The financial crisis is now severely impacting the real economy and business confidence. The recession is global. GDP expectations for the coming six months have been therefore revised downwards for all major regions. Compared to earlier crises, there is this time no relief from external EU trade demand.

EU chemicals industry activity

The worldwide financial and real estate crisis and the latest turmoil in the stock market have directly affected the chemicals industry in Europe. For the first time since 2003, the EU chemicals industry's output (excluding pharmaceuticals) declined in 2008. After a modest start in the first two quarters, output in chemicals has declined in the course of the year, especially since the third quarter and data for Q4 2008 are even more depressed indicating a sharp drop in chemicals production for most EU countries.

Sales of chemicals to industrial sectors and the key customer sectors have been severely affected during the last months and expectations for the upcoming months are even more negative. Chemical companies are preparing for 2009 but they will face a very difficult business environment. Investment plans for 2009 are more cautious and investment decisions are currently severely downsized in several cases. The lack of availability of funds for the chemicals industry and the lack of credits for consumers are putting pressure on both the demand side and the supply side. Companies are making a lot of efforts to counteract the severity of the economic decline, and contributing to the stabilisation of the current situation, by trying to keep their skilled permanent staff.

Several key customer sectors of chemicals such as construction, automotive, and machinery and equipment, are in a recession and generating therefore less demand for chemicals. These sectors are suffering from low consumer confidence and consumer credit restrictions. The most spectacular example is that of the automotive value chain where major destocking is taking place. This development causes temporary shutdown of chemical production activities which is expected to last until demand recovers and stocks have to be stabilised.

Consequently, the sectors most affected by the economic crisis are base chemicals, polymers and specialty chemicals, and to a still significant but lesser extent consumer-related chemicals (e.g. detergents which are less sensitive to economic crises).

The overall chemicals confidence indicator for the EU declined in Q4 2008 and most chemicals companies are reporting a fall in the production trend observed in recent months while stocks of finished chemicals increased. Their assessment of the current overall order book and export order book is increasingly negative. The EU

chemical industry activity is experiencing a considerable drop in orders in most EU countries, or even cancellation of previously confirmed orders.

EU Chemicals Outlook

The financial crisis has reduced consumers' willingness to spend and the increasing uncertainty of the business climate is harming competitiveness of European manufacturers. Since the second half of 2008, the number of orders received and production output figures have both been falling in important customer industries with the result that chemicals output is expected to weaken further in the next few months. The European chemical industry has experienced a downward production trend since the middle of 2008, and it is unlikely this negative trend will be stopped or reversed during the first half of 2009. Chemical companies have become less optimistic and - with global economic activity slowing down - there are no real signs of improvement before the third or fourth quarter of 2009.

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