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ISSUE BRIEF

SLOVAKIA FIT FOR 55: EUROPEAN GREEN DEAL AND HEAVY INDUSTRY

Two European Green Deal (EGD) measures are of particular relevance for heavy industry that need to be fit for Slovakia's transition: EU Industrial strategy and the carbon borer adjustment mechanism or CBAM.

EU INDUSTRIAL POLICY POTENTIAL

According to the European Commission's 2020 impact assessment, the industrial sector is expected to reduce emissions by at least 20% by 2030. Decarbonization is one of several competing objectives in the strategy, leaving a **clear opportunity for better alignment of industrial and climate policy using the EU budget and EU recovery fund to drive green and digital transitions.**

The global race for green technologies and solutions provides strong underlying imperative for competitive sustainability. Three of the five largest steel producers (all based in Asia) have adopted net-zero 2050 pledges, with US Steel recently joining. China in particular is pushing greener industrial policy in its next Five-Year Plan in conjunction with fresh 2060 carbon neutrality goal. This will see RDI spending grow to more than 7% compared to EU's current 2.2%.

Much of the guidance and oversight sits at the member state level, meaning governments will need to work with **the EU to achieve closer of alignment of RDI spending with climate goals, incentives for cleaner products, standards to grow demand for cleaner products, trade policy, state aid support and green public procurement, making it a market maker not taker.**

CBAM FOR COMPETITIVENESS

This comes under the backdrop of rising carbon prices, up 45% since the December 2020 EU Council meeting when leaders agreed to new more ambitious 2030 targets, and reaching record highs in April. In a recent Reuters report, eight surveyed analysts raised their annual average forecasts to EUR 46.32 per tonne in 2021 and EUR 55.67 in 2022, up 18% and 20% respectively from January.

This strikes at the heart of **carbon leakage and CBAM** vis-à-vis third countries that do not have equivalent carbon pricing or emissions targets.

Heavy industry, generally categorized as steel, cement, and chemicals, is an anchor of economic output and employment across the CEE region, making its competitiveness and survival imperative for policymakers. Thus CBAM is popular as a protection instrument against the import of more carbon intensive final products from countries with lax climate legislation that are not penalized by a carbon price.

In March, Slovakia was one of nine signatories (Czechia being the only other Visegrad country) of a letter to the European Commission supporting CBAM.

While most agree with the European Commission's main objective of instituting this mechanism to fight climate change by avoiding carbon leakage, the devil is truly in the details with such a complex and comprehensive bureaucratic undertaking. But overcoming technical issues and WTO compliance pale in comparison to the **real test facing the EU in the form of future trade relations with the US and China who strongly oppose it.** Commission Executive Vice President Franz Timmermans, overseeing the EGD, recently said that CBAM would be operational by January 2023 at the earliest.

Moreover, within the bloc there are **deep divisions over free allocations** during the transitional timeline for CBAM, with industry and several governments pushing back on the prospect of losing them.

To date, the focus of EU industrial policy has mostly been on protecting European industry from cheaper dirtier imports rather than supporting investments in cleaner production processes, relying on the free allowances. Following the European Battery Alliance, tighter environmental standards regardless of origin can serve as a less explicitly interventionalist approach.

SLOVAKIA

A *Low-Carbon Growth Study for Slovakia*, serving as the modelling basis for the country's 2050 low carbon strategy, points to high investment requirements and labour reallocation in the deep decarbonization period after 2030 to 2050 net zero as the most challenging for Slovakia. Here the social aspect of just transition will be pronounced, like coal regions and the automotive industry before it, requiring preemptive labour reform for the reskilling and training of the workforce linked to emerging clean technologies and industries.

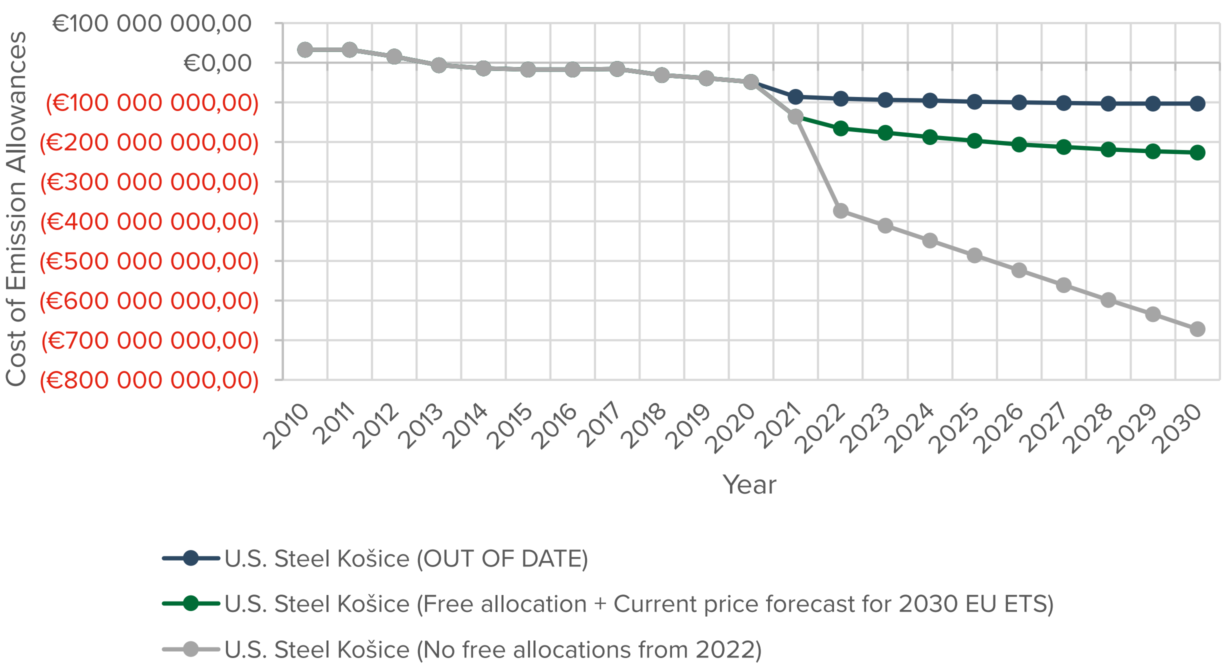
Ensuring that the vast sums of EU grants from the RRP, to ETS Modernisation and Innovation, and the upcoming 2021-2027 tranche of MFF are used cost-effectively and matched where possible by the private sector will be key to setting up early stage R&D and pilot projects. This should follow a clear national strategy with benchmarks for clean hydrogen production, energy efficiency and circular economy.

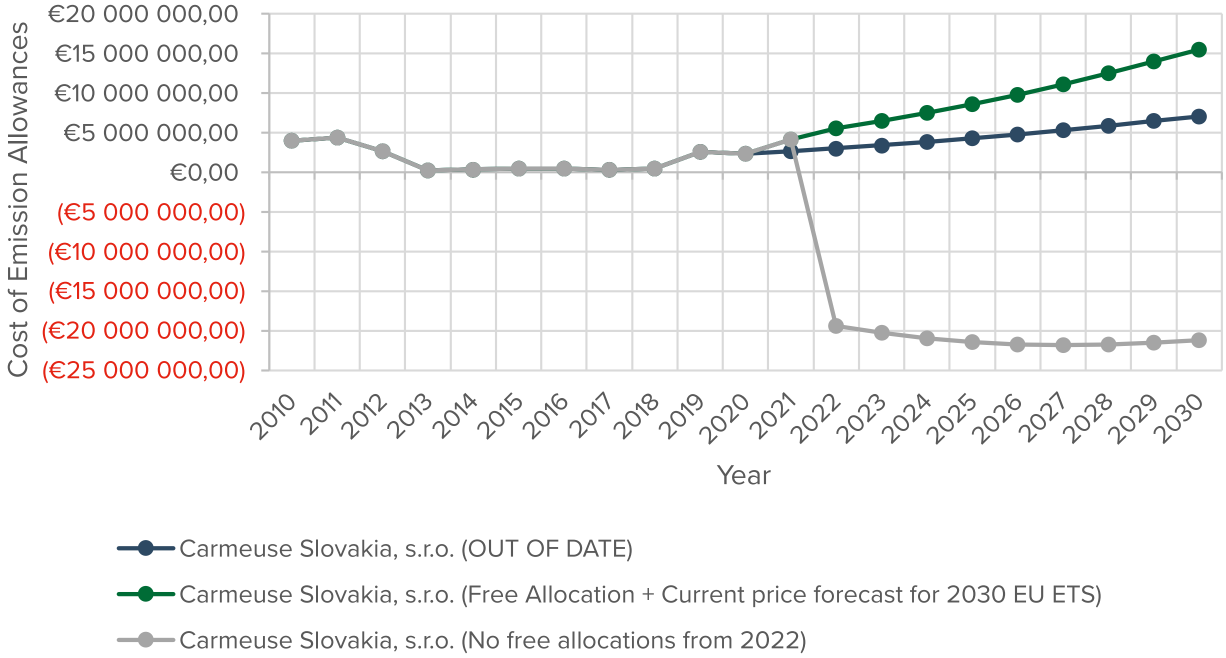
Slovakia's RRP, which included EUR 350 million of investments into decarbonization of industry targeting cost-efficiency, and Modernisation Fund, both finalized in the first half of 2021, need to lead the way and compliment the MFF strategy, which already brings Slovakia and the EU to 2030 and delivery on climate targets.

The long-term solution will be some combination of CCS and hydrogen, with natural gas and energy efficiency providing medium-term carbon abatement gains. These clean technologies are in the very early stages with green hydrogen enjoying strong EU support, including Important Projects of Common European Interest (IPCEI) of which Slovakia is involved in three.

Currently Slovakia produces gray hydrogen mostly in the chemicals industry between two large plants, Fortischem in Novaky and Duslo in Sala. Meanwhile the Slovnaft oil refinery plans to build another H2 plant using natural gas in Bratislava.

Finally, returning to GLOBSEC's *'Achieving more by 2030'* industry ETS projections from December 2020, the following charts show the impact of free trade allowances from 2021 on the price of allowances with updated (higher) carbon prices for three major industrial players, US Steel, Kosice, Duslo and Carmeuse. The original predictions are represented by the blue line, with free allocations on the orange line and no free allocations on the gray line. It makes clear the very strong impact of free allowances on the cost of EU allowances, especially in the first year before CBAM would come into existence at the earliest.

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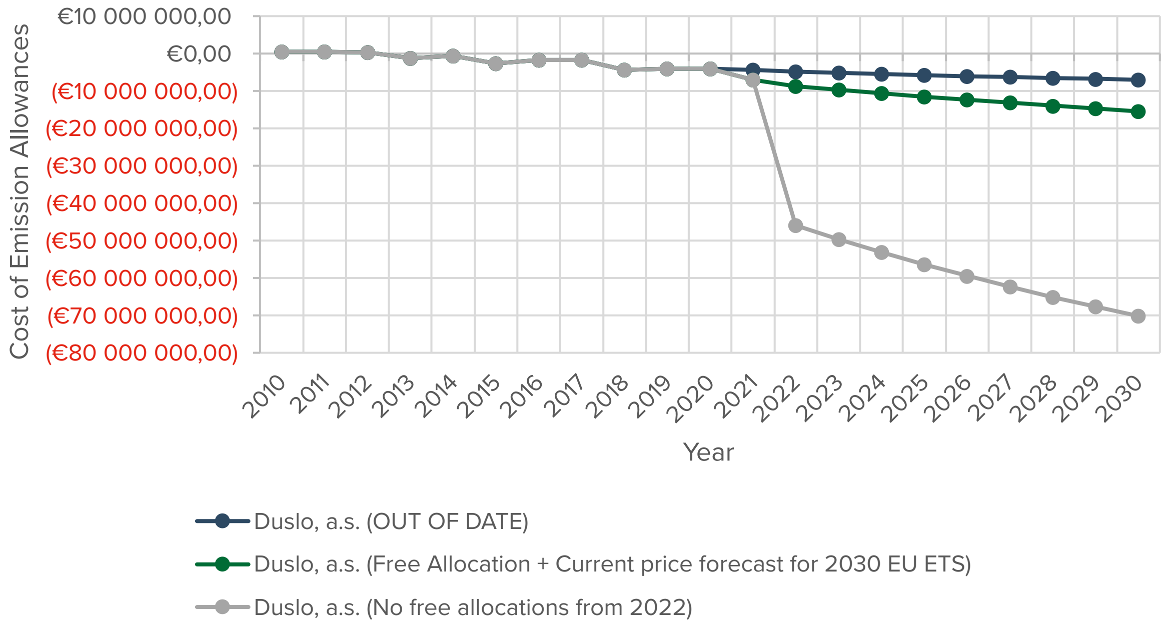
Carmeuse Slovakia, s.r.o. (OUT OF DATE)
Carmeuse Slovakia, s.r.o. (Free Allocation + Current price forecast for 2030 EU ETS)
Carmeuse Slovakia, s.r.o. (No free allocations from 2022)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Duslo, a.s. (OUT OF DATE)
Duslo, a.s. (Free Allocation + Current price forecast for 2030 EU ETS)
Duslo, a.s. (No free allocations from 2022)