Emission Trading System - Aviation

T&E's feedback to EU Commission's proposal

November 2021

The Commission is proposing to reform the EU ETS rules for aviation to try and address some unfair privileges the sector was benefiting from and start applying a more effective price on aviation emissions. But it unfortunately continues to implement Corsia, ICAO's carbon offsetting scheme despite its confirmed lack of economic and environmental integrity.

The European Commission's impact assessment itself includes a number of arguments that justifies the need for policy makers to go further than the current proposal:

1. **Remove free allowances** as soon as possible and finance the deployment of e-fuels through the use of auction revenues
2. **Reintegrate extra-EU aviation emissions** within the scope of the EU ETS and limit the application of Corsia on routes departing from Europe given lack of carbon leakage risks
3. **Propose additional measures to strengthen the EU ETS** and address non-CO2 emissions

1. Remove free allowances to finance e-fuels

The principle of free allocation was implemented to counter the risk of carbon leakage, where production moves from the EU to third countries. But the principle of carbon leakage does not apply to the aviation sector, as the "product" (i.e. transporting passengers) cannot be "moved" to another third country.

- The European Commission's impact assessment (IA) clearly notes that "there is no evidence of carbon leakage at present for aviation, because there is equal treatment of all airlines on flight routes covered by the ETS" (page 23). It explains that "a significant risk for carbon leakage for aviation due to the ETS has **not been substantiated** due to its very nature (difficulties or even impossibility to change/divert route due to the very nature of the traffic)". This "**undermines the effectiveness of the carbon price signal thereby removing incentives for aircraft operators to decarbonise their activities.**" (page 18)
- In addition, the IA mentions that with the impact of COVID-19 on air traffic, and the likelihood that 2019 levels will not be reached before 2024, "a continuation of the current allocation levels would generate not costs, but windfall profits for operators (...) and **would create downwards pressure on the prices of ETS allowances**". (page 18) There is no reason for these free

allowances to continue until 2027 and they **should be phased out immediately**, **as requested by Poland[1] in 2020**.

The revenues generated by putting an end to 32.3 million tonnes of free allowances could help finance **contracts for difference (CfD) promoting the development and use of sustainable alternative fuels**[2]. These CfDs are agreements whereby public subsidies are used to meet the gap between what it costs to produce such a fuel, and what the market is willing to pay. CfDs have been used effectively in the past to support novel alternative technologies such as renewable electricity (wind, solar), and through an auctioning process can be awarded to the producer offering the lowest cost, therefore ensuring public money is put to the most efficient use.

2. Stop ignoring the bulk of aviation emissions

Despite removing some unfair pricing advantages, the European Commission's proposal to revise the EU ETS fails to properly address the bulk of aviation emissions - over 60% of emissions[3] - which take place on extra-EU flights. Due to issues inherent to offsetting and Corsia's lack of environmental integrity, integrating the system in Europe represents a threat to its existing climate commitments under the Paris Agreement (read more of our analysis here and the EU's assessment here).

- **EU confirms Corsia's ineffectiveness**

Corsia, **ICAO's offsetting scheme, is the worst option for the climate** and should not be the main tool to regulate emissions on extra-EU flights. It is a cheap offsetting scheme that continues to allow aviation emissions to grow. It includes credits that don't actually deliver emissions reductions, risk being double counted and are mostly priced under €1. The EU's IA confirms this:

- ➔ "Due to uncertainties associated with CORSIA participation, additionality of offset credits, and with accounting, the policy options with wider ETS coverage provide more certainty of environmental effectiveness" (page 78)
- ➔ "CORSIA's current aim, carbon-neutral growth of international aviation emissions above 2020 levels, is not ambitious enough to deliver a significant contribution from the international aviation sector towards the Paris Agreement's global goal." (page 86)
- ➔ "ICAO has no instruments at its disposal to enforce compliance, and thus no penalties can be enforced by ICAO in case of non-compliance with CORSIA" (page 79)

[1] Council of the EU (2020), Implementation of full auctioning for the aviation sector under EU ETS

[2] T&E (2020) Legislating for aviation alternative fuels

[3] EASA (2018) Figures and Tables | European Aviation Environmental Report

Despite all this, the EU is still proposing to implement Corsia. It imposes conditions on the offsets that airlines can use to fulfil their Corsia obligations to try and improve their environmental integrity: if they are issued by countries party to the Paris agreement, applying Corsia and are not double counted within their own climate target. But **how can the EU guarantee that offsets aren't double counted**, when its own assessment finds that "**none** of the CORSIA eligible programmes have comprehensive provisions which guarantee avoidance of double counting" (page 77). The proposal also gives a free pass to airlines on flights to and from third countries that don't implement Corsia properly and therefore allows the EU to even further lower its own sustainability standards and climate commitments.

It is politically and environmentally unacceptable for the EU to continue exempting some airlines from paying an effective price for over 80% of their emissions. As Europe and other countries and regions transition to climate neutrality, the highest coverage of flights by the EU ETS, have the greatest potential to support the deployment of new, low carbon solutions. (page 80)

- **EU has the right and obligation to regulate all EU aviation emissions**

The Paris agreement requires all countries to reduce emissions from all sectors of the economy, including aviation (and shipping). Unlike the Kyoto Protocol, the central pillar of the Paris Agreement is a temperature goal. Parties are obligated to implement "economy-wide absolute emission reduction targets", that is, to control anthropogenic emissions so that global warming is limited to well below 2°C. According to legal research, **a failure to address all anthropogenic emissions** – including all shipping and aviation emissions – **would violate the central aim of the Agreement**.

The EU's National Determined Contribution indeed includes emissions from outgoing flights, which means the EU should be at least responsible for the emissions generated by flights leaving its territory. With this in mind, the EU's ReFuelEU proposal mandates the use of SAF **on all departing flights** from Europe, as this scope is essential to address emissions from long haul flights, which contribute the most to aviation's overall climate problem. Despite regulating the content of the fuel being sold to third country airlines, the EU's proposal to revise the EU ETS fails to cover these flights' emissions. By refusing to at least include departing aviation emissions, the **proposal fails to remain coherent with the rest of the EU's Fit For 55 proposals for aviation**.

Finally, the **European Court of Justice confirmed the EU's right to regulate airlines based outside the EU** on a route basis, which is necessary to provide equal treatment on routes (page 10 of the EU's IA), which means the EU's can legally reintegrate departing flights within the scope of its EU ETS.

- **Carbon leakage risks are limited and full scope ETS has social benefits**

The EU's IA confirms that "the carbon costs associated with the options assessed (including full scope EU ETS) are **unlikely to have a significant impact on hub choice for passenger airlines**, given the

high costs of changing networks and hub location." (Page 55) The IA also notes that the impact of the different options on fares paid by customers is small and varies by **less than €1 for intra-EEA flights** in 2030 and **less than €2 for extra-EEA flights**. "Even at the uppermost end of the uncertainty range, the [**full-scope option of the EU ETS**] **is at most €7 higher for one way for extra-EEA fares**." (page 79)

These very insignificant changes in prices will not lead to flights shifting away from EU hub airports towards other non-European airports, thus leading to carbon leakage. Even adding the potential cost increase of fuel resulting from the ReFuelEU proposal, the IA estimates that (Page 57) "The cumulative impacts when considering the effect of ReFuelEU and the increased use of Sustainable Aviation Fuels (SAF) will also be limited. Higher use of SAFs should lead to a reduced demand for ETS allowances and CORSIA offsets".

The EU's IA also confirms that enlarging the scope of the EU ETS to cover extra-EU flights would not only be the best environmental and economic option but also lead to positive employment impacts. "The modelling suggests that, among the policy options explored, and when taking into account the effect of revenue recycling, the **option of extending the EU ETS to cover all flights** (…) would have the **greatest positive impact on EU27 employment and GVA**." (page 82)

3. Consider additional measures to strengthen the EU ETS

- **Applying a multiplier to aviation emissions**

In order to further encourage emissions reduction in the sector and also address irregularities in the way the sector has been treated over the past years, **a multiplier could be applied to increase the amount of allowances airlines would actually need to surrender**. This would drive emissions reductions by creating sufficient price signals to contribute to the achievement of carbon neutrality in aviation by 2050. The Market Stability Reserve (MSR) should however take into account demand from aviation with these discounting factors, in order to adapt the amount of allowances it would need to absorb and avoid having a surplus or a shortage of allowances on the market. There could be two main arguments justifying the use of a multiplier for aviation emissions:

- ❏ **Compensation for lack of kerosene taxation**: The minimum kerosene tax of 33 cents/litre in the Energy Tax Directive equals a CO2 price of 130 EUR/ton. Based on the current CO_2 prices a discounting factor of 5 could be applied to compensate for the energy tax exemption for kerosene fuel.

- ❏ **Compensation for non-CO2 impact of aviation**: Non-CO_2 emissions represent two thirds of aviation's climate impact but are not addressed in the proposal. By putting an effective price on aviation non-CO_2 effects, airlines and air traffic managers will be incentivised to use cleaner

fuels that reduce these effects or climate optimise their route to avoid areas of the atmosphere with the highest risk of non-CO_2 effects.

- **Minimum price for CO2 allowances**

In order to ensure the ETS price signals resist any excessive fluctuations caused by future crises, a minimum price for auctions could be implemented both in the aviation and the stationary sector. The price could be set in a way that it increases over time and thus also reducing uncertainty for investors whether emission abatement technologies will be economical. The UK introduced a minimum CO2 price for energy installations covered by the ETS in 2013, and this contributed to reducing the carbon intensity of the UK's energy mix by phasing out investments in coal[4].

- **Voluntary cancellation of allowances**

Under Art. 12(4) of the ETS Directive member states have the right to voluntarily cancel allowances in the event of a policy driven coal phase out. Such a voluntary cancellation ensures that no other power plant can use the newly available certificates from the closed installation to increase emissions and output. The right to voluntary cancellation could be expanded to the aviation sector, for example to take into account reduced demand for aviation, when air travel shifts to rail, or whenever member states withdraw subsidies for regional airports.

4. Policy recommendations

T&E recommends that policy makers take into account the policy recommendations below when revising the EU ETS rules for aviation, in order to make the EU ETS for aviation better and bigger.

- **Strengthening the EU ETS for aviation by:**
  - Removing free allowances for aviation and using the revenues to develop and deploy SAF
  - Applying discounting factors to aviation emissions
  - Establishing a minimum price for CO2 allowances
  - Enabling voluntary cancellation of allowances to take into account any future reduced aviation demand

- **Countering any international attempts to undermine the ambition of the EU ETS** as a tool to regulate aviation emissions
  - Reintegrate long haul aviation emissions through the ETS until Corsia actually starts requiring airlines to purchase quality offsets (which is clearly not before at least 2027)

[4] House of Commons (UK) (2018) Carbon Price Floor (CPF) and the price support mechanism

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Further information

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