# Carbon Market Watch reply to the European Commission's Inception Impact Assessment for updated rules to the EU ETS aviation coverage

Carbon Market Watch (CMW) welcomes the opportunity to provide feedback to this European Commission Inception Impact Assessment (IIA), and urges the Commission, Parliament, and Council to adopt measures which strengthen the EU's climate action in the aviation sector, as it currently falls short of the required level of ambition to meet the Paris Agreement's objective of keeping global temperature rise to a maximum of 1.5C°.

1. *Views on the options considered*

The aviation sector's emissions have been growing much faster than other sectors around the world. The sector is responsible for a significant share of overall EU GHG emissions, and yet still benefits from numerous privileges: free allocation of allowances, exemption from fuel taxes, exemption from VAT on international flights, state aid (e.g. subsidies to regional airports which indirectly subsidizes the airlines themselves), no pricing of emissions from flights departing from or arriving in the EU/EFTA, no measures to address the climate damages from non-CO2 effects, … During the covid-19 pandemic, European airlines have received over €30 bln in aid from Member States[1] (including grants, loans and other forms of public support). The same airlines have successfully pressured the European Union and its member states, as well as other countries members of the International Civil Aviation Organisation (ICAO), to adopt measures which will effectively postpone the start of CORSIA - the aviation sector's global market based "climate policy" - by several years.

It is high time that this preferential treatment for airlines ceases and, in light of States' inability to agree on an ambitious global measure to regulate the climate impact of the aviation sector at ICAO, that the EU ends all exemptions which airlines have been benefiting from and adopts fair climate policies for the aviation sector.

*1.1 Views on the proposed options for CORSIA implementation*

All options which would result in a de facto step-back from the current coverage of aviation greenhouse gas emissions in the EU/EFTA are inacceptable. This includes options 3 (CORSIA only), 5 (EU ETS covering intra EU/EFTA emissions up to 2020 level[2], CORSIA covering emissions above 2020 level for intra EU/EFTA and for flights departing or arriving in the

[1] https://carbonmarketwatch.org/our-work/aviation-emissions/aviation-bailout-tracker/

[2] The IIA refers to "2020 levels". Given that the ICAO CORSIA baseline was modified from the 2019-2020 average to a 2019-only level, we assume that the options presented by the Commission would therefore be modified in line with this change, i.e. all "2020 levels" would become "2019 level".

EU/EFTA), and 6 (EU ETS applies only to intra EU/EFTA flights and only for operators registered in the EU, CORSIA applies to to other operators for flights between EU/EFTA countries and departing or arriving in EU/EFTA countries). Option 6 would also significantly distort competition and favor non-EU airlines.

CORSIA is not a credible climate strategy, and covering more emissions with CORSIA should not be deemed a sufficient objective if the price to pay is a reduction in the coverage of the EU ETS. While CORSIA's level of ambition might be increased in a further review of the mechanism, it is highly unlikely that it will ever reach a level comparable to that of the EU ETS. Given the current dynamics at ICAO, further weakening of CORSIA at the next review is still a possibility, and any discussions to increase the stringency of the system will be extremely difficult.

Option 1 (full coverage of emissions under the EU ETS) is by far the most environmentally integer option. In fact, this is the option which has been agreed by the co-legislators nearly a decade ago, before the temporary "stop the clock" measure was prolonged for an entire decade. Options 2 (EU ETS intra EU/EFTA, no CORSIA) and 4 (EU ETS intra EU/EFTA, CORSIA for flights departing and arriving in the EU/EFTA) are similar, as the main impact they will have is within the EU/EFTA, i.e. CORSIA is not expected to have a significant impact to reduce greenhouse gas emissions from aviation.

Note that option 3 (CORSIA only) was already assessed by the Commission in its 2017 impact assessment, which concluded that "*this option would reduce the EU's level of climate ambition. The EU would move from its existing level of ambition to accept that aviation emissions are stabilized at 2020 levels. Furthermore, increases above this level would not be compensated with domestic emission reductions, but by using international offsets, representing reductions achieved in third countries and not coming from a cap-and-trade system with possibly less environmental integrity (e.g. emission reductions are not counted compared to a fixed cap but to projected "business-as-usual" emission growth; thus, in case of a too generous "business-as-usual" projection, emissions that would effectively have never occurred may be counted as "reductions")*"[3].

Finally, we propose that the Commission also analyses the impact of a 7th option, which would combine elements of the listed options. Under this option, the EU ETS would apply to all intra-EU/EFTA flights as is currently the case, and would also apply to emissions from flights departing from or arriving at airports in the EU/EFTA up to an operators' 2020 levels for those flights. CORSIA would cover operators emissions above their 2020 levels, for flights departing from or arriving at airports in the EU/EFTA. CORSIA would not cover flights within the EU/EFTA (the EU ETS would cover such flights). This option has the benefit of increasing the

3 https://ec.europa.eu/transparency/regdoc/rep/10102/2017/EN/SWD-2017-31-F1-EN-MAIN-PART-1.PDF

level of climate action in the EU, and extending the EU ETS to its originally foreseen international scope, while at the same time showing the EU's commitment to implementing international agreements, i.e. CORSIA. The "stop-the-clock" measure was adopted to give more time to States to agree on a global measure. This measure, CORSIA, has now been agreed, but only covers a small share of international aviation emissions. As the EU has long signalled, it should now act to cover the remaining share of international emissions (those outside of the EU/EFTA) with the EU ETS.

*1.2 Views on proposed options for the allocation of EUA(A)s*

Airlines have paid very little for their greenhouse gas emissions in the EU, both relative to the climate impacts created/reinforced by their activities, and relative to their total operating costs. In 2017, compliance costs related to the EU ETS amounted to an estimated 0.3% of airlines' total operating costs according to EASA[4]. A similar finding was produced in the EU Commission's 2017 impact assessment, which States: "*based on a sample of EU and US airlines, the EU ETS seems to lead to price increases between 0.43 % and 0.94 % for passenger tickets (excluding taxes and charges). Ryanair has been one of the most transparent airlines by publishing figures of the cost to passengers of climate change measures. These have been cited as being €0.25 for passengers flying from continental Europe, and £0.25 for passengers buying tickets in the UK. Concerning transatlantic flights, US airlines have included fees around $3 to cover for EU ETS costs in their ticket prices. This price top-up due to the EU ETS is much lower than most airport taxes and charges (e.g. US charges of $16 for passengers to arrive and to depart)*"[5].

The same 2017 assessment report also highlights that, given the low carbon price levels, there is no risk of leakage in the aviation sector: "*distortions in border regions are theoretically conceivable, as traffic might shift from within the EEA towards nearby airports outside the EEA in response to an increase in relative prices for intra-EEA traffic. [A]lthough given the limited economic impact (price per RTK[…]) it is considered to be highly unlikely that companies modify their established routes due to this*". The Commission's 2006 impact assessment further clearly explains that a risk of relocation to airports outside of the EU ETS is not material with current carbon prices of around 25-30€/tCO2e, and highly cumbersome for airlines and passengers[6].

Therefore, Option 4 (55% auctioning of EUAAs by 2030) is insufficient and would continue to provide airlines with undue protection and windfall profits. Option 3 (full auctioning by 2030) is similarly unnecessarily slow in correcting the existing treatment of favor to airlines. While option 2 (full auctioning by 2025) can seem more reasonable, there is no clear rationale to

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[4] https://www.easa.europa.eu/eaer/topics/market-based-measures/the-eu-emissions-trading-system

[5] https://ec.europa.eu/transparency/regdoc/rep/10102/2017/EN/SWD-2017-31-F1-EN-MAIN-PART-1.PDF

[6] See section 5.3.2 p.31 https://ec.europa.eu/transparency/regdoc/rep/2/2006/EN/2-2006-1684-EN-1-0.Pdf

postpone the start of full auctioning to airlines beyond what would be necessary for administrative purposes. And given that the current infrastructure of the EU ETS is already very advanced, it is realistic to expect that - from a technical standpoint - it will be possible to shift to 100% auctioning to the aviation sector very fast. Therefore, option 1 (full auctioning from the adoption of the regulation) is the most appropriate option.

*Further considerations on the IIA*

Allocation of allowances

First, it should be noted that subsidies to the aviation sector, especially in the form of failing to price their climate damages, is detrimental to society in several ways. Not only does it fail to drive airlines to invest in cleaner technologies, but it also diverts much needed public finances (mostly through forgone revenues from freely allocated allowances or unpaid taxes), which could have been spent on climate action, health, poverty alleviation, etc. The benefits to the aviation sector of being shielded from basic climate policies should therefore be weighted against both the societal cost of lower investments in public goods and the increased future cost of investing in climate action to compensate for today's inaction.

Free allocation of allowances is ineffective to incentivise emission reductions. While in theory it is equivalent to auctioning, it breaches the polluter pays principle and in practice it does not set any financial burden on polluters and therefore fails as a climate policy instrument. Under the ETS, both energy-intensive industry and aviation, which have received most to all of their allowances for free, have failed to reduce their emissions, while the power sector, which had to purchase allowances through auctions, has delivered most of the ETS' reductions. The aviation sector has generated windfall profits from the free allowances it has received[7], resulting in a "polluter gets paid" system. The Commission should therefore measure the actual risk of leakage which the aviation sector faces, as well as quantify the windfall profits which the aviation sector has earned through the EU ETS, in order to better understand the historical impact of the system on airlines.

In addition to this, when considering the social and distributional impacts of pricing emissions from the aviation sector, it should be considered that air-travel forms a much larger share of individual carbon budgets for the wealthiest Europeans, compared to less well-off citizens (see graph below)[8]. A similar evaluation is shared in the EU Commission's 2006 impact assessment:

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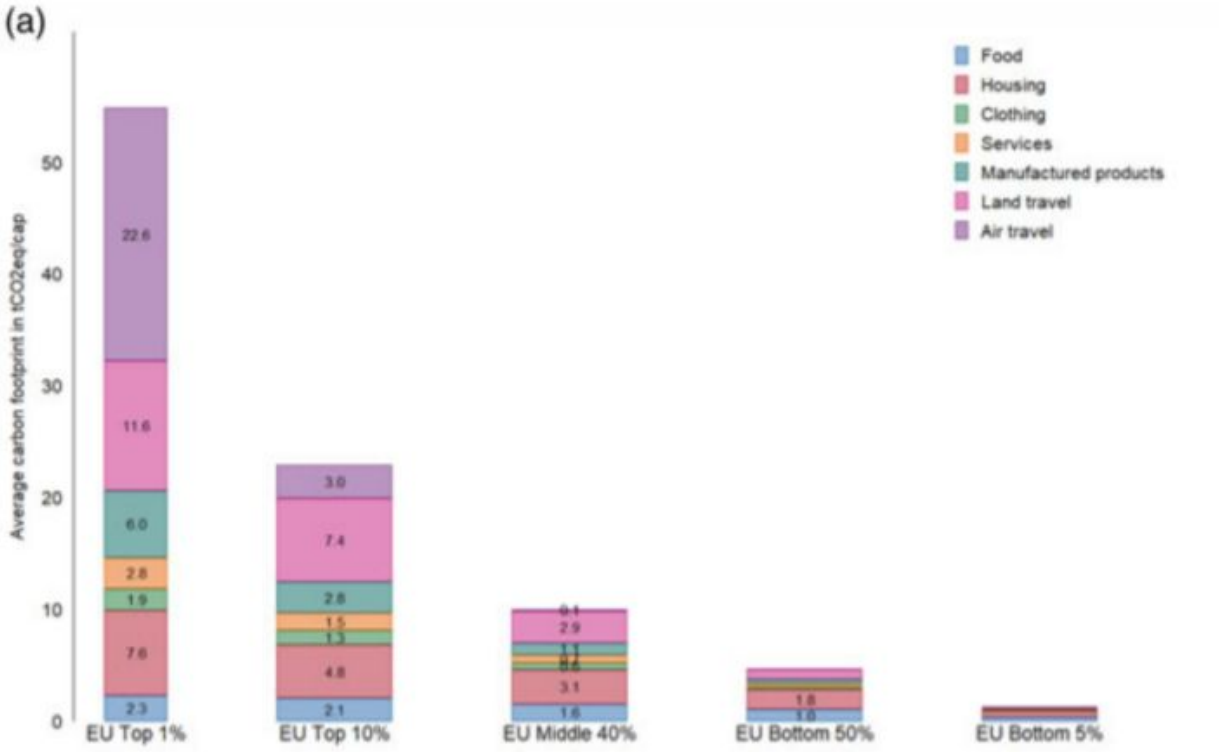
7 https://www.transportenvironment.org/sites/te/files/publications/CE_Delft_7931_Costs_and_Benefits_Stopping_Clock_Final.pdf

8 https://www.cambridge.org/core/services/aop-cambridge-core/content/view/F1ED4F705AF1C6C1FCAD477398353DC2/S2059479820000125a.pdf/unequal_distribution_of_household_carbon_footprints_in_europe_and_its_link_to_sustainability.pdf

"*according to data on the socioeconomic distribution of air transport users, increased ticket prices would be borne predominantly by the wealthier segments of the population*"[9].




Considering potential financial impacts on airlines from higher carbon costs, it should be noted that airlines pass-on these costs to their customers, thereby potentially generating significant windfall profits if the allowances are allocated for free. As the Commission noted in its previous impact assessments, carbon prices have not been high enough to result in price rises that would significantly affect demand. Even if this was to materialise, i.e. carbon prices would increase ticket prices to an extent that would significantly reduce demand, the Commission should assess the extent to which such lower demand would result in a material degradation of airlines' profit margins, based on airlines earning structure. This is because many airlines generate a large amount of their profits from business travel, which are typically much less price sensitive than leisure travel, and therefore demand for such travel would be less affected by an increase in price due to carbon costs. The financial impact on airlines would as a result be softened.

Given the low carbon prices, relative to the abatement costs in the aviation sector, it is unlikely that pricing emissions alone will lead to decarbonise the sector. The EU ETS remains a useful tool, and should cover the aviation sector, but as was indicated in previous impact assessments,

[9] https://ec.europa.eu/transparency/regdoc/rep/2/2006/EN/2-2006-1685-EN-1-0.Pdf

emissions from the aviation sector are likely to continue to rise if no other policies are adopted, while lower emissions are achieved in other sectors covered by the ETS. Until now, the power sector has carried most of the reductions from the EU ETS. However, it should not be assumed that EUAs purchased by airlines "offsets" their emissions, because this purchasing does not necessarily force another sector to reduce its emissions, given the oversupply of allowances, and the functioning of the market stability reserve. For example, an EUA purchased by an airline might have been absorbed and cancelled by the MSR anyway[10]. In order to measure the real impact of airlines purchasing EUAs to meet their ETS compliance obligations, the Commission should therefore measure in its impact assessment, the size of a future supply of emission allowances, generated by a large amount of unused and unneeded EUAs received by coal power plants set to shutdown[11], as well as the impacts of the covid-19 pandemic, which could create a significant oversupply of allowances on the market.

The Commission should also assess the possibility for States to cancel allowances when airlines or airports end their activities, as is currently foreseen to account for the closure of power plants.

Non-CO2 effects

The IIA states that non-CO2 effects will be considered to the extent relevant. We urge the Commission to make a proposal to regulate non-CO2 effects, as these are both relevant and significant. Non-CO2 effects are typically estimated to multiply the global warming impact of CO2 emitted by the aviation sector by 2-4 times, with significant differences depending on specific flights, e.g. its cruising altitude. While there is still some scientific uncertainty around the exact factor to be used to capture non-CO2 effects, uncertainty is not a valid justification for inaction. Choosing not to regulate non-CO2 effects is equivalent to assuming they have no impact. This is not in line with the best available science, which has shown that non-CO2 effects do increase the climate impact of flights. In addition, applying the precautionary principle would also lead to taking non-CO2 effects into account in the EU's climate policies. The EU Commission should therefore urgently publish its report on non-CO2 effects, as mandated during the last ETS review (Directive (EU) 2018/410, Article 30), and propose ways to regulate the non-CO2 impacts of flights both within the EU/EFTA as well as international flights, e.g. through NOx charges or through a levy imposed based on the size of non-CO2 effects of a given flight, to extent that this is technically feasible.

[10] It is more realistic to discuss this in terms of percentage of a given allowance which would be absorbed, based on the MSR intake rate, which might be modified in 2021. This example is for illustrative purposes.
[11] As countries shut down their coal power plants, many EUAs will become unnecessary, as the plants they were supposed to be acquired by will have shut down. To avoid this, Member States have the possibility to cancel these EUAs - instead of auctioning them - but so far no such plan has been adopted. Germany is the only country where this is being considered. See our report: https://carbonmarketwatch.org/publications/avoiding-a-carbon-crash-how-to-phase-out-coal-and-strengthen-the-eu-ets/

CORSIA

As noted above, CORSIA cannot currently be considered a credible climate policy. It is unlikely to impose any offsetting requirements on airlines before 2023, given its recent baseline change, it is likely to be oversupplied for several years, and a significant volume of the credits which are already eligible for use under the system are likely of questionable environmental integrity (e.g. CDM credits, forestry credits from voluntary standards, ...). Replacing any part of the EU ETS with CORSIA will lower the effective carbon price faced by airlines, lower the pressure for other sectors covered by the EU ETS to reduce emissions (as airlines need to buy fewer allowances), lower revenues for member states (as airlines need fewer allowances, and EUA prices could potentially sink), and increase the risk of airlines relying on international carbon offsets of doubtful environmental integrity to greenwash their activities and encourage customers to fly more by clearing their conscience.

While the EU has already conceded several changes to reduce the stringency of CORSIA (most recently revising the baseline of the scheme), in an attempt to increase participation in the scheme, none of the BRICS countries has volunteered their participation before the start of the mandatory phase in 2027. The EU should not continue weakening its own climate policies, in the hope that other countries will join an ineffective international climate policy a few years earlier than planned.

In its impact assessment, the EU Commission should investigate the potential losses of auctioning revenues from implementing CORSIA instead of reverting to a full scope ETS as originally planned, with full auctioning. It should also assess the potential for climate mitigation through the use of international credits under CORSIA, based on currently eligible credits, taking into account the risk of non-additionality, non-permanence, and other environmental deficiencies of such credits. For example, the EU itself has banned the use of land-use credits under the EU ETS, and allowing airlines to rely on such credits through CORSIA would be a step backwards from this decision.