

Landing Airplanes in Green Europe

By **Juan Delgado** | Wednesday, December 12, 2007

A proposal passed by the European Parliament in November 2007 to include airlines within the European emissions trading scheme (ETS), effectively means that airlines will have to pay for the right to pollute. Juan Delgado discusses what this will mean for the airline industry, its passengers — and environmentalists.

The environment is causing trouble for U.S.-European trade relations. First, the European REACH program — a regulatory scheme requiring the registration of hundreds of chemical substances, which entered into force in June 2007 — was described by U.S. Ambassador to the EU Boyden Gray as unworkable and “potentially disruptive” for international trade.

Now, it is the proposed regulation to include aircraft emissions within the European emissions trading system that stands accused of being ineffective, expensive and invading other countries’ regulatory competence.

What is Europe regulating this time?

This step is consistent with the spirit of the carbon-trading scheme, which covers most carbon-intensive industries in an effort to reduce

carbon emissions.

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Why should a sector that emits around 3% of current total emissions — and which is rapidly growing — be excluded from the scheme? Under the scheme, airlines must reduce carbon emissions by 10% when they join the EU's carbon cap-and-trade scheme in 2011.

The new measure does not only apply to domestic flights — but also to incoming and outgoing flights to and from Europe. That means that international airlines operating in Europe will be part of the scheme — and bear part of the burden.

Should the United States worry?

Not good news for U.S. carriers. After five consecutive years of net losses, 2006 was the first year of net profit for the U.S. airline industry.

Safety concerns and costs, skyrocketing fuel prices and stronger competition from low-cost carriers have driven costs up and profits down. If anything was unwelcome by the industry at this moment, it was a new tax on carbon emissions.

Will prices increase?

Prices will probably increase. According to the estimates of the European Commission — if airlines fully pass on costs to customers and the

price of carbon reaches €30 (\$44) per ton — airline tickets for a roundtrip journey could increase between €4.6 (\$7) to €39.6 (\$58) by 2020, depending on the length of the trip.

The regulation foresees a heavier burden if no measures are adopted for other greenhouse gases. But in practical terms, airlines will not be able to pass on all the additional costs, so they will bear part of the burden.

This is too much for an industry in financial trouble — according to airline industry representatives. According to environmentalists, it is too little to deter people from flying.

Will emissions be reduced?

Carbon efficiency of airlines has increased dramatically in the last decades, mainly driven by increasing fuel prices — rather than by environmental concerns. Reducing emissions in the air is not a cheap option, though.

The good thing about emissions trading schemes is that they allow airlines to contribute financially to cut emissions in other sectors where it is cheaper for them to do so. In that sense, although emissions in the airline industry will continue to grow, total emissions in the economy will decrease.

Protecting EU airlines?

But the most controversial aspect is not its cost or its effectiveness, but the feeling that Europe is going too far with its

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regulatory ambitions. The fact that the allowances given to airlines would be decided at a national level could, according to the U.S. government, “empower each such state to discriminate against foreign airlines in favor of its own.”

Could the regulation become a protectionist measure in favor of European carriers? Not really. The measure applies equally to European and U.S. carriers and can be applied in quite a transparent manner.

The object of the regulation is measurable — carbon emissions — and objective. Discrimination against foreign airlines would be easily detected and therefore not likely to happen.

Not a border tax

In this sense, the measure differs from a border carbon tax. A border tax hits the carbon content of products imported from countries that do not price carbon. In the case of a border tax, the mechanism for pricing carbon imports differs from the one applied to domestic products.

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A border tax applies to the estimated carbon footprint of imports, while the EU ETS applies to effective emissions. This discrepancy might allow for hidden protectionism — that is, applying different burdens to domestic and foreign firms.

No discrimination

However, this is not the case for the airlines emissions regulation: Both local and foreign companies play the same game — and their burdens are determined

according to the same rules.

The true worry of the United States is that Europe is increasingly regulating its businesses. “REACH, Microsoft, aircraft emissions, what will be next?” wonder many U.S. representatives. Obviously such measures have consequences on trade.

But it would be unfair to say that they aim to protect EU industry — as long as they are applied objectively to EU and non-EU firms and in a transparent fashion. The content and quality of such regulations can be contested, but not their neutral impact on the competitiveness of domestic and foreign firms.

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Mind your own business

To be sure, pursuing multilateral options is the first best policy option, especially in global issues such as climate change. But what happens when this does not work because one important player categorically refuses to consider such measures?

Should countries abstain from taking unilateral action? Surely under those circumstances it is preferable for all parties concerned that this unilateral action applies not only to domestic firms but to all firms operating in that region, whether they are foreign or domestic.