



## ICAO Assembly Oct 2004: climate disaster coming up!

In October 2004 ICAO, the UN's International Civil Aviation Organisation, will hold its triennial Assembly. A resolution is on the table with disastrous wording for the future on environmental policy in aviation, not just at international level, but also at regional level. This paper provides an overview of the situation.

### **Background: aviation is a large contributor to global warming**

Aviation is a very important contributor to global warming. The 1999 Special Report on Aviation and the Global Atmosphere middle estimate for 1992 was 49 mW/m<sup>2</sup> or 3.5% of total radiative forcing. A recent update (EU-project TRADEOFF, AAC workshop, 2003) generated a middle estimate of 116 mW/m<sup>2</sup> for 2000. This more than double impact estimate is partly due to traffic growth, partly due to new insights into the radiative impacts of contrail-induced cirrus clouds. The contribution of the aviation sector to total radiative forcing can consequently be estimated at some 7 per cent. For comparison: the contribution of the sector to global GDP is approximately 1 per cent, and to global employment approximately 0.2 per cent. Given the fact that aviation is also the fastest-growing single source of greenhouse gas emissions (3 per cent increase in emissions per year), in a couple of decades the contribution of aviation to total radiative forcing could easily amount to 15 or 20 per cent.

In spite of this very unfavourable environmental record and gloomy outlook, there is hardly any policy in place to reduce the emissions of greenhouse gases. Emissions from international aviation fall outside the scope of the Kyoto Protocol; the Protocol mentions that these emissions should be addressed 'working through ICAO'. In terms of concrete measures, some countries apply – generally very low - fuel taxes or CO<sub>2</sub> emission charges on domestic flights, such as the US (about 1 cent per litre) and Norway. International aviation is generally exempt from paying VAT and excise duties on fuel. In 1997 the EU partly tackled another tax advantage of the sector, namely duty free shopping. As of 1 July 1997, this was abolished for intra-EU flights, but it still exists for flights from and to the EU.

### **Economic instruments and the European perspective**

One of the most important ways to reduce the climatic impact of aviation is so-called *market-based measures*. These include emissions trading and emission-related taxes or charges such as fuel taxes or so-called 'en route emission charges'.

*Taxation of kerosene* has been debated for a very long time as it would make the polluter pay and create a better level playing field between modes. Studies on the issue yield the following results:

- Contrary to what is often said, the Chicago Convention on the basis of which ICAO was founded in 1944, does not forbid the taxation of fuel.
- There is a legal problem, though, with the numerous bilateral air service agreements (ASAs) that often contain no-tax clauses.

- However, there is room to tax kerosene used for intra-EU flights. The EU's Directive on the Taxation of Energy Products allows Member States to make bilateral agreements on this.
- Besides, following a CJEC ruling in 2002, negotiations are going on for a new framework for an EU-US bilateral agreement that will supersede existing agreements between individual Member States and the US. The EU is keen on keeping the option open to introduce kerosene taxation on these flights, in line with the Directive mentioned above.
- A disadvantage of kerosene taxation is the economic distortions it causes: it provides large incentives to avoid them e.g. by switching to airports outside the charged zone or by taking untaxed fuel into a taxed area ('tankering').

Understandably, this disadvantage seriously undermines political support for this option.

We have seen that the US has a domestic kerosene tax. The question therefore arises what problem the US could have if the EU would introduce it for intra-EU flights. The US point of view is that they just tax foreign carriers and the EU could do perfectly the same. The difference is that foreign carriers are not allowed to execute US domestic flights, while there are quite some non-EU carriers that execute intra-EU flights. Taxing only EU carriers would therefore seriously distort competition and is hence not a realistic option.

*En-route emission charging*, a kind of kilometre-charging in the air, for example in the European airspace managed by EUROCONTROL, is a somewhat newer option that has been discussed for some 5 years now. An EU-sponsored study on this option was issued in 2002<sup>1</sup>, but the Commission has failed to act despite promises in the Communication on Air Transport and the Environment (1999) and the Sustainable Development Strategy (2001). This option potentially has comparable benefits compared with kerosene taxation, and some points in favour:

- Legal obstacles seem somewhat lower as the option is not explicitly mentioned in legally binding agreements;
- Economic distortions are much smaller and could be considered even negligible because the system is territory-based rather than fuel-based;
- The system can be designed in a revenue-neutral manner (dirtier-than-average aircraft pay, cleaner-than-average receive a bonus) so that the sensitive issue of 'who gets the revenues and what should be done with them' is avoided. But this option of course does not comply with the "polluter pays principle".

The only disadvantage compared with kerosene taxation is the slightly more complex administration.

Because of the advantages of this option compared with kerosene taxation, the EU is keen on keeping it on the agenda although it undertook virtually no concrete action. Very recently (July 14, 2004) it announced the ambition to broaden the EU funding sources by making it possible to use aviation charges for the EU budget. This is really just an idea that has arisen in the context of future funding of the Community's needs).

*Emissions trading*, in particular the 'open' form (linked with systems in other sectors), has always been much more popular in the aviation community and many governments than forms of charges and taxes, primarily because it is felt that emission reduction measures outside the aviation sector are much cheaper than inside it. The EU (DG ENV) is currently starting up a study to expand the EU scheme

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<sup>1</sup> Economic incentives to mitigate the global environmental impact on aviation in Europe, CE Delft et al., Delft, 2002

for fixed sources with aviation. In its White Paper on Aviation, the UK has expressed its ambition to work on the introduction of such a scheme by 2008 in its Presidency period, 2<sup>nd</sup> half 2005.

When this last study will be finished, the European Commission will dispose of all the information necessary for a political choice on one of the three options.

**Against this background, the EU is very keen to keep all the options open, without expressing yet a specific preference for one of them.**

### **Market based measures: the international (ICAO) perspective**

In the text below, we specifically go into the development of ICAO policy on market-based measures to reduce greenhouse gas emissions from aviation. This is the area where the largest dispute exists between the US and the EU.

In December 1996 ICAO adopted so-called guidance to its Contracting States on the use of taxes and charges. This guidance expresses a strong preference for charges (meant to cover specific costs) rather than taxes (which flow to general budgets of governments).

On the one hand, this guidance made it quite a bit harder for Contracting States to introduce emission-related charges, primarily as they had to prove the charges had to cover certain costs. On the other hand, this guidance still left some room for Contracting States to introduce such charges unilaterally.

Since 1996 ICAO has continued work on taxes and charges. At the 2001 Assembly in 2001, again the 1996 guidance was re-affirmed and States were urged not to introduce levies inconsistent with this guidance. Formally this is still the situation we're in at the moment.

**However, over the last months things have changed drastically.** Early June 2004 the ICAO Council, the day-to-day 33-states governing body that prepares the triennial 188-country Assembly, proposed a text on emission-related levies that essentially did not deviate much from the 2001 text, and a quite open text on emissions trading. The text was drafted by Mr Kotaite from Lebanon, president of the Council. The EU could live with Mr Kotaite's original text.

However, the US approached a couple of countries and drafted a protest letter with finally 21 (of 32) other countries, saying that the text by Kotaite did not reflect the discussions that had taken place over the last years in CAEP, ICAO's environmental committee. In order to avoid unilateral action (in concrete terms: an EU en route emission charge of emissions trading scheme) the letter proposed a couple of amendments

- It classifies the 1996 guidance on taxes and charges as '**unsufficient**'.
- It urges contracting states not to introduce emission-related levies **at all**, rather than not to introduce emission-related levies "inconsistent with current guidance". This is the basic punchline: there is danger that the door is closed for any state that would think of something like this.
- It requests that ICAO should not just develop guidelines for countries that want to introduce **emissions trading** for aviation, but also that "... the Council should ensure the guidelines for an open emissions trading system establish the **structural and legal basis** for aviation's participation in an open emissions trading system". This is a much stricter formulation indicating that **FIRST** ICAO should establish a legal basis (which will not happen in the near future) before States can do anything.

This severely restricts the EU's freedom to introduce a system as it wishes.

As said, the EU protested against this but did not get a majority in the Council (there are only 8 EU Member States represented in the Council).

Consequently, Mr Kotaite has now come forward with a Council proposal to the Assembly that gives in to all demands of the US-group.

In addition, the ECAC, a group of 41 European countries, has prepared a formal statement saying they 'cannot support the proposals for the Assembly Resolution .... so that the possibilities to implement market-base measures to reduce greenhouse gases will be restricted and, particularly, that States are urged not to impose CO2 charges until ICAO has conducted necessary legal, economic and technical studies'.

### **How serious? Very serious**

If the text passes, is it then legally really unfeasible to introduce anything like emission charges ?

Resolutions do not have direct legal power, therefore they use formulations like 'urges States to ....' et cetera. They only become legal when added as annexes to the Chicago Convention and countries have not 'notified a difference' as it is called. But the Resolution at stake will not be added to the Convention. So in theory the Resolution has more moral than legal power.

Voting at the Assembly generally goes with consensus, but in these type of conflict cases, Resolutions (like the A33-7 environmental resolution) can be voted on and accepted by majority. It is highly likely that this revised Resolution will pass with majority vote as many countries, notably developing and oil-producing countries but also some others, support the US view.

In these cases, Contracting States then have the option to make a "reservation" against the Resolution, which makes clear they do not agree with it and do not intend to live up to it.

Although making a reservation sounds quite simple it is not a step that countries easily make. ICAO is founded on consensus and reservations are seen as counterproductive to the consensus machine (which is in itself true of course). But countries are also afraid of longer-term political or trade impacts, or that the matter is taken to the WTO. Therefore, substantial political will is required to make a reservation to a Resolution.

Not making a reservation and going ahead anyway is not a good option either. That would certainly lead to great transatlantic political or trade difficulties, greater than making a reservation.

In brief: the situation is **very serious** and much political will is required to keep options open for Contracting States.

### **What would be the best outcome?**

There is no real gain in this, only damage control.

The first-best solution would be if a compromise text were adopted that left room for Europe. The European power to force a good compromise strongly depends on its

unison. If there are small signals that a couple of European states are hesitant to make a reservation the US will feel strong and push forward a compromise text very close to what is now on the table.

Second best would be, if a text would come out that does not satisfy European needs, that all European, and probably even more, Contracting States make a reservation to it.

**In brief: it is now of utmost importance that as many Contracting States as possible - at least the 41 ECAC states but preferably also other States that take sovereignty and climate change seriously - not only show they do not agree with the current draft text on market based measures, but also show they are prepared to make a reservation to any text that would restrict States more than current guidance already does.**

### **Conclusion**

This is an issue that is just as much about sovereignty as about environmental policy. While not everyone agrees on the need for certain instruments, everyone agrees that States or Regions should not be stopped by a UN body to implement policies as they see fit and that could make economic, fiscal or environmental sense now or in the future.

EU States, ECAC states, and possibly as many other ICAO Contracting States as possible should therefore add the deed to the word and make a **reservation** to any text on 'market based measures' that reduces the freedom for regions of the world to implement policies as they see fit. It is a matter for transport policy, for environmental policy, but also for fiscal policy and energy policy. UNEP and UNFCCC should also be aware this runs counter to the aims they pursue.

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