

ETS for aviation: Financial Risk or Regulatory Benefit?

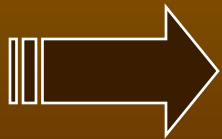


International Conference on Contemporary Issues in Air
Transportation, Air Law & Regulation
New Delhi, India

By
Martine De Serres
April 24, 2008

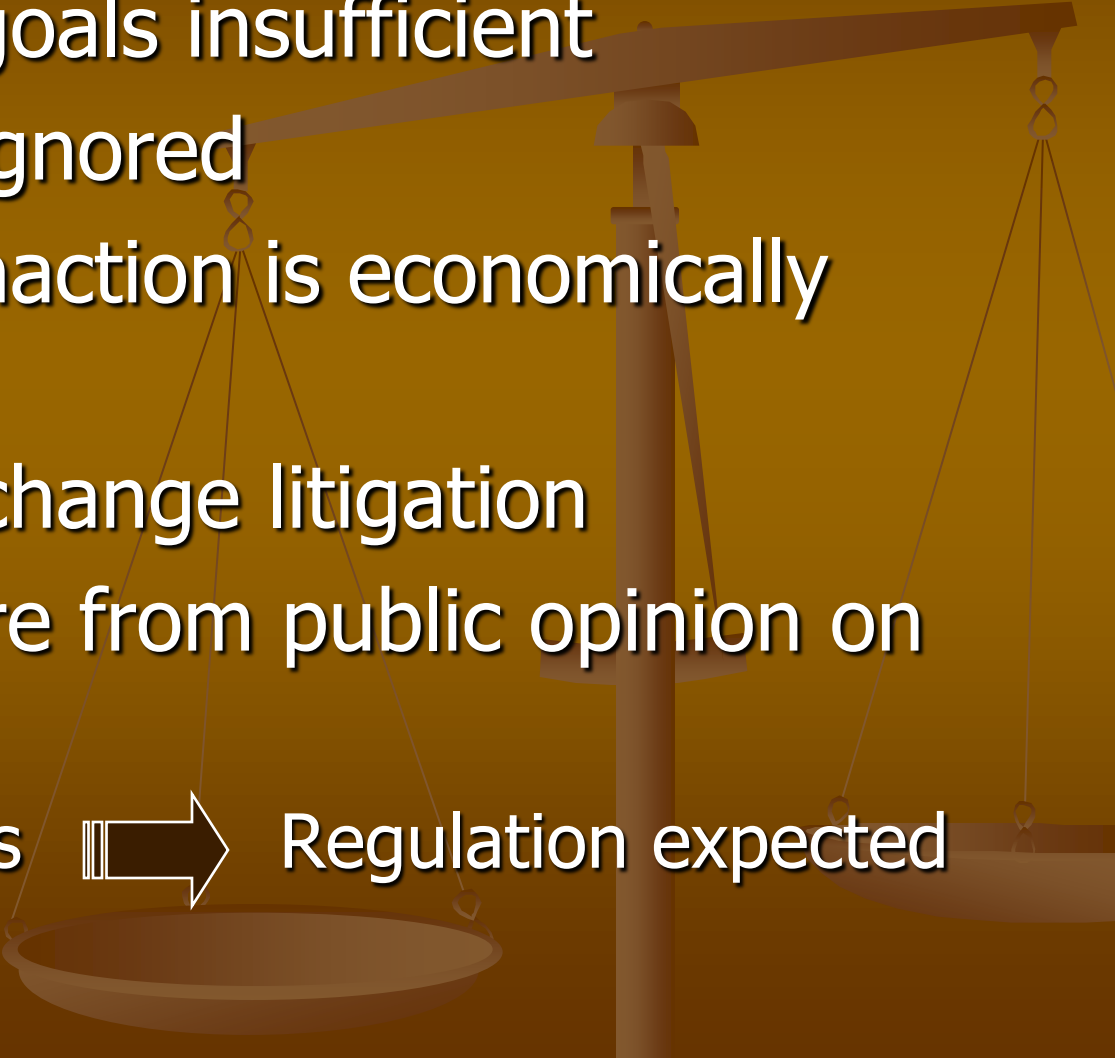
Aviation's situation

- Fastest growing contributor to climate change (3.7-6.6% annual traffic growth)
- 5% contribution by 2050
- Zero footprint by 2050 is science fiction
- Technological and managerial improvements cannot account for growth



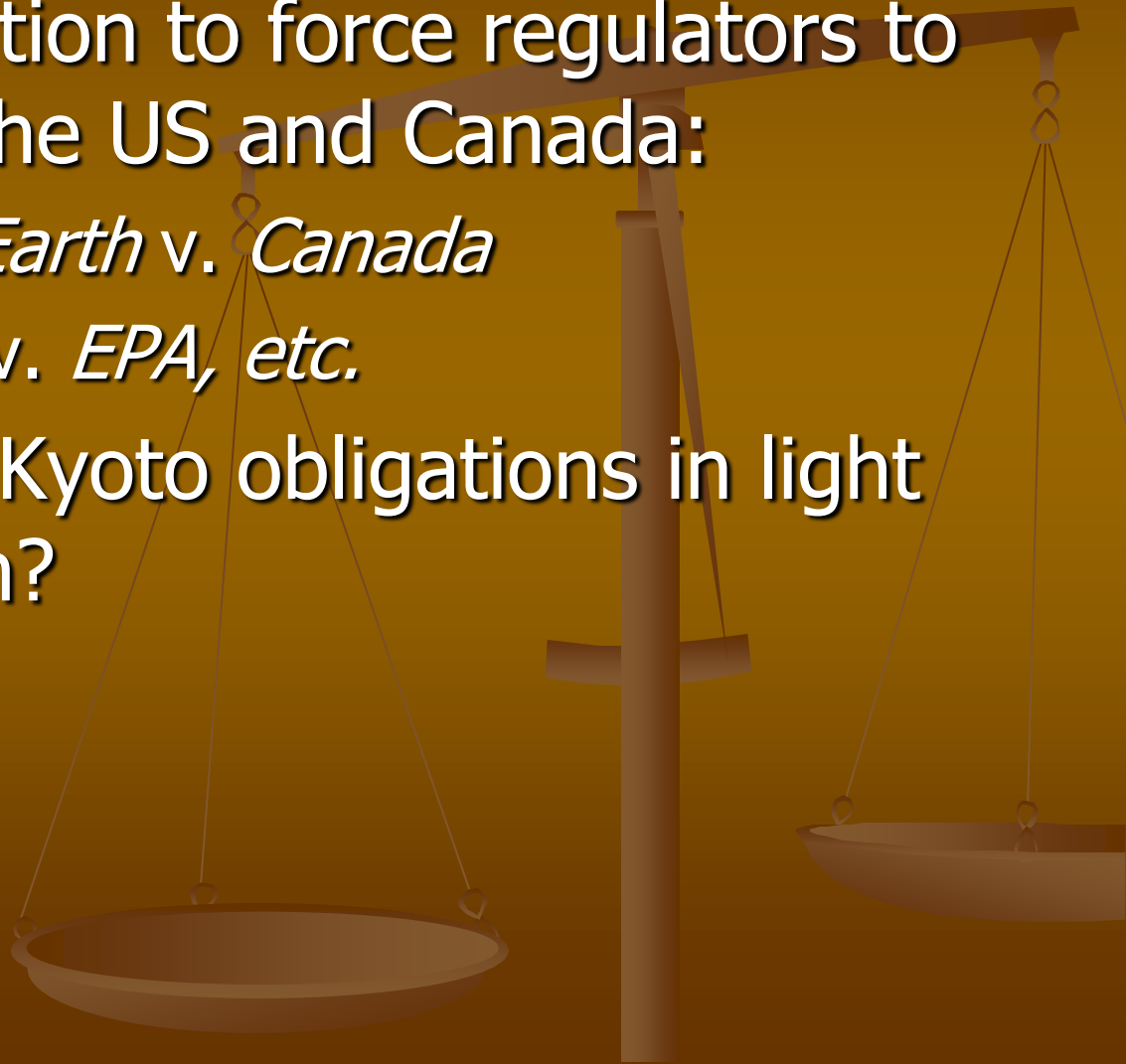
Unmanageable growth

A time to act

- Kyoto Protocol goals insufficient
 - Kyoto Protocol ignored
 - Stern Review: inaction is economically unsound
 - Rise of climate change litigation
 - Growing pressure from public opinion on
 - On industries
 - On governments
- ➡ Regulation expected
- 

Unilateralism or duty to act?

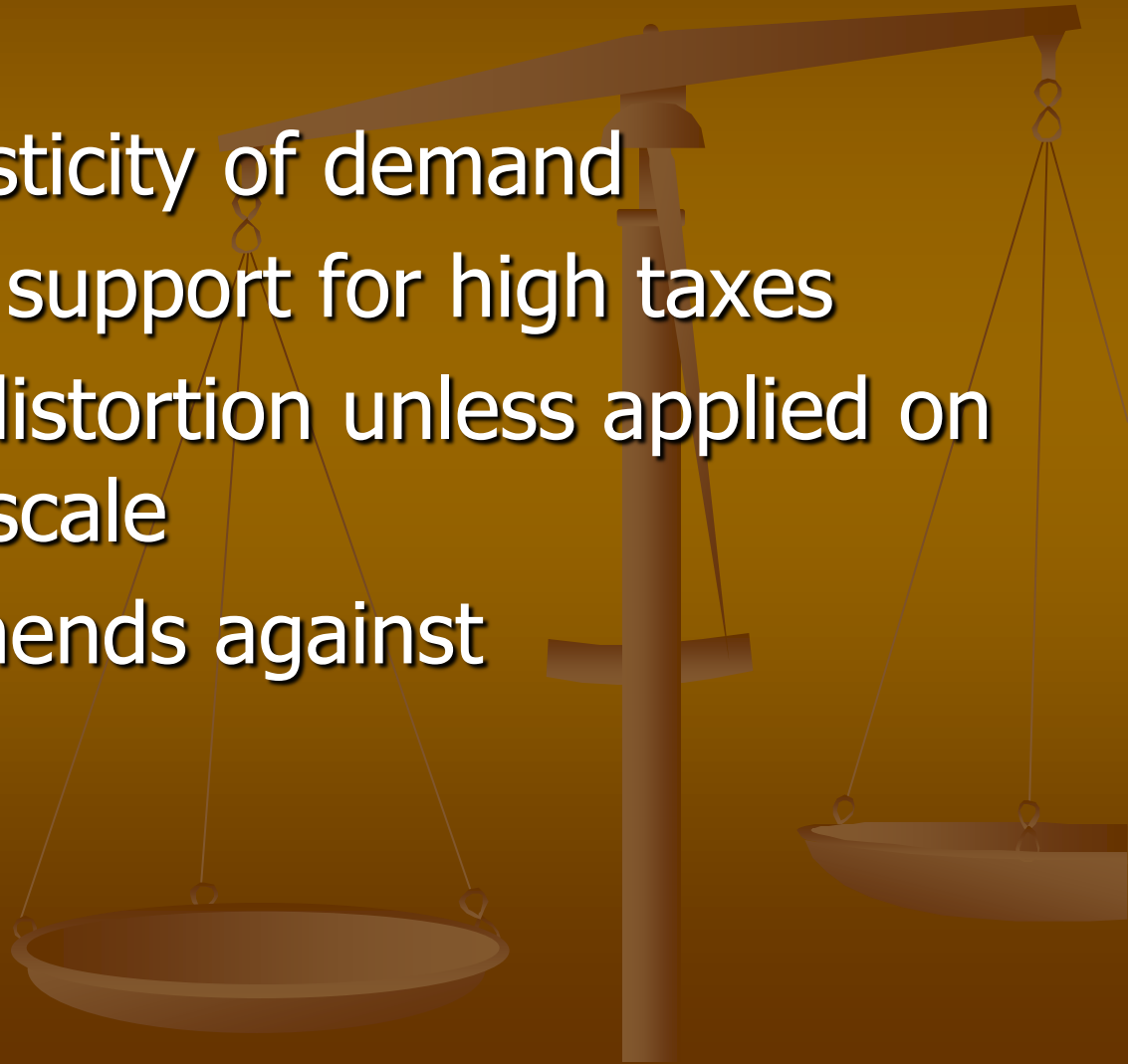
- Increasing litigation to force regulators to take action, in the US and Canada:
 - *Friends of the Earth v. Canada*
 - *Massachusetts v. EPA, etc.*
- Do States have Kyoto obligations in light of ICAO inaction?
- Duty of care?



What's the best solution?

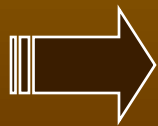
TAXES:

- Low price elasticity of demand
- Little political support for high taxes
- Competition distortion unless applied on international scale
- ICAO recommends against

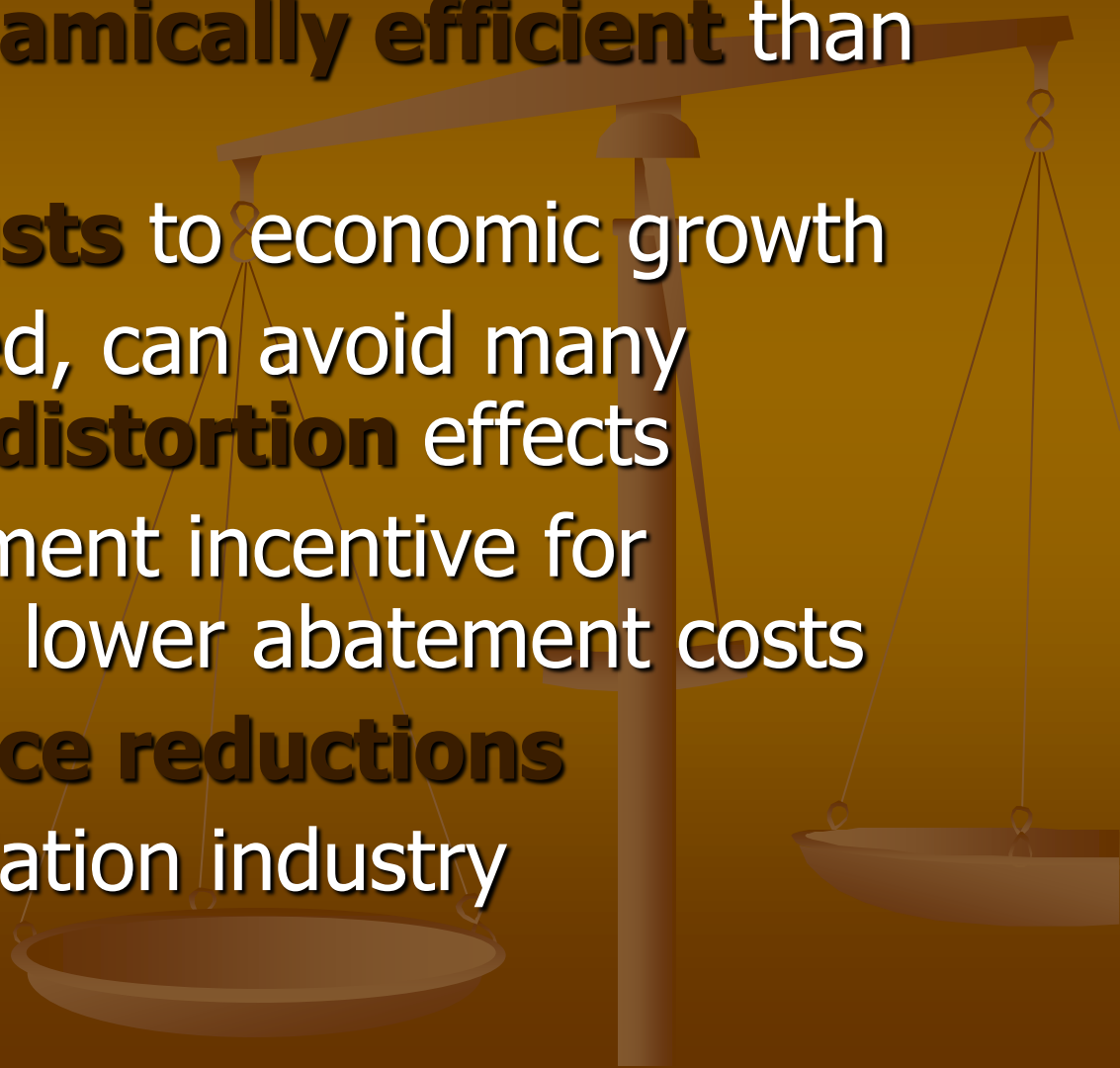


ETS: the best solution

- ETS more **dynamically efficient** than taxation
- ETS **self-adjusts** to economic growth
- If well-designed, can avoid many **competition distortion** effects
- Creates abatement incentive for industries with lower abatement costs



Finance reductions
for aviation industry

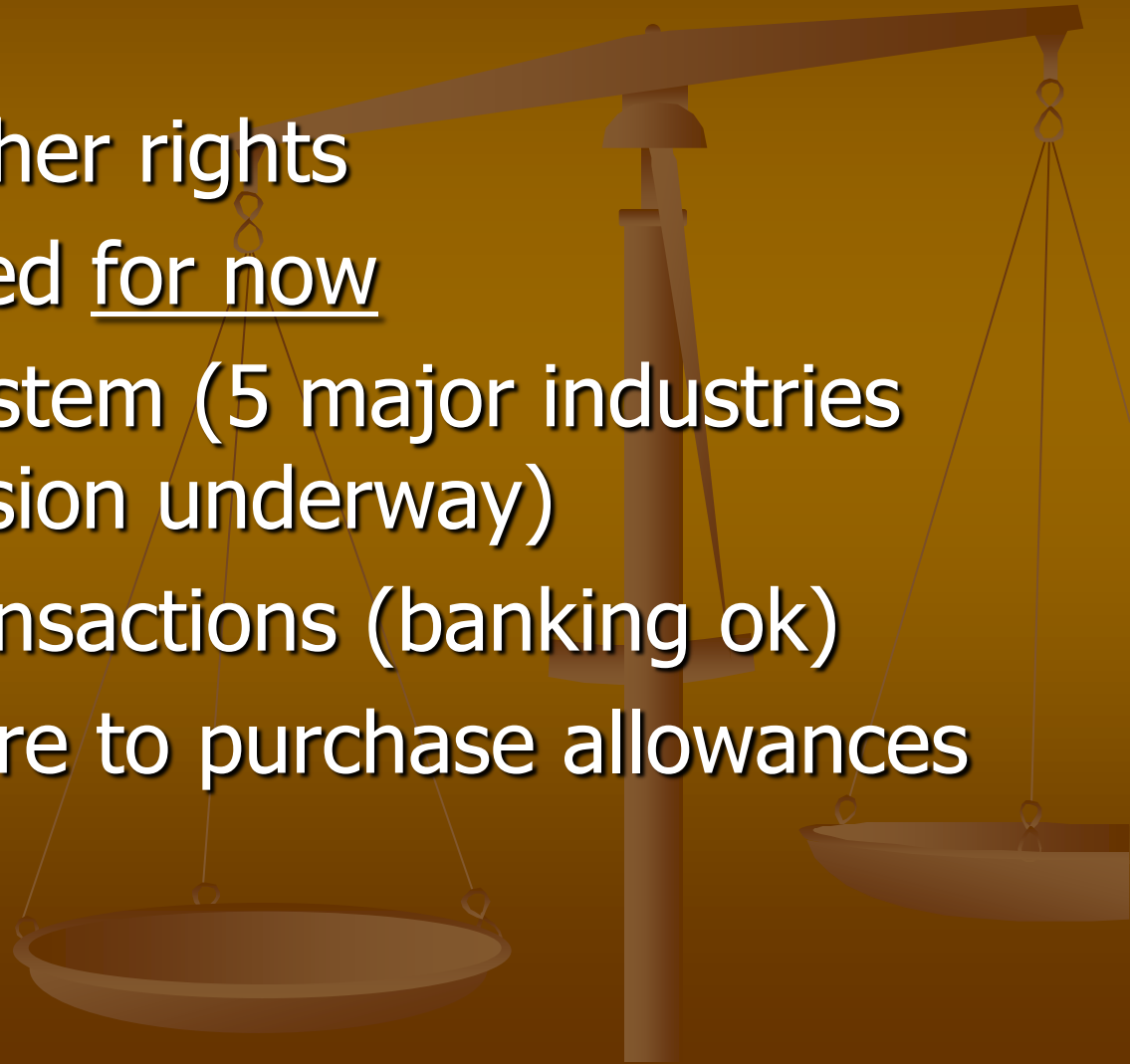


Design elements of an ETS

- **Auctioning** most credits may dampen competition distortion effects
- **Downstream** ETS that includes other GHG than CO₂ will efficiently reduce all aircraft emissions
- **Open ETS** can finance reductions in other sectors & compensate for air travel
- **Large spatial scope** and coverage will strengthen flexibility of an open ETS
- **Banking** could promote early action and protect against price fluctuations

Overview of EU ETS

- Mostly grandfather rights
- Only CO₂ covered for now
- Downstream system (5 major industries covered, expansion underway)
- Unrestricted transactions (banking ok)
- Penalty for failure to purchase allowances



Is EU ETS well-designed?

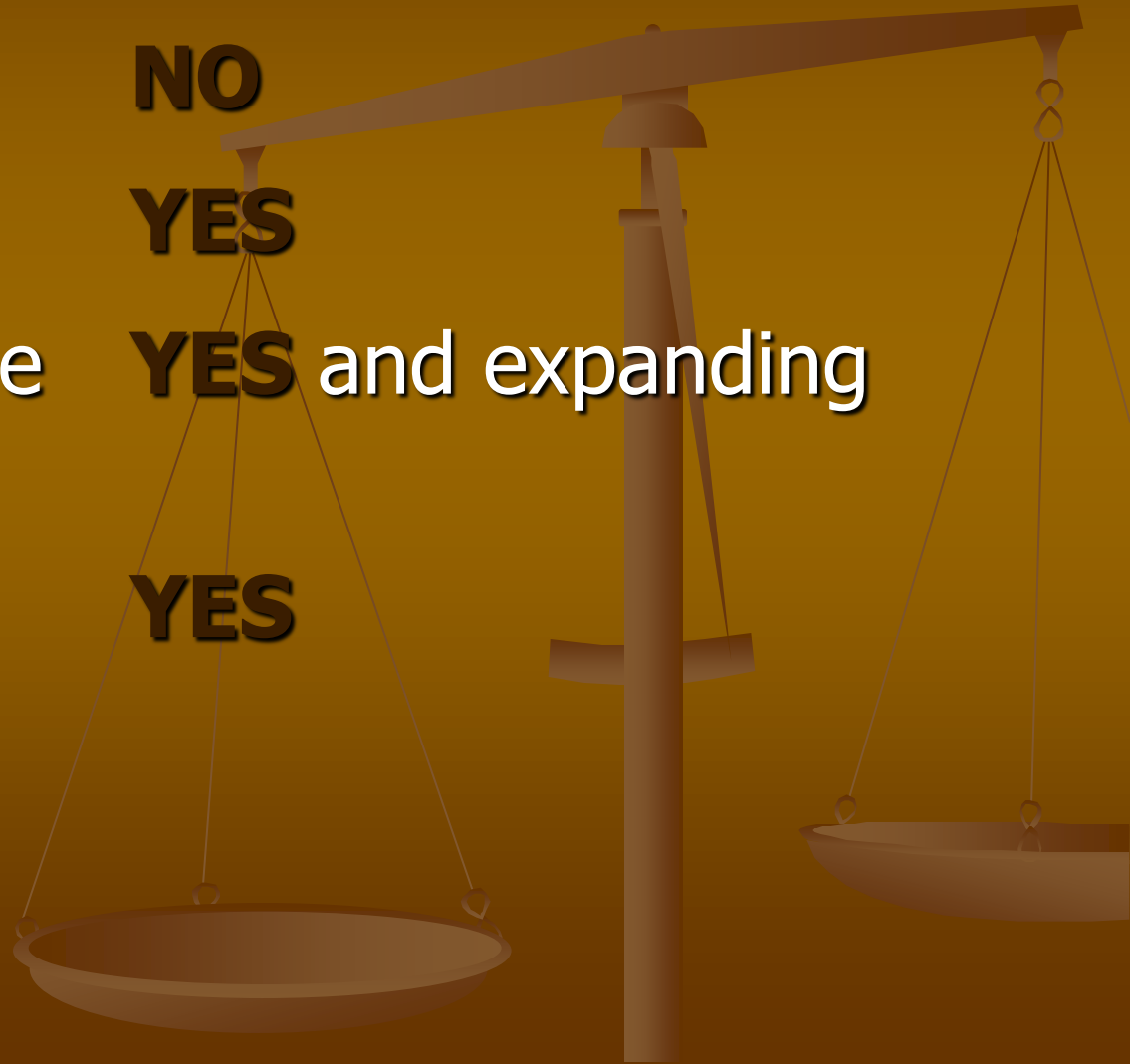
- Auctioning
- Downstreaming
- Open ETS / large scope
- Banking

NO

YES

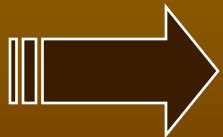
YES and expanding

YES



Shortcomings of EU ETS

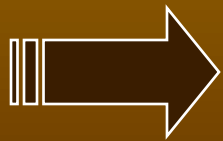
- Trading period (5 years) may be too short for adequate financial planning
- More auctioning needed
- Allowance price is too low to efficiently promote reductions; too many sellers



Need emissions buyers

EU proposal to include aviation

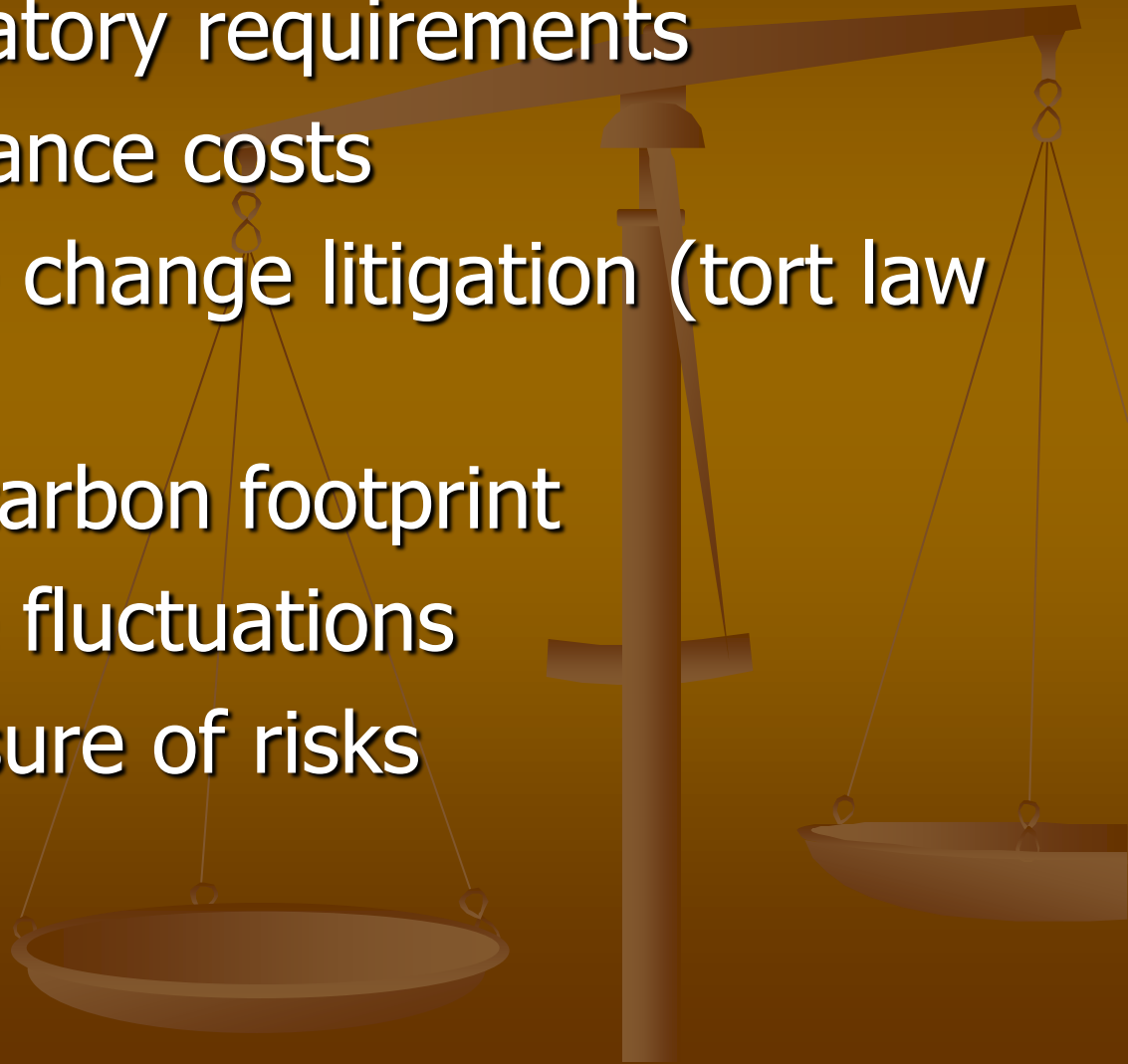
- Foreign airlines included by 2011
- Allocation based on historical emissions from 2004-2006
- No double-counting: EU will negotiate with states with equivalent requirements



**Invitation to create
international ETS**

Business risks

- Uncertain regulatory requirements
- Increased insurance costs
- Possible climate change litigation (tort law – duty of care)
- Uncertainty of carbon footprint
- ETS quota price fluctuations
- Financial disclosure of risks



Managing risks

- Support ETS to avoid taxes
- Self-assess risks
- Create climate change funds
- Self-assess footprint
- Seek ETS credit (green technologies)
- Understand carbon accounting
- Environmental risk insurance
- Bank credits

