

## The EU Aviation Scheme & International Law

The Centre for Policy Research held a discussion on **The EU Aviation Scheme & International Law** on Friday, the 5<sup>th</sup> of August 2011. The topic was introduced by Lavanya Rajamani, Professor, and chaired by Navroz Dubash, Senior Fellow, CPR. This discussion was a part of CPR's *Climate Initiative* as well as its *International Law Seminar Series*.

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### Context

As the multilateral climate negotiations flounder unilateral climate actions by states have begun to gain ground. The most controversial of these is the extension of the EU Emissions Trading Scheme (ETS) to aviation, and its application to all airlines that land in or depart from EU airports. Underlying the thicket of political considerations is a set of intriguing legal issues. These include:

- To what extent does this scheme conform to customary international law? Can the EU regulate non-EU airlines in relation to GHG emissions that occur in other states' territories/airspace and over the high seas? Is this an exercise of extra-territorial jurisdiction, and if so, should it be permissible in the service of a common environmental goal?
- To what extent is this scheme contrary to or supported by existing multilateral agreements on climate change and civil aviation (the FCCC, the Kyoto Protocol, Chicago Convention, etc)?
- To what extent can this scheme be characterized as a 'unilateral trade measure' and challenged before the WTO or other fora?

In her introduction, Lavanya Rajamani introduced Directive 2008/101/EC – its objective, coverage, scope and rationale. She outlined the operational details of the scheme, including provisions on measurement, reporting, verification and compliance, as well as for optimal interaction with third countries' equivalent measures on aviation. She also explored the legal arguments that could be made by the EU as well as by India and other countries either in support of or in opposition to the scheme. These arguments centre around interpretations of customary international law (in relation to the exercise and limits of extra-territorial jurisdiction); compatibility or lack thereof with the FCCC provisions relating to precaution and common but differentiated responsibilities and respective capabilities; compatibility or lack thereof with ICAO resolutions; and compatibility or lack thereof with WTO law.

A lively discussion ensued on these issues that explored both the technical aspects of the EU-ETS Aviation Scheme and broader questions over ethics and actions in the global political arena.

## **The EU ETS Aviation Scheme**

Examining the scheme from a technical point of view, the discussants picked up on a few key elements for elaboration. In order to follow a fair and non-discretionary allocation strategy, the total pot of allowances (provided free) is divided between airlines based on revenue per ton kilometre (RTK) over the past year and is therefore proportional to the business of the airline in that year. Baseline calculation for allocation of allowances under the scheme is based on emissions from 2004-2006. Allowances equal to the volume of actual emissions are surrendered by airlines at the end of the year, with any deficits made up for by either purchase from the market (efficient airlines, CDM credits etc.) or participating in an auction. However, it is not mandatory for airlines to participate in the auction. This system benefits efficient airlines (and it was pointed out that Indian airlines are likely to fall under this category) as they sell their extra allowances for profit. This scheme also does not disadvantage new entrants to the market as present RTK is taken into account for determining allowances.

The scheme has direct economic implications for the aviation industry. Over and above the operational cost to ETS compliance (as well as the cost of purchasing any additional credits required) a severe penalty for non-compliance will have to be borne by airlines. There is a statutory civil penalty in the event of a default of EUR 100 per tonne plus the cost of surrendering the allowances that should have been submitted for the previous year's emissions trading period. In view of the likely additional cost burden compared to their competitors outside the EU that are not subject to emissions market based measures airlines have given the scheme a frozen reception. For instance, airlines in the US have brought an action against the EU challenging the legality of the EU-ETS as it applies to the aviation sector.

Many developing countries echo the sentiments of the aviation industry on this development. India has characterized the EU scheme as a 'unilateral trade measure' and threatened a WTO challenge. China is claiming that the energy efficiency requirements it is seeking to impose for its aviation industry are 'equivalent' measures under the EU scheme.

## **Common but Differentiated Responsibilities**

Discussants highlighted that the core objection of developing countries to the scheme was fear of erosion of the principle of 'common but differentiated responsibilities and respective capabilities' enshrined in the UN Framework Convention on Climate Change (UNFCCC). Some participants questioned if through this scheme the EU was trying to redefine differentiation unilaterally, and in the process setting a precedent for others to follow. Some further argued that this scheme could be seen as permitting the EU to determine how developing countries take on mitigation actions in their aviation sector. The Aviation EU-ETS Directive

allows for the airlines of a country outside the EU to be exempted for flights arriving in the EU if their government adopts 'equivalent' measures to tackle carbon emission reductions from aviation. However, the definition and criteria for determining equivalence remain unclear, even within the European Commission. Further, even if technically the EU does not dictate criteria to countries for determining equivalence, it remains the final arbiter of the equivalence of a country's mitigation plan for aviation as it relates to the scheme.

### **Financial implications**

Discussions focused on the additional revenue the scheme will generate and the likelihood of that being used for funding climate mitigation and adaptation actions in developing countries. Two important concerns were raised in response to this possibility: First, while there is a suggestion in the EU Aviation Directives on the issue, there is no clear and mandatory provision to this effect. Notwithstanding the political will in the EU member states to use this money for climate benefits in developing countries, there is no legal mandate to do so. Some countries (such as the UK) oppose such hypothecation of funds. Thus, there is uncertainty about the use of revenues accruing from this scheme and their deployment for climate purposes. Second, a more contentious issue is around no-net incidence. In its current avatar, it appears that the scheme could use money from developing country airlines to fund climate objectives in their countries, which would mean that developing countries end up paying for their own mitigation and adaptation. This goes against the concept of no net incidence on developing countries that Non-Annex I countries have held on to in negotiations over levies on international transport.

Related to this, questions were also raised about the use of certified emission reductions (CERs) for the EU-ETS in a post-2012 context. Discussants pointed out that new European restrictions coming into force will severely limit the eligibility of CER offset credits in the EU-ETS. This will constrict the market, as well as make it difficult for developing country airlines to choose to comply with the scheme by primarily using CERs generated in their country. There are also likely to be restrictions on the use of CERs from particular projects (such as HFC<sub>23</sub> or other industrial gas projects).

In response to this concern, it was highlighted that this scheme was not discriminatory to developing countries as 90% of the scheme would be paid for by European airlines. Further, the only people in developing countries who would end up paying higher prices are the upper and middle classes making frequent international trips.

### **Concerns over unilateralism**

Underpinning this discussion was a larger concern over the use of unilateral instruments over multilateral ones in international relations. Legal experts pointed out that although the ICAO permits market-based approaches it emphasizes the

need for 'mutual agreement' in imposing and implementing these. Aviation and maritime sectors require global measures to tackle the question of mitigation. UNFCCC delegated responsibility for managing aviation emission to ICAO. ICAO passed this on to States: An ICAO resolution allowed signatories to integrate aviation into their trading schemes. This 'carve out' approach has provided a justification for the scheme. However, the ICAO resolution clearly highlighted the need for any such action to be based on mutual agreement. This qualification has clearly not been followed in this case. Without a broad-based multilateral consensus on this scheme it would be difficult for the EU to justify extending such a policy to airlines of other countries in so far as it relates to fuel used and GHG emissions in non-EU airspace. In response to this, some participants felt that this scheme could possibly create incentives for others to scale up their ambition on tackling emissions from international transport.

The issue of this scheme being an example of extra territorial jurisdiction was also explored. Some argued that extra territorial jurisdiction can be exercised by the EU based on the 'effects' doctrine, which permits the exercise of jurisdiction over the extra territorial activities of foreigners which produce economic effects within their territory.

### **Effectiveness**

A serious question was raised about the effectiveness of this scheme in making a significant contribution to reducing GHGs. The scheme may force airlines to buy new, more efficient aircrafts even as they discard fully functional old ones. This approach disregards the amount of manufacturing energy and energy locked-up in the older aircrafts while calculating net emissions. Further, penalizing short-haul as opposed to long-haul aviation would be more efficient. But the scheme is counter-intuitive in this sense.

### **Scope for challenge**

Given the many concerns that developing countries have about this scheme, should they wish to challenge its legitimacy what options stand open in front of them? While some questioned whether WTO could be an appropriate forum for dealing with this issue, others argued that this scheme could be challenged at the WTO. This tax on 'services' could easily be translated into a tax on 'goods'. This is possibly in violation of Art 2.1 of the WTO. Art 2.2 (a) states that the a country is allowed to impose taxes on imported goods, as long as there are equivalent taxes on same goods manufactured within its territory. This implies that unless the EU imposes taxes on relevant goods, this scheme could be seen as discriminatory.

There are certain exemptions for LDCs at the WTO, however, there is no such exemptions under this scheme. For instance, Ethiopian Airlines is a large fleet, from an LDC, which would be treated at par with a fleet from the US with comparable

revenue per ton kilometer. Further, aircraft manufacturing countries, like the US and Brazil, could approach the WTO presenting this as a non-tariff trade barrier.

### **Broader political context**

Discussants highlighted that while the EU's efforts to think of innovative ways to tackle the problem of climate change were appreciated, the legitimacy of this particular scheme for mitigation as well as generating climate finance was questioned. The biggest concern was the unilateral nature of this scheme. This was perceived to be unfair and unacceptable. There was general concern that this scheme could be in violation of established principles of International law. It was feared that this would set a precedent for unilateral action outside the UNFCCC and could lead to a flurry of border and carbon taxes and an unhealthy context of tit-for-tat (such as the bipartisan US Bill).

There was a concern expressed that while the primary context is concern over emissions from the aviation sector, the broader context is also relevant. First, in the context of ongoing negotiations, many developing countries might feel that their good faith efforts to take on national plans and mitigation efforts, so far in the absence of substantial financial commitment from industrialized countries, was being reciprocated not by suitable concessions but by potentially punitive unilateral measures. This narrative, which could easily take hold, would be damaging to trust building within the negotiations. Second, the geopolitical context of the financial crisis, which the developing world is (at least so far) weathering better than the EU and US, is also relevant. There was an expressed sense that it would be unwise for the EU to start a process which is seen as undermining global financial coordination at this point in time.

For many, but not all, in the meeting, the operative question was how to re-engage with constructive multilateralism toward addressing aviation emissions.

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CPR's *Climate Initiative* seeks to generate research and analysis on the global climate negotiations, and on the links between the global climate regime and domestic laws, policies and institutions in India. It also seeks to create a platform from which scholars and activists can engage in policy and academic debate on climate change.

For more details on our work, please visit:  
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