

Context

A new study shows that the aviation industry will receive substantial additional windfall profits from the proposed ‘stopping of the clock’ for flights to and from Europe under the EU Emissions Trading System (ETS). Airlines should not retain these windfall profits – that would be unjust, self-serving and a betrayal of passengers’ contributions to fight climate change - but give them to the UN’s Green Climate Fund established to assist developing countries tackle the impacts of climate change.

The inclusion of aviation in the EU ETS

Under the EU ETS all airlines operating in Europe must submit ‘allowances’ for every ton of carbon emitted, as with any other sector of the ETS. Allowances were created for the aviation sector equivalent to the sectoral cap of 3% below the average annual emissions between 2004-6. Of these allowances, 15% will be auctioned, and the remainder¹ were distributed freely to carriers proportional to their reported share of activity in 2010. Airlines can obtain additional allowances from auctioning and carbon markets to meet any shortfall between their actual reported emissions and their initial free distribution of allowances.

How do windfall profits occur?

Windfall profits normally occur in emissions trading when allowances are handed out for free to operators. Company “bottom lines” are automatically enhanced by receiving these allowances for free because the allowances could be sold immediately on carbon markets and thus have a real value - experience nevertheless shows that, despite receiving these allowances for free, companies charge their customers for the full value of these allowances to enhance their profitability. The ability to pass on these costs and generate windfall profits is especially evident in competitive industries of which aviation is no exception.

Windfall profits under the ETS arising from the free allocation of allowances

Thus even though the largest chunk of allowances were handed out to the carriers for free, the experience² and economic theory detailed above tells us that airlines will have passed through the costs of the freely obtained ETS allowances in most circumstances thus generating windfall profits at the expense of air passengers.³ IATA actually admitted as much in a paper which appeared briefly on their website in 2007 before being withdrawn – you can nevertheless still read it on Transport & Environment’s website.⁴ Thus, even had the clock not been stopped for flights to and from Europe, airlines are likely to have made windfall profits from the ETS. The table below (Section A) estimates the windfall airlines are expected to realise due to the opportunity costs arising from the free allocation i.e. regardless of the one year derogation.

¹ Minus 3% set aside for new entrants to the market

² See for example a study by MIT: <http://goo.gl/IBuXk> or a review of the available literature: <http://goo.gl/0mZvT>

³ See for example a study by CE Delft showing the pass through in different ETS sectors, available at: <http://goo.gl/uWU9l>

⁴ http://www.transportenvironment.org/sites/te/files/iata_financialimpact_07.pdf

Windfall profits due to the 'stop the clock' proposal

The Commission's proposal to derogate from the ETS for flights to and from Europe for one year is likely to result in "once off" exceptional windfall profits. This is because airlines will almost certainly have raised revenues on intercontinental flights to cover the purchase costs on carbon markets of the permits needed to cover emissions not accounted for by the free allocation. These purchase costs will now not arise in 2012 as no permits need to be surrendered leading to an exceptional "stopping the clock windfall profit" in 2012 as shown in Section B of the table below. Section C shows the total estimated windfall profits arising from the opportunity costs of the free allocations and the stop the clock decision.

	Section A: Estimated ETS Windfall (million €)		Section B: Estimated Stopping the Clock Windfall (million €)		Section C: Total Estimated Windfall (million €)	
	50%	100%	50%	100%	50%	100%
Cost passed through						
All airlines	436	872	243	486	679	1,358
EU and EEA-EFTA airlines with intercontinental operations	243.4	486.8	135.8	271.6	379.2	758.4
All US airlines	56.3	112.6	31.4	62.8	87.7	175.4
All Chinese airlines	15.6	31.2	8.7	17.4	24.3	48.6
All UAE airlines	10.6	21.2	5.9	11.8	16.5	33

What should airlines do with these profits?

Airlines raised revenues from their passengers to meet their financial commitments under an EU scheme to reduce the climate impact of aviation. This initiative, as far as it affects intercontinental flights, has now been put on hold for a year by the EU in order to give time for ICAO to agree on a global solution. Airlines should not retain these windfall profits but contribute them to the UN's Green Climate Fund, established to assist developing countries tackle the impacts of climate change. Nicholas Calio, CEO of Airlines for America (A4A), the lobby group that spent USD \$4.3 million pushing the US to pass the EU ETS Prohibition Act, has already protested that the ETS revenues should be used for such purposes:

*"The purported reason for this illegal tax is to benefit the environment. But none of the funds collected by the EU have to be used for environmental purposes."*⁵

Leaving aside the three inaccuracies in his statement (the ETS is not in fact illegal, the ETS is not a tax and Germany has committed 100% of aviation allowance payments to environmental purposes), it suggests an airline industry concern to use funds from the ETS for environmental purposes. Now is the perfect opportunity for European, American and other carriers to show they are serious about the climate change impacts of their industry by contributing these windfall profits to environmental purposes. Failure to do so would represent further evidence of their cynical disregard for aviation's impacts on the climate.

⁵ <http://www.politico.com/news/stories/1112/83284.html>