Association of European Airlines

20 September 2012

AEA response to the Consultation on review of the auction time profile for the EU Emissions Trading System

Introduction

The European Commission published on 25 July 2012 a proposal to modify the time profile for auctions of allowances during phase 3 of the European Union Emissions Trading Scheme (EU ETS).

The Commission proposes to reduce the volume of auctioning in the first three years of phase 3 and bringing them back later in phase 3.

AEA has strong concerns against the Commission's initiative which are detailed below.

Consequences for climate change policy and objectives

The inclusion of international aviation in EU ETS has triggered strong objections and threats of counter-measures from non-European governments and stakeholders. One of the main arguments made by non-European stakeholders and governments against EU ETS is that the scheme is merely intended to generate revenues for Member States and is equivalent to a tax, which would question its legality under international law. In its decision of December 2011, the Court of Justice of the European Union defended the view that the EU ETS could not be compared to a tax, notably because there is no "rate defined in advance" (Case C-366/10, Judgment of 21 December 2011, para 143).

A change in the auction profile would without any doubt be seen by non-European governments as a manipulation of carbon prices, contradicting the Court of Justice's arguments and weakening Europe's affirmation that EU ETS is not a tax aimed at generating revenues. The opposition against EU ETS will therefore only be further invigorated by an intervention in the carbon market by the European Commission, thereby undermining the chances of finding a rapid diplomatic settlement to the international dispute triggered by EU ETS.

In addition, while many efforts are being dedicated to facilitate an agreement on a global market-based measure for aviation's emissions in the International Civil Aviation Organisation (ICAO), the Commission's proposal will make it more difficult to 'sell' to sceptical governments the notion of market-based mechanisms when, clearly, market forces are being subject to artificial interference.

The perception that the Commission is interfering with market dynamics is reinforced by the fact that it previously decided the early auctioning of phase 3 allowances to accommodate the needs of the electricity and power sector and avoid an increase in the price of allowances. Ironically, it is the same sector that now calls on the Commission to delay the auctioning of phase 3 allowances to artificially inflate the price of allowances.

Environmental impact

Figures 7, 8 and 9 of the Commission's working document indicate that changing the auction profile will have no impact on total emissions.

Furthermore, considering that the surplus of allowances is the main problem which the proposal seeks to address, the effectiveness of the proposal is null. Indeed, figures 7, 8, and 9 of the Commission's working document show that at the end of phase 3 the surplus will be the same, whether or not a change in the auction profile is implemented.

Economic impact

The Commission's working document rightly underlines on page 18 that 'a carbon price drop of €1 means a loss of total auction revenue for the entire phase 3 of around €9 billion'. While the proposal will allow governments to increase their revenues significantly, the aggregated impact on European companies will logically be the opposite.

For the aviation sector, the statement on page 10 that only 'some' aircraft operators would have a deficit of allowances is misleading. Indeed, AEA estimates that over the third trading period aircraft operators will have to acquire approximately 780,000,000 allowances from other sectors. A €1 increase in the average price would therefore raise the cost of EU ETS by an additional €0.78 billion which, to put things in perspective, is more than the average annual net profit of European airlines (€0.75 bn between 2007 and 2010).

In contradiction with other statements, in the Memo dated 25 July 2012, the Commission explains that the back-loading is not aimed at increasing the price of carbon allowances, even though it admits that 'it is not possible to determine with certainty the absolute impact of back-loading on carbon prices over time'. The Commission affirms that while the price will increase in the short term, it is expected to decrease when the volumes of allowances are increased again.

Such a statement is also misleading since, as the Commission is well aware, the requirements of phase 4 are likely to be made more stringent following the review of the Directive in the coming years. With the perspective of a more stringent phase 4, demand for carbon allowances after 2014 will increase along with carbon prices. As a consequence, when the back-loaded allowances will be put back on the market, the price of carbon will not be lower, but on the contrary higher. As a result, back-loading allowances now allows to increase the price of carbon in the short term, while buying time to propose another regulatory proposal to avoid any reduction in the price thereafter. Governments are thereby able to maximise the revenues from the auctioning by putting allowances on the market when demand is the highest.

Need for a better impact assessment of the proposal

In its Memo of 25 July 2012, the Commission states that the option to change the auction time profile would only be used in 'exceptional circumstances, such as the present situation". The Commission seems to consider that the present situation is exceptional because supply outstrips demand not only due to lower than expected emissions but also because of regulatory aspects specific to the transition into phase 3.

The effects of these 'regulatory aspects specific to the transition into phase 3' should have been foreseen by the Commission as they originate from the Commission itself. This lack of foresight and understanding of the possible impacts of EU policies stresses the need for better impact assessments in the European decision-making process, including in relation to the current proposal.

Legal certainty

The proposal to change the auction profile is accompanied by a proposal to clarify Article 10(4) of Directive 2003/87/EC. In the Memo dated 25 July 2012, the Commission explains that the amendment of Article 10(4) is required to 'provide a high degree of legal certainty after such a change [in the profile of auctions]'.

We regret that the Commission only seeks to provide a high degree of legal certainty after the change, and not before. We also note that the proposed amendment to Directive 2003/87/EC stands in contrast to previous statements by the Commission that no modification to it will be countenanced.

Furthermore, we are concerned that the amendment of Directive 2003/87/EC may generate more legal uncertainty than certainty by giving the Commission a blank check to adapt the auctioning timetable whenever it deems it appropriate and modify the rules of the European carbon market at its own discretion. Indeed, the expressions 'where appropriate' and 'orderly functioning of the market' could hardly be any vaguer.

Conclusion

In light of the above, AEA cannot support the Commission's proposal to change the auctioning profile. In particular, the Commission fails to provide convincing evidence of a significant impact on emission reductions during the third trading period, which might have excused the negative impacts on the European economy.

But beyond the absence of notable overall positive impacts, AEA's main concern about the proposal is the damaging signal it sends to Europe's international partners. AEA fears that intervention in the carbon market will fuel the opposition of non-European governments against EU ETS and undermine the chances of reaching a global agreement on aviation's emissions at ICAO in 2013.