Aviation Carbon ETS LON February 2012

The way forward: prospects for securing a global agreement to addressing aviation's climate change impact

Closing remarks by Mark Watson, Head of Environmental Affairs, CX

I have what is usually the unenviable task moving towards the close of this event. But on this occasion I'm pleased to be one of the last on stage because after everything that's been said about what's happening right now, it's time to inject some more positive thoughts about the way forward as we conclude our discussions.

I hope that you've found the past couple of days useful, informative and insightful. We've heard from airlines about the challenges of ETS compliance and implementation, from Regulators on how the scheme will work going forward and from the finance experts on the issues around carbon trading. Carbon is already becoming a game changer for our industry and it's vital that we understand the issues to succeed. The fact that over 300 of us are here in London is testament to that.

First then to the EU ETS. One can see that as climate change continues to pose a significant threat to the future of our planet there is a need for an urgent action. We can also identify with the need for action to regulate emissions in our industry. There has, in addition, been a history of compromise at an international level prior to the EU ETS.

But the reality is that the EU ETS is as much an outcome of political motivation as it is a desire for urgent climate action on behalf of Europe. The fact that the Directive can offer no guarantees to ensure that EU Member States will hypothecate revenues from the scheme into climate adaptation or mitigation is evidence of that. Today as we discuss the ETS here in London, officials in Beijing, Washington, Moscow and New Delhi are now actively considering what their next steps will be. The outcome of these deliberations is uncertain but in recent weeks we have already seen new regulations prohibiting some countries' airlines from participating in the scheme. This puts airlines in an impossible position - they are then forced to choose between breaking the law in either their own country, or in Europe. And in the background, threats of a trade war still loom.

How did it come to this? The answer is simply that it is a result of one region taking unilateral action to attempt to regulate an industry that is better regulated on a global basis. It is also a result of an ill-conceived policy which may have been effective for fixed emitters, being ruthlessly applied to a very different, mobile and very global industry.

We have heard from airlines including BA and Qantas that the EU ETS will lead to significant competitive distortion. And Cathay Pacific agrees, as it penalises non-stop long haul flights, which are more fuel efficient than those with intermediate stops.

We have already seen that an attempt to impose a regional approach to emissions regulation in aviation in one area of the world has led to the development of a patchwork of other regional schemes where national governments intend to charge airlines for emitting CO_2 in their jurisdictions. The problem is that they end up charging airlines more than once for the same CO_2 emissions. We've heard about other schemes, such as Australia, and it seems that as more governments try to find solutions to the need to regulate air transport emissions, the net result is further cost, complexity and distortion.

Thankfully, a handful of governments including the Netherlands and Ireland have taken the sensible decision to repeal or withdraw plans to implement carbon taxation or other measures in order to preserve the need for fair and open competition between airlines, perhaps borne of a recognition that, in a globalised world people want and need to fly, and a more deeper argument that aviation does indeed play a vital role in overall economic and social development and should be incentivised rather than penalised.

But the more that regional approaches proliferate, so the regulatory framework becomes ever more fragmented and complex. Ultimately, it is not just the airlines that are penalized – so too are airline passengers – as they face more complexity, bureaucracy and cost. Market distortions are highly likely as some carriers take steps to pass the costs onto passengers in response to the additional cost burden caused by emerging regional schemes.

I could go on. But now that we've had the chance to hear just what's happening in Europe, to understand what airlines are doing and how policy makers in Brussels expect things to play out, where does it leave us as industry?

We did after all, make a commitment back in 2009 to move towards Carbon Neutral Growth from 2020 and reduce our net CO_2 emissions by 50 percent by 2050.   More importantly, we also made a strong commitment as a sector to call on governments to work towards a global sectoral agreement on aviation emissions. Since then we've been part of and made representations to the UNFCCC climate talks at COP15, 16 and 17. We have also engaged with our own UN body, the International Civil Aviation Organisation (ICAO) and urged policy makers to move the agenda forward in a positive way.

There are now some very pertinent questions that need to be addressed - where are we going as aviation, given the emergence of regional schemes such as the EU ETS and the Australian carbon scheme?

Furthermore, what we are we doing ourselves to be proactive and be "at the table", and not "on the menu" as it were, or are we now simply at the whim of policy makers who wish to see our growth curtailed and our sector brought into line in accordance with somewhat misguided beliefs and, on occasion, questionable data about the true nature of our impacts?

How far and what is ICAO doing towards achieving the goal of a global agreement?

How significant are this year's UNFCCC discussions in Rio?

And, most important of all - how likely is it that we will get a global deal on aviation emissions that we can live with?

Now, I'm well aware of the dangers of making predictions and forecasts. It would be naive of me to believe that everything's OK at this point. Clearly the concerns and acrimony caused by the imposition of the EU ETS have, at least in part, had the unfortunate result that much of our focus has shifted towards dealing with the compliance and political issues associated with that scheme.

There is clearly still much to do if a global scheme is to be realised. But, I do believe that with effort and political will, it is achievable and that we can move beyond principles into action. Moreover, if we are to avoid an even more complex and costly global regulatory environment, it must be achieved.

We have been saying for a number of years that the issue of international aviation and environmental protection needs a global solution. The industry, through bodies such as IATA and regional associations, has made it abundantly clear that a global scheme is the right, and indeed the only way forward here. However, global agreements are not easy things to achieve and in the absence of a global deal, so governments have acted independently and regional schemes have started to emerge.

And while the rest of the world (particularly India, Russia, China and the US) cries foul to the ETS in Europe and now considers retaliatory actions against it, the EU is sticking firmly to its line that aviation emissions needed to be controlled, action had to be taken somewhere to get the ball rolling and that the train has now left the station. That train, I would argue, is in danger of becoming a runaway.

The position adopted by the EU (that little has been done by the industry to address climate change) is to say the least disingenuous to those investing significant time and resources across the different sectors that comprise aviation which are together dedicated to reducing our climate change impacts, from new technologies to biofuels.

There also seems to be little recognition of the industry assuming responsibility for its growth impacts through agreeing ambitious global Sectoral targets including CNG from 2020 and a 50 per cent net reduction in CO2 emissions.

Cathay Pacific supports the concept of emissions trading as ETSs can, if properly designed, have a positive impact in terms of reducing emissions, driving environmental improvements and incentivising industries. But not where such schemes are imposed on a regional basis or extra-territorially. We fully endorse the need for a global agreement and as a business have been calling for our emissions to be regulated in a global agreement under ICAO since 2008.

Let us be clear. A global agreement based on the principles and mechanisms of the current EU ETS (the EU ETS writ large if you will) is far from desirable. Indeed we don't need to be coerced by the EU to take action.

Given the stubbornly high price of fuel, which can account for around 40 per cent of an airline's operating costs in a given year, and the continued volatility of the trading environment, we can ill-afford to end up with a global scheme which leads to yet more competitive distortion, complexity, and higher costs for aircraft operators and passengers.

What we need therefore, as we said back in 2009 and keep saying, is a global scheme that is based on a number of already agreed core principles including cost effectiveness, equity, transparency, non-distortion, environmental effectiveness, and that can accommodate the differing needs of states.

The right way for this to be achieved is via ICAO, which has the mandate to undertake such work. It won't be easy and, to paraphrase recent comments made by Secretary General Raymond Benjamin, ICAO has its work cut out when it comes to climate. There are clear differences among Member States but it is still possible to achieve a global solution with the ICAO framework. And the fact that ICAO has a framework in place makes it possible.

The basis for arriving at a solution is the Resolution on environmental protection adopted by the 37th ICAO Assembly. Although it contains a number of reservations, it nevertheless made ICAO the first UN Agency to lead a sector in the establishment of a globally harmonised agreement for addressing its CO_2 emissions.

The Resolution led to the voluntary submission to ICAO by June 2012 of national action plans. These action plans will allow States to identify how they can reduce CO_2 emissions from international aviation and the assistance needed. This will help ICAO to monitor progress in achieving global aspirational goals and to address specific needs of States.

More recently, ICAO has been undertaking work to assess the possible Market Based Measures that could form the basis of a global scheme, and quantifying the potential emissions reductions and/or market distortions which may result under each MBM. These include:

- Global Departure Levy (setting fees for all departing passengers and for cargo);
— Global Carbon Levy (charging on fuel consumption, similar to a global fuel tax);
— Global Offsetting System (offsetting aviation emissions by reducing emissions in other sectors);
— Global Carbon Levy and Offsetting Combined (carbon levy revenues to be used to purchase offsets); and
— Global Emissions Trading System (an emissions trading system covering all international aviation carriers).

This is still very much work in progress and ICAO will be undertaking more detailed evaluation of the options by June this year in order to submit these to the Council in 2013.

IATA CCTF

In parallel, the industry is also making progress with its work designed to contribute to the ICAO market based measures road map. IATA's Climate Change Task Force, of which CX is a member, was established last year to provide recommendations to IATAs Board of Governors regarding the implementation of the industry's Carbon Neutral Growth 2020 strategy, including options and scenarios for market based measures.

We've already undertaken a very detailed analysis of the industry, overall emissions and the trajectory between now and 2020, and beyond. As in ICAO, there are a range of mechanisms that could be employed with regard to how we can best achieve this. We are also cognisant that there is no easy way to move us into a new era of Carbon Neutral Growth.

Ultimately we acknowledge that we must take action if we are to meet our commitment to tackling climate change as an industry, something to which of all of us within IATA remain firmly committed.

In any consideration of how to develop a global scheme for aviation emissions, one of the biggest challenges remains the issue of how to address the UN principle of Common But Differentiated Responsibilities (CBDR). In short, how to accommodate the differing needs of states, in particular, developing countries. For too long CBDR has remained one of the most prevalent issues in global climate negotiations as countries struggle to agree on whom should shoulder most of the burden of climate change. The complexity of the issue cannot be underestimated and for a global deal to be struck, there must be a breakthrough in the climate deadlock between Annex I and Non Annex I states which has been a feature of so many UN climate negotiations in the past.

The industry has been aware of this for several years now. The Aviation Global Deal Group, of which Cathay Pacific is a founding member, has been in existence since 2008 and proposed a mechanism for a global Sectoral scheme, based on the notion of a global ETS.

I don't wish to go back over old ground, as AGD's work has been well covered and has been presented in public, and to ICAO back in 2010, but it should be noted that AGD did envisage a scheme that could, if the political will existed, address both CBDR and preserve the terms of the Chicago Convention.

It suggested that this balancing act could be achieved by calling for equal treatment of airlines in a system in which revenue disbursement would favour less developed countries, as well as incentivising aviation/environment R&D, and the acceleration of sustainable biofuels. Clearly things have moved on since 2010, but solutions and possible mechanisms for how a global solution could be realised remain more valid than ever.

The Green Climate Fund

One of the milestones reached at COP16 in Cancun relates to long-term financing, establishing a Green Climate Fund with a goal of mobilising 100 billion USD annually by 2020. It was agreed that such financing would come from a variety of sources including the potential generation of revenue through the application of market-based measures to international aviation.

A new Fund raises a number of key issues, not only in terms of how this relates to existing work in ICAO, but the real danger that aviation (and shipping) are being unfairly targeted as possible contributors to the scheme. If that happens then aviation could find itself paying several times over for its emissions thanks to existing policy instruments such as regional ETSs and charges such as the UK APD, on top of a new Green Climate Fund. In our view, this is far from fair, equitable or indeed desirable.

A levy of this nature would not make a meaningful contribution to reducing aviation's carbon emissions, would erode the possibility to invest in improvements within the industry, and would likely be layered onto existing economic instruments further increasing the already significant burdens faced by the industry.

The international aviation sector should not be singled out as a source of revenues for all other sectors. This is likely to result in a shortage of resources to facilitate mitigation activities by the sector itself.

Furthermore, such action could hinder progress of the activities requested by the ICAO Assembly, given that it adopted the principle of proportionality. The Assembly also strongly recommended that any revenues generated from such measures should be applied to mitigating the impacts of aviation emissions.

In closing I would say that we've covered a lot of ground over the past 2 days. There are still many questions that remain unanswered and, to quote Tony Tyler of IATA, when it comes to the EU ETS and the reaction of individual states and regions outside of the EU, "only time will tell".

Although there are very legitimate concerns regarding the EU ETS, we must not lose sight of the bigger picture. The need for a workable global solution remains more pressing than ever.

The institutional framework that's available to make this happen may not be ideal but nonetheless it does exist. It is not impossible to get to an agreement, with a shift in political will and some creative thinking. We should all do whatever it takes to support industry and member states of ICAO to ensure that we do achieve a global agreement.

The EU ETS has already given us a taste of what we may get if we fail. Climate change requires urgent action at a global scale. Given this, the only remaining question we need to ask ourselves is, can we afford to fail? And I think we all know the answer.

Thank you.