

REVIEW OF THE EU ENERGY TAXATION DIRECTIVE

Introduction

Air transport is a major contributor to the socioeconomic development of European nations. A coherent regulatory and fiscal framework at EU level should support the industry's energy transition away from fossil fuels. In the context of the European Green Deal, the European Commission is seeking to ensure greater consistency between its climate and energy policies. This includes a review of the 2003 Energy Taxation Directive to align it with more recent legislation, such as the Renewable Energy Directive and the EU's Emissions Trading Scheme (ETS).

Green Deal policy objectives will have a major impact on transport. The inclusion of aviation in the EU ETS and CORSIA were significant developments. However, throughout its ecosystem, the air transport industry is severely impacted by the COVID-19 crisis. Since the beginning of the outbreak, our industry has faced massive booking cancellations, in addition to a huge decrease in operations due to uncoordinated travel restrictions worldwide that often lack solid risk assessment. The potential impact of a collapse of the air transport industry on the overall EU economy is tremendous for trade, tourism, investments.

A4E's core objective is that aviation can grow sustainably while continuing to benefit the social and economic development of countries across Europe in the coming decades. This requires a coherent policy framework that promotes sustainability while supporting competitiveness. **Climate policy regulation in the form of sector-specific taxes, levies or bans are ecologically and economically counterproductive. They reduce the aviation industry's capacity to invest and innovate whilst potentially shifting CO₂ emissions to other regions.** Carbon pricing is already applied to aviation through the EU Emissions Trading System (ETS), and globally through CORSIA. Moreover, many airports in Europe apply differentiating fees for more polluting aircraft.

About: Launched in 2016, Airlines for Europe (A4E) is Europe's largest airline association, based in Brussels. The organisation advocates on behalf of its members to help shape EU aviation policy to the benefit of consumers, ensuring a continued safe and competitive air transport market. With more than 720 million passengers carried each year, A4E members account for more than 70 per cent of the continent's journeys, operating more than 3,000 aircraft and generating more than EUR 130 billion in annual turnover. Members with air cargo and mail activities transport more than 5 million tons of goods each year to more than 360 destinations either by freighters or passenger aircraft. Current members include Aegean, airBaltic, Air France-KLM Group, Cargolux, easyJet, Finnair, Icelandair, International Airlines Group (IAG), Jet2.com, Lufthansa Group, Norwegian, Ryanair Holdings, Smartwings, TAP Air Portugal, TUI and Volotea. In 2019, A4E was named "Airline & Aviation Business Development Organisation of the Year" by International Transport News. Follow us on Twitter @A4Europe.

Smart market-based measures

Smart economic instruments such as carbon trading and offsetting schemes are preferable to taxes, as they achieve substantial emissions cuts at least cost to consumers, which is something that simply imposing taxes does not lead to. Market-based measures have therefore the advantage of ensuring the achievement of pre-defined environmental targets in a cost-efficient manner. By putting a price on CO₂ emissions, emitters are incentivised to reduce their carbon footprint the most cost-efficient way. Such instruments also provide further stimulation to progress in the other elements of the basket of measures, including driving efficiency in every aspect of an airline's business.

Carbon pricing is already applied to aviation through the EU ETS. In short –if the ultimate policy objective is to induce a change in behaviour in favour of more sustainable energy use, then there needs to be an alternative to switch to. **Fiscal measures reduce the investment capacity of the aviation industry, and do not reduce emissions per se. They will not help to achieve the objectives of the European Green Deal of increasing welfare whilst at the same time, decarbonise the EU's economy.**

Aviation is part of the EU ETS since 2012. It is currently the **only transport sector part of the scheme** where the cost of emissions has reached €26 per tonne of CO₂. In total, the net reduction in aviation related CO₂ emissions for the entire 2013-2020 phase is estimated to be 193 million tonnes. In 2019, A4E airline members purchased over **20 million tonnes of CO₂ certificates representing around 60% of their emissions**. At current market prices, this represents **a contribution of up to €550 million to the greening of Europe's economies through the ETS every year.**

Regional measures and the competitiveness of the EU aviation industry

Regional climate solutions risk shifting CO₂ at the expense of airlines based in the region. Aviation is a global economic activity and air traffic is international by nature. Global solutions are therefore the most effective in terms of climate and environmental policy addressing air traffic.

For these reasons, CORSIA, the Carbon Offsetting and Reduction Scheme for International Aviation agreed upon at ICAO in 2016 will be the first global scheme to limit CO₂ emissions from 2021 onwards. The EU played a key role to achieve this historic outcome and are committed to support the introduction of the scheme. CORSIA, which is overseen by ICAO, will deliver projects that will reduce carbon by around 2.5 billion tonnes between 2021 and 2035.

While CORSIA as a global instrument has minimal negative competitive effect, the ETS hinders EU airlines' global competitiveness. A global scheme offers a level playing field for European airlines, provides a global solution to the global carbon challenge, and minimises the risk of **loss of market share and carbon leakage**. The drafting of regional climate measures should avoid creating competitive disadvantages and market distortions at an international level such as fuel "tankering" (transporting with extra fuel on board to avoid uptake of fuel in the EU), aircraft redeployments, flight switching by passengers, shifts in travel demand

or changes to infrastructure investment, just to name a few of these likely carbon leakages. Proposals for a carbon border adjustment mechanism for selected sectors to reduce the risk of carbon leakage should take into consideration such disadvantages.

All national and regional policy on aviation emissions must now be done with the utmost care to align with and support CORSIA, avoid double regulation of the same CO₂ emissions, and avoid international dispute. This applies especially when considering the future of the EU ETS' application to aviation.

The strategic importance of sustainable fuels for aviation

The aviation industry will rely on fuel-based propulsion for the foreseeable future. Sustainable aviation fuels (SAFs) are one of the most effective means to reduce aviation CO₂ emissions in the coming decades¹.

Measures to support the development of truly sustainable aviation fuels have until now proven inadequate and were not sufficiently considered in the 2018 review of the revised Renewable Energy Directive (REDII). The review of the ETD could explore incentives for the production and deployment of innovative sustainable fuels instead of new forms of taxation.

The industry needs an alternative to kerosene available on a commercial scale. **If the core issue is to cut carbon emissions from all sectors, the long-term policy response must be to develop and deploy the alternatives that will make aviation cleaner in the first place, and then, in the second place, to consider the use of carbon pricing to incentivise a shift to more sustainable energy sources. Anything else risks putting the cart before the horse.**

One of the main barriers to establishing a supply chain for SAFs is the transition from demonstration to commercial scale production. Producers may struggle to attract investment in the absence of a long-term and stable regulatory framework that provides predictability and assures investors they will make a return. EU policies have an important role to play in setting the right incentives. Unfortunately, the strategic importance of access to SAFs was not reflected in REDII. Member States are required to ensure that at least 14% of the energy used in the transport sector comes from renewable sources by 2030. Sustainable fuels can be counted 1.2 times towards this target for aviation, whereas the same fuels can be counted 4 times toward the target for road transport. This discourages the use of SAFs while generating higher demand from the road transport sector. Road transport can be electrified; aviation is dependent on these fuels to achieve lower emissions.

Short of a dedicated EU industrial policy for the deployment of SAFs, with appropriate financing instruments and regulatory measures, several actions can be taken to facilitate deployment, overcome the challenges of scaling-up production, and support the development of an innovative EU-based industry.

¹ These drop-in fuels are compatible with existing engine technologies and can reduce lifecycle CO₂ emissions by up to 85%.

The effect of taxes in the deployment of SAFs

Tax incentives or other regulatory measures to stimulate investment in, and production of, SAFs play an important role in developing low or zero-carbon alternatives to conventional fossil-based fuels. The 2019 evaluation of the ETD found that it did not reflect the current mix of energy products on the EU market and in particular the emergence of advanced biofuels. It also noted that the “potential preferential tax treatment of low carbon energy products (...) is a powerful tool to influence investment, production and consumption decisions.”

The ETD does not currently provide for the EU-wide preferential treatment of such fuels, although Member States can apply national rates that do so. As it assesses how the ETD’s provisions on taxation of renewable fuels can be amended to align with the EU’s energy, climate change and environment policies, and to promote the use of such fuels, the EC should consider the introduction of a tax incentive scheme for SAFs, which could be modelled on the United States’ Blender’s Tax Credit scheme.

Other fiscal or financial instruments at national level could also be considered, such as a tax incentive for investors, as well as grants and co-financing of facilities with public institutions, which could reduce initial capital requirements for private actors.

Tax incentives or credits will have a more stimulating effect on the industry’s uptake of SAFs than taxing airlines or end users. In the absence of low-or zero-carbon alternatives on any significant scale, and at commercially viable prices, it is hard to see the purpose of a tax on kerosene. Subjecting jet fuel to excise duty –possibly through a removal of the exemption in the Energy Taxation Directive –will not reduce emissions from flying in the long term, whilst also leading to distortive effects such as tankering. It is also unlikely that a fuel tax would send such a strong signal to prospective SAF producers or investors that they decide to ramp up production or investment to a scale where the fundamental challenge of limited supply and high prices will be overcome.

A fuel tax would affect the price of and demand for air travel, at least in the short term, but it is likely that a substantial number of passengers will continue to fly. It is also likely that the viability of some businesses will be affected by incurring up to an estimated €27 billion in additional costs. Given the average low profit margin of European airlines, some of them may not weather that storm. A tax will under any circumstances reduce the global competitiveness of European airlines.

A tax will also inevitably affect the economies of EU Member States, especially peripheral regions and island nations, and the mobility of EU citizens. More importantly, in the context of the European Green Deal, **a fuel tax will reduce the scope for private investment in low-carbon technologies and fuels**. It is also an open question as to whether the revenues from imposed taxes would be invested in programmes and initiatives that will in fact lead to the deployment of low-carbon technologies or fuels for the aviation industry. This has not been the case in the Member States that have introduced national ticket taxes.