



ecbi policy brief

International Air Passenger Adaptation Levy (IAPAL)

A proposal by the
GROUP OF LEAST DEVELOPED COUNTRIES (LDCs)
within the framework of the BALI ACTION PLAN

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with
Thirteen Questions and Answers

compiled by
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The LDC Proposal

Executive Summary

Following the very successful example of the French ‘Leading Group’ solidarity levy to combat HIV/AIDS, the LDCs Group proposes an *adaptation solidarity levy on international air passengers* to provide more adequate funding for adaptation activities in the poorest and most vulnerable countries and communities.

In line with the French levy, the LDC Group proposal is to establish a small passenger charge for international flights – differentiated with respect to the class of travel – *to raise between \$8bn and \$10bn annually* for adaptation in the first five years of operation, and considerably more in the longer term. This will constitute a significant step *towards ensuring adequate financing for developing country adaptation* costs.

The levy is to benefit the Kyoto Protocol *Adaptation Fund*, which currently is replenished by a two percent solidarity levy on the share of proceeds from the Clean Development Mechanism. It is to be universal in the sense of covering all international air travel and collected by airlines at the point of ticket sale. Being international and dependent only on the evolution of the air travel demand – and not on bilateral replenishment – the funds raised will truly be *new and additional*, as well as *significantly more predictable* than traditional funding mechanisms.

The levy will also be the able to provide individual people and businesses who have the means to fly internationally with the opportunity to take on their responsibilities and express their solidarity with those fellow human beings who are much less capable to deal with, the impacts of the international passenger flight emissions. The levy provides for an *equitable mechanism victim compensation* in a sector which – due to the non-national character of the emissions – eludes the traditional interpretation of common but differentiated responsibilities in terms of national (historic) emissions.

The proposed levy will have on significant effect on passenger numbers – less a tenth of the expected annual growth rate – and hence *minimal to no negative impact on tourism dependent economies*. By contrast, it will have *significant positive impacts on the development of the poorest and most vulnerable countries and communities*, by avoiding climate change impacts through timely and adequate adaptation measures funded by the revenue raised through the levy. (continued on p. 6)

The Answers

(Q.1) Why create competition to the French Solidarity Levy for HIV/AIDS and malaria?

On 1 July 2006, France began collecting an ‘international solidarity contribution’ of €1 on all European economy class flights (€10 in business class) and €4 on international economy flights (€40 in business class) departing from its territory. This was to generate more stable and more predictable revenue in order to meet the needs of the developing countries in achieving the Millennium Development Goals (MDGs). The levy is expected to generate revenue of €200 million per annum, to be spent on the fight against pandemics, including access to anti-retroviral treatments for HIV/AIDS.¹

With regard to meeting the development needs of developing countries: *adaptation to the impacts of climate change* is a pre-condition not only to growth, but *to holding on to what has been achieved thus far*. Without it, many of the MDGs will not be achievable. Moreover, some of the health sector issues targeted by the French levy, such as the fight against malaria, themselves need to adapt to the impacts of climate change.

As concerns passenger acceptance of such a levy, a key advantage of earmarking the revenue for adaptation as opposed to other worthy causes – such as the fight against HIV/Aids – is the *direct connection between the activity levied (flying) and the earmarked purpose* (reparation for costs imposed by climate change impacts). Without such a link, the airline industry could well object to any such levy on the ground of being unfairly used as a general ‘milk cow’ for good causes. Moreover, the French levy, while mandatory at the passenger level, is voluntary at the country level, and this is unlikely to change. Covering the cost of adaptation in developing countries, by contrast, is a commitment which the developed countries have signed up to in the UN Framework Convention on Climate Change. Thus there are good reasons for the IAPAL scheme to be mandatory also at the country level.

At the same time the French earmarking choice has created a precedent which could be incorporated in the spending portfolio of a general IAPAL.

(Q.2) What would be the impact on tourism, particularly in the most vulnerable countries?

Tourists travelling to most vulnerable countries mostly come from developed countries, on long-haul flights. Demand for long-haul flights has a low response to changes in prices. Even if a slight drop in demand is experienced, it is not likely to significantly affect the upward trend in tourist arrivals in most vulnerable countries. Between 1996 and 2006, tourist arrivals in Africa and South Asia increased at annual rates of 6% and 6.6% respectively, in a period when oil prices were also increasing. Maldives saw a 96% increase in tourist arrivals between 1995 and 2004, and had 96.4% occupancy rates in its hotels and resorts in 2007. In practice, therefore, a small levy will not deter passengers from travelling.

¹ In 2004, the French Landau expert report recommended the use of international levies for development purposes. The *Leading Group* (Leading Group on Solidarity Levies to Fund Development) began with a declaration on hunger and poverty by President Chirac of France and President Lula of Brazil, noting the need to find additional resources for financing development beyond ODA. The Leading Group is now an informal inter-governmental body with more than 50 member countries and with a Presidency that rotates every six months. Some of the initiatives to come out of this process are: The French airline levy and UNITAID (implemented), the International Finance Facility for Immunization (implemented), and further innovative financing and the environment (studies).

(Q.3) Could there be exemptions on who the levy is applied to?

It is not self-evident how the emissions of international flights should be allocated to countries, which makes it difficult to argue on the basis of the principle of common but differentiated responsibilities between countries. This is why the levy is primarily seen as a **solidarity levy**, based on the personal capability of airline passengers to compensate the poorest and most vulnerable people for the impacts caused by these international emissions.

As a solidarity levy, it is clear that anybody who can afford to fly business or first class is sufficiently capable to pay this compensation. As for economy class travel, there may be circumstances – such as in the case of relatively poor migrant workers – where an exemption might be justified. However, the best way to deal with such cases would be for the relevant **government to pay the levy on behalf of these passengers** from sources such as international climate change finance or budget support ODA. In the case of Bangladesh, for example, this would currently amount to €/\$40 million per annum, or about 1 percent of remittances, 3 percent of ODA.²

(Q.4) Why exclude air freight?

Air freight was deliberately excluded from the IAPAL concept, because it is meant to be fundamentally based on the principle of **individual responsibility** for and **capability** to deal with the burden of the climate change impacts caused by the levied activity. This is relatively straightforward in the case of passengers, but not so in the case of freight. In light of the fact that international trade usually involves a change of ownership, the question would be: who should be charged, the sender or the recipient? Moreover, to impose a levy on goods is politically much more sensitive than to impose one on passengers, not least because the former might fall foul of the WTO rules.

(Q.5) Why does IAPAL only focus on air travel and not maritime travel, which is also contributing to climate change?

International maritime travel is relatively small in comparison to air travel, and the bulk of it is travel on cruise liners (currently about 12 million passengers per annum). As such, it could in principle be included in an International Passenger Adaptation Levy, provided that it would not add excessive transaction costs to do so.

(Q.6) Why IAPAL? Why not use an adaptation levy on emission permits instead, as suggested by the European Commission?

The European Commission's Communication of 28 January 2009 suggests that funding 'could come from a global instrument to address international aviation and maritime transport (e.g. the proceeds from auctioning allowances under a global cap and trade system applying to those sectors)'. Although it does not explicitly earmark such funding for adaptation, this would obviously be a possibility.

The proposal presupposes a cap-and-trade regime for international aviation, and it is not at all clear whether such a scheme would be politically acceptable, particularly to developing countries which will see it as an imposition of a binding sectoral mitigation target. Even if it

² In 2005, Bangladesh had a 'stock of emigrants' of around 5 million according to the World Bank *Migration and Remittances Factbook* (www.worldbank.org/prospects/migrationandremittances). Assuming one return flight per year on average this would amount to 10 million single trips @ €/\$ 4.- per trip = €/\$ 40 million. The inward remittance flow from workers in 2005 was \$4.3billion, ODA \$1.3bn.

were politically acceptable, it may still be advisable not to mix up the mitigation scheme with raising revenue for adaptation. The EC scheme would ***tie the revenue to the price of carbon***, which may fluctuate considerably more than passenger figures, which is the main determinant of the IAPAL revenue. Moreover, having a separate revenue stream as envisaged in IAPAL – and not merely a share of some larger stream (auction revenue) – is more likely to provide predictable ‘core funding’ for adaptation.

(Q.7) Could IAPAL revenue collected in developing countries be earmarked for use in the collecting countries?

One of the defining characteristics of IAPAL is that it is collected ***internationally*** – and not by countries – primarily to avoid the ‘domestic revenue problem’ of tax payers’ reluctance to send nationally collected levies abroad, particularly in economically difficult times. The only way in which one might justifiably earmark certain IAPAL revenue streams to recipient countries is by defining the streams in terms of revenue collected ***from citizens of the countries*** in question.³ And while that might be possible – albeit not easy to implement – it would be against the spirit of IAPAL (see separate question below).

(Q.8) How much would different countries and UN groupings be contributing to IAPAL revenue?

IAPAL is ***not levied on countries, but on individuals***, and while, in principle, one could classify the revenue with respect to the citizenship of the international passengers (see Q.7), this would not only be quite difficult to implement on the ground, but it would be contrary to the spirit of the levy which is meant to be an expression of personal solidarity, ***based on personal capability and responsibility***.

(Q.9) Is it fair to levy passengers from poor countries when they have not contributed much to climate change?

IAPAL proposes to levy passengers because of the individual polluting activity (i.e. the flight they are on), and not because of the (historic) responsibility of their countries. Moreover, the levy itself is determined by the individual capacity of passengers, which ensures that those passengers from poor countries who can afford to fly help their poorer counterparts to adapt to climate change.

(Q.10) Does IAPAL have a special appeal to passengers because it supports those who are most vulnerable to climate change?

IAPAL is an international levy ***earmarked*** for supporting the most vulnerable to cope with an important impact of the activity that is being levied, namely international air travel. It has been shown that this kind of earmarking is most acceptable if the activity that is being levied has a direct link to the purpose for which the revenue is being earmarked.⁴ Given this, it stands to reason that the IAPAL should be at least as acceptable as the French solidarity levy (see Q.1), if not more so.

³ There is really no justification for earmarking the levy paid by an international passenger for a country just because the journey begins or ends in that country. The only way in which a country might have a claim over IAPAL revenue is from its citizens, but even this claim is rather tenuous.

⁴ For more on this, see Benito Müller, *To Earmark or Not to Earmark? A far-reaching debate on the use of auction revenue from (EU) Emissions Trading*, Oxford Institute for Energy Studies, EV 43, November 2008

(Q.11) Why not make the levy voluntary?

There are two ways in which an IAPAL could be made voluntary, namely with respect to state participation – as in the case of the French solidarity levy – or at the personal level, by giving the individual passengers a choice to pay, be it through opting in or opting out. At the national level, it is questionable if one were to get much wider coverage than the 50 or so countries that are part of the voluntary Leading Group with the French aviation levy. As for passenger contributions, it is more than likely that the revenue generated through a voluntary scheme would drop significantly if the levy were made voluntary for passengers. This is not necessarily because passengers do not wish to pay a small levy, but because they may simply forget or do not want to take the extra step to actually pay.

(Q.12) Why a per passenger rate?

The prime objective of the levy is to raise revenue for adaptation. In particular, it is not aimed at affecting behaviour, particularly for long-haul flights (see Q.2). This is why it is conceived as a *solidarity levy*, to be levied in proportion to the individual capacity to pay. There are two ways in which this could, in practice, be implemented, namely either as a (progressive) percentage levy on the ticket price, or as a (differentiated) poll levy. IAPAL is based on the latter simply because of ease of monitoring and collecting.

(Q.13) How does IAPAL fit the related G77 proposals on finance?

The G77 and China proposal for a *Financial Mechanism for Meeting Financial Commitments under the Convention* (submitted by the Philippines, FCCC/AWGLCA/2008/MISC.2/Add.1; pp.35ff) itself does not mention specific revenue raising instruments, but it does specify a number of requirements on funding to be counted towards UNFCCC Art 4.3 commitments: ‘The main source of funding will be through the implementation of commitments under Article 4.3. The funding will be new and additional financial resources, which is over and above ODA. The major source of funds would be the public sector. It should be ensured that there be predictability, stability and timeliness of funding. The resources shall be essentially grant-based (particularly for adaptation), without prejudice to certain concessional loan arrangements in appropriate form, to meet the needs of a specific programme.’

The UNFCCC Submission by India on the subject,⁵ in turn, stipulates that ‘Each developed country Party or any grouping of developed country Parties would be free to decide the means for raising these contributions through country specific or region specific auctioning of emission rights, carbon taxes, and specific levies on sectoral emissions or any other means considered feasible within their borders, [in particular, any] levies on international travel or use of marine haulage that are negotiated under the Convention.

In short, IAPAL is not only perfectly compatible with but included in the relevant developing country submissions.

⁵ Government of India Submission on Financing Architecture for Meeting Financial Commitments under the UNFCCC. 17 October 2008.

The LDC Proposal (continued from page 1)

Background. In light of the fact that adaptation to climate change impacts is crucial to development, especially for the poorest and particularly vulnerable countries and communities, and given the inadequacy of existing adaptation funding, the proposed solidarity adaptation levy on international air passengers will provide a **development life-line** for these countries. The proposed levy is therefore not only in line with the idea underlying the French Leading Group on Solidarity Levies to Fund Development, but it has the added advantage that the purpose of the levy – to fund adaptation in particularly vulnerable countries – is directly linked to the activities being levied in accordance with the **polluter pays principle**, a feature which will be **key to the public acceptability** of the proposed levy.

The proposed levy also conforms to the idea of **common but differentiated responsibilities and respective capabilities**, but because of the non-national nature of the activities this conformity is not with respect to the responsibilities and capabilities of countries, but with respect to (i) the personal responsibilities of passengers due to the international emissions produced and (ii) their capability revealed by the ability of flying internationally. Indeed, given the international character of the activities in question and of the resulting emissions, **the only equitable way** to deal with the non-national responsibilities for these activities is at the personal level, which – given the price levels of international flights – also respects the idea of respective personal capabilities.

Operational Details

- The revenue of the levy is go to the Kyoto Protocol Adaptation Fund to fund its activities.
- The level and travel class differentiation of the levy is to be according to the **tried and tested formula** of the French levy, at present \$6 (€4) per economy trip, and \$62 (€40) per business/first class trip.
- The levy is to be collected by airlines from their passengers at the point of sale and transferred by the airline to a dedicated account of the Adaptation Fund.
- The airlines will be compensated by the Adaptation Fund for reasonable administrative costs incurred in the course of collection.
- The Board of the Adaptation Fund will be requested to operationalise the collection mechanism for the levy, if necessary in consultation with the relevant international bodies concerned with the aviation sector.

Revenue. The calculations of the near-term revenue estimates of \$8bn to \$10bn are based on a travel class differentiation of \$6 (€4) per international economy class ticket, and \$62 (€40) per business/first class ticket – in line with the French solidarity levy, as well as IATA figures and estimates for current international passenger numbers (760m) and annual demand forecasts (5.1% p.a.). The calculations also assume 93% coverage of all international scheduled air traffic, as reflected in International Air Transport Association (IATA) membership, and 99% collection efficiency.

This revenue, by its very nature, will be **new and additional** to the traditional flows of bilateral funding for adaptation. Given its nature, the revenue will also not be subject to the problems of bilateral replenishment, and it will be **predictable** due the stability of the airline sector.

Potential Impact on Development. Understandably, many poor and vulnerable countries which rely heavily on air passengers in their development aspirations might be worried about the impact on their economic development of the proposed solidarity levy. As it happens, the sensitivity of international air travel demand, particularly long haul, to price increases is very low. Given average price elasticities of passenger demand of -0.66 and -0.60 for short and long-haul travel demand,⁶ respectively, an average price increase of 0.8% – equivalent to the levy of \$6 to a \$750 economy class ticket – would result in a drop in demand of **0.52%** and **0.47%** for short and long-haul flights, respectively: an order of magnitude less than the expected growth of air travel of 5.1% per annum. Given this, and the considerable benefits in terms of avoided impacts that will accrue to the recipients of the funds raised, the proposed solidarity levy will have substantial positive effects on the development of the poorest and most vulnerability countries and communities.

Potential Impact on Airline Business and Competition. As a passenger levy is borne by passengers directly and as the cost of collection is reimbursed to the airlines, the only impact of the proposed levy will be through its demand implications, which as noted earlier, will be minimal with respect to the expected demand growth. With respect to potential competitiveness implications, the universality of the levy will insure that unfair distortions are avoided.

⁶ InterVISTAS Consulting Inc (2007) **Estimating air travel demand elasticities**, Report prepared for IATA.