CAFOD Submission to the UK House of Commons Energy and Climate Change Committee Inquiry: The EU Emissions Trading System

A global and equitable mechanism for carbon pricing of international maritime transport is a key building block to an effective EU climate policy.

12 August 2011

Executive Summary

1. This submission focuses on international maritime transport and aviation (sectoral agreements). Unless the rapidly-growing emissions from these global sectors are addressed, the goals and effectiveness of EU climate policy will be seriously undermined.

2. Global carbon pricing of international shipping emissions is needed to achieve this mitigation objective. Technical measures recently adopted by the International Maritime Organization (IMO) would achieve an emissions reduction of just 1% below BAU by 2020. Carbon pricing would expand the market-based approach pioneered by the EU ETS. It could also contribute $10-15 billion per year to finance climate action in developing countries.

3. Ensuring no net incidence (NNI) or costs on developing countries is crucial to reconcile a global maritime scheme with the UNFCCC principle of “common but differentiated responsibilities and respective capabilities” (CBDRRC). The UK and the EU should also be supportive of compensating poorer countries that would be most affected by carbon pricing of shipping emissions. CBDRRC and any impacts on poor countries could be addressed through a Rebate Mechanism (RM), such as is currently under consideration at the IMO. The RM would ensure NNI on developing countries and would also provide flexibility for wealthier developing countries to forego their rebates voluntarily, in whole or in part.

4. Raising long-term climate finance from pricing shipping emissions is fair, affordable and necessary. Fair, as all developed countries would pay, with the EU and UK contributing 28.5% and 4% of the total revenues respectively. Affordable, given the minimal potential increase it would entail on prices of imported goods (under 0.2% on average). Necessary, as mobilizing the predictable, stable, new and additional sources of climate finance required under the Cancun Agreements, with developed countries meeting their goal of providing $100bn annually by 2020, requires a range of sources of new financing.

5. Establishing a global maritime carbon price could constitute a helpful precedent for action in the aviation sector. Concerns raised by developing
countries about current EU plans to include international aviation in the ETS are that they do not address concerns about CBDRRC and there is no proposal to channel revenues towards financing action on climate change.

6. **Conclusion:** A global and equitable mechanism for carbon pricing of international maritime transport is feasible. Agreement on such a mechanism should be pursued actively by the UK and the EU. Such a mechanism would significantly reduce emissions from this sector, while ensuring no net incidence on developing countries. It could also raise substantial finance to help poorer countries adapt to climate change and build low carbon development. As such, it would constitute real progress towards a functioning global climate regime. The UK should champion such an approach through coordinated action with its EU partners and at the G20, with the aim of reaching agreement at the UNFCCC Summit in Durban, in December 2011.
1. **Introduction: Focus on international maritime transport and aviation**

1.1. **The Catholic Agency for Overseas Development (CAFOD)** welcomes the opportunity to submit the following evidence to the UK House of Commons Energy and Climate Change Committee Inquiry on the EU Emission Trading System.

1.2. CAFOD is the official relief and development agency of the Catholic Church in England and Wales. We work with partners in more than 40 countries across the world supporting poor communities. CAFOD prioritises partnerships with local church organisations but works with people of all faiths or none.

1.3. CAFOD has been campaigning for several years for a fair, ambitious and global deal to cut carbon emissions and for sufficient resources to be mobilized to support countries suffering climate change impacts. Our partners are working with vulnerable communities at the frontline of climate change, for instance in Kenya and Bangladesh.

1.4. From August to December 2011, we are calling for the UK government to commit to providing its fair share of long-term climate finance and, working with its EU partners, to proactively seek agreement on the mobilization of new sources of climate finance and on establishment of the new Green Climate Fund at the next UNFCCC Summit in Durban (see: [http://www.cafod.org.uk/dontdroptheball](http://www.cafod.org.uk/dontdroptheball)).

1.5. We commend the EU’s pioneering work in developing the ETS, while acknowledging that its current emissions reduction targets are weak and need strengthening.

1.6. However, it is CAFOD’s view that without global coverage of the rapidly growing emissions from international maritime transport and aviation (i.e. coverage extending well beyond the current EU ETS), the goals and effectiveness of EU climate policy will be seriously undermined. The greenhouse gas emissions from these two inherently international sectors are significant and growing and therefore require coordinated global approaches. This has been widely recognized, including by the UK House of Commons Environmental Audit Committee.¹

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¹ In 2009, the Committee, in its report *Reducing CO2 and other emissions from shipping* (fourth report of Session 2008-09), concluded: “The emission of greenhouse gases from shipping is a serious problem for international climate change policy […] The Kyoto Protocol handed developed economies the responsibility of working to curb emissions from shipping through the International Maritime Organization (IMO). Very little progress has been made […] The Government’s position on the use of emissions trading to tackle GHG emissions from ships lacks coherence. Ministers support the use of revenue from a trading scheme to fund climate change adaptation in developing countries but oppose the hypothecation of revenues for that purpose.
1.7. Carbon pricing, also referred to as a market-based measure (MBM), would achieve this objective and would complement any technical and operational measures aimed at reducing emissions from these sectors. The latter alone are insufficient to achieve the desired objective. Any MBM should ensure that there is no net incidence (NNI) or costs incurred by developing countries, in line with the UNFCCC principle of “common but differentiated responsibilities and respective capabilities” (CBDRRC).

1.8. A significant portion of the revenues generated by such an MBM could be used for climate financing, contributing to the promise by developed countries, including the UK, to raise $100 billion annually to support developing countries by 2020. The proposed approach addresses these two issues at the same time.

2. **Global carbon pricing on international shipping to reduce emissions**

2.1. Carbon dioxide emissions from international shipping can be reduced through technical measures, operational measures and market-based measures (MBMs).

2.2. After several years of negotiations on measures to address carbon dioxide emissions from international shipping, in July 2011 the International Maritime Organization (IMO) adopted a technical measure applicable to new ships, in the form of the Energy Efficiency Design Index (EEDI). The IMO also adopted operational measures applicable to all ships in the form of Ship Energy Efficiency Management Plan (SEEMP).

2.3. The negotiations leading to the adoption of these regulations demonstrated that it is possible to reach global agreements on reducing emissions from international shipping but only when the special circumstances of developing countries are taken into account (in this case, through promotion of technical co-operation and transfer of technology relating to the improvement of energy efficiency of ships and a waiver for a phased implementation).

2.4. The adoption of the EEDI and SEEMP are very welcome but insufficient steps. The EEDI, for instance, will deliver emissions reductions of just 1% below business as usual (BAU) levels by 2020.² These technical and operational

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² The 1% emission reduction can be estimated through the following simple calculations. Annual emissions from new ships entering service are 5% (based on an annual scrapping rate of 3% and an annual increase in overall emissions of 2.2%, i.e. the average emission growth scenario). Thus when the regulation applies to all
measures will also not deliver any finance, but will rather require funding

2.5. Thus a revenue-raising MBM is needed, both to deliver real cuts in emissions and to raise finance. Essentially, a MBM would put a price on emissions from international shipping, either through a levy or an ETS. The carbon price would incentivize implementation of cost-efficient, in-sector emissions reductions and could also pay for the most cost efficient out-of-sector emissions reductions (i.e. in other sectors, including forestry), adaptation to climate change in developing countries and also be used for technical co-operation and, potentially, R&D for clean shipping.

2.6. Whether the carbon price for shipping would be established through a levy or ETS is a secondary issue. Well-designed proposals for each option are under consideration at the IMO, even if the majority of countries, as well as industry stakeholders, would prefer a levy, mostly for practical reasons.3

2.7. The key outstanding issue is to how reconcile the principles of the UNFCCC relating to CBDRRC with the requirements of the IMO regime, where measures must be applicable to all ships, irrespective of flag and nationality, in order to deliver a scheme that is both universal and equitable. A proposal that could achieve this, a Rebate Mechanism, is also under consideration at the IMO and will be discussed in more detailed in the next section.

2.8. Assuming that revenue generated from shipping activities by developed countries is used for climate change action, carbon pricing could raise circa $10 – 15 billion per year in climate finance for the new Green Climate Fund ships, without any waiver, with EEDI improvements of 10%, the regulation will deliver reductions of 0.5% annually (5% of 10%). To calculate total improvements by 2020, the improvements from the individual periods are added together. New ships subject to the improved EEDI would be entering the service from around mid-2017, for ships not applying for a waiver, and from mid 2019 for ships applying for a waiver. Given that 75% of ships are registered in developing countries that could issue a waiver, and assuming that 2/3 of new ships registered in developing countries would apply for the waiver, the percentage of all new ships with improved EEDI would halve in the period when the waiver applies (=0.25 + 0.75 x 1/3). Thus the estimate of emissions reduced in 2020 is the sum of improvements from new ships delivered from mid-2017 to 2020 and equals 1.25% (= (0.25 + 0.5 + 0.75 + 1) x 0.5%). This needs to be somewhat discounted for three reasons: some of the technical improvements or slowing down of new ships would happen with or without the EEDI; the EEDI does not yet apply to all ships; and the EEDI improvement rate is less than 10% for some ships. Thus the improvements from EEDI in 2020 are estimated at circa 1% from BAU level.

3 See, for instance, the position stated by the International Chamber of Shipping (ICS) in its press release of 6 July 2011: “MBMs are expected to provide a means whereby shipping can make a significant financial contribution to environmental projects in developing countries - satisfying the UNFCCC principle of ‘Common But Differentiated Responsibility’, something which is important to developing countries. ICS has recently announced that if Market Based Measures to reduce CO2 emissions are developed by governments then the international industry has a definite preference for a mechanism that is fuel levy/compensation fund-based rather than any emissions trading scheme” [emphasis added]. See: http://www.marisec.org/pressreleases.htm
shipping emissions would expand the market-based approach championed by the EU ETS globally to another large sector with emissions comparable to the emissions of Germany. On the other hand, including the EU/regional share of international shipping in the EU ETS would only apply to emissions in the EU sphere.

2.9. In the European Commission’s ongoing consultations, a regional approach to MBM for shipping emissions is opposed by nearly all stakeholders, both on grounds of impracticality and low efficiency. Such an approach, assuming that all the practical challenges relating to this inherently global and complex sector could be resolved, would have limited effect since the EU’s share of international shipping emissions is estimated at circa 30% (based on the EU share of international seaborne trade).

3. **Ensuring no net incidence (NNI) or costs on developing countries**

3.1 The Rebate Mechanism (RM) proposal currently under consideration by the IMO aims to reconcile the principles of the UNFCCC with the application of global carbon pricing for shipping by rebating the cost burden incurred by a developing country. It would thus ensure no net incidence on developing countries from the introduction of a carbon price. We believe that this proposal, along with use of the revenue generated from developed countries for climate action in developing countries (see next section), is the key to breaking the current deadlock in negotiations in the complex area of emission reductions and innovative financing from international transport.

3.2 The RM proposal – and, more generally the concept of NNI or cost burden – has generated considerable interest from a number of developed and developing States and observer organizations at both the IMO and the UNFCCC.\(^6\) These concepts have been endorsed in the 2010 report of the UN High Level Advisory Group on Climate Finance (AGF)\(^6\) and are likely to be discussed further in the forthcoming World Bank/IMF report on sources of climate finance requested by the G20 Finance Ministers meeting in October 2011.

3.3 The RM was designed to apply to any revenue-generating market-based mechanism for shipping (maritime MBM) – be it a levy or an ETS. It can also apply to aviation. Through the RM, developing countries could be rebated the potential cost or incidence of any maritime MBM. The RM also provides

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4 This figure is calculated on the basis of the 60% of total shipping activities attributable to developed countries, a carbon price of $25/tCO\(_2\) and emissions of 1,000 MtCO\(_2\), and assumes that a major share of the revenue raised would be used for climate action in developing countries.

5 See for instance, the following submissions to the IMO by the World Wildlife Fund, Germany, and France, respectively: MEPC 62/5/14, MEPC 62/5/15, and MEPC 62/5/34

3.4 The mechanism calculates the rebate country-by-country, using global maritime MBM costs and a trade-based key, namely a country’s share of seaborne imports. Each developing country receives its attributed rebate, unless it chooses to forego it. A developing country that chose to forego its rebate, or part of it, would receive international recognition for its action and the revenues could potentially contribute to South-South cooperation, including climate change action.

3.5 Developed countries would not be entitled to rebates but would be automatically credited for their share of financing raised through the MBM, based on the same attribution key. Consequently, the net revenue raised, after rebates, would come from customers in developed countries only, thereby complying with the principles and provisions of the UNFCCC in relation to CBDRRC, while simultaneously ensuring a universal approach to reducing shipping emissions.

3.6 The rebate key could be adjusted yearly, in line with changes in trade patterns. The optimal rebate keys for 150+ developing countries and attribution keys for developed countries are calculated based on 2007 trade by sea and air. As an example, assuming that the total maritime MBM costs $10 billion, Ethiopia’s annual rebate would be $6 million (i.e. 0.06% of $10bn).

3.7 Thus to make further progress on the global carbon pricing of shipping emissions, the EU and especially the UK, given that the IMO is headquartered in London, should support compensating poorer countries that would be most affected by such approach, as proposed in a Rebate Mechanism.

4. **Long-term climate financing from pricing shipping emissions: fair, affordable and necessary**

4.1. The second condition in order for global pricing of shipping emissions to be consistent with the principles and aims of the UNFCCC is for the net revenue generated, or a significant share of it, to be channelled towards climate financing. This would help to mobilize the $100bn that developed countries agreed to provide annually by 2020 to support climate action in developing

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7 See, for instance, the RM proposal described in MEPC 60/4/15 and MEPC 61/5/33 submitted by the International Union for Conservation of Nature (IUCN), or the report of the IMO’s MBM Expert Group contained in document MEPC 61/INF.2.

8 Detailed analysis is available in the study on the Optimal Rebate Key, available at: [www.imers.org/docs/rebateKey.pdf](http://www.imers.org/docs/rebateKey.pdf).

9 See: [http://www.imers.org/docs/RM_outline_and_keys.pdf](http://www.imers.org/docs/RM_outline_and_keys.pdf)
4.2. Raising climate finance from pricing shipping emissions is fair, affordable and necessary, providing there is no net incidence on developing countries, especially the poorest, as described in the previous section.

4.3. It would be fair because everyone would pay for the shipping emissions globally, but the revenue raised from developed countries would go to finance climate action in developing countries. As an example, assuming the total revenue raised is $10 billion, the EU would be credited with $2.85 billion in climate finance, including $400 million credited to the UK, assuming that all the revenues raised are used for climate finance (reflecting the attribution keys of 28.5% and 4% for the EU and UK respectively).

4.4. This would also be easily affordable, owing to the high-energy efficiency of seaborne transport. The potential increase in prices of imported goods is low, under 0.2% on average (equivalent to 2 pence in every 10 pounds). 10

4.5. Finally, it is necessary to mobilize predictable, stable, new and additional sources of climate finance, including to meet the goal of providing $100bn in climate finance annually from developed countries by 2020, from a mix of different sources. This is highlighted by the UN High Level Advisory Group on Climate Change Financing (AGF). This consideration is particularly pertinent given the significant budgetary challenges currently faced by some developed countries.

5. **Progress on a maritime carbon price could be helpful to negotiations on aviation**

5.1. Concerns about equity issues and the lack of earmarking of revenue for climate finance have also been raised in relation to the proposed inclusion of aviation in the EU ETS. In fact, the EU is facing concerted challenges to its unilateral approach to tackle emissions from aviation – court challenges from US airlines, opposition from the USA and Russia and threats of retaliation or

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10 The average cost impact is calculated as 0.16% for 2020, by dividing the total cost of $26.3 billion by estimated seaborne trade of $16.6 trillion (both figures for 2020). The total cost is calculated by multiplying the forecast emissions of 1,050 MtCO2 by an assumed carbon price of $25/tCO2. In reality, the average cost impact is likely to be even lower: the current calculation ignores fuel savings arising from behavioural change and any efficiency improvements, while the carbon costs are counted at the assumed carbon price applied to all shipping carbon emissions. Similar average results are obtained when using bottom-up incidence calculations for individual countries, although impacts on different product categories vary, with low value-to-weight products impacted most.
5..2. Thus the best approach to the inherently global sectors of international transport is a concomitantly global one, with equity concerns addressed through the inclusion of a rebate mechanism and earmarking of revenues for climate finance. We believe that there is currently an opportunity to move forward with such an approach. China, Brazil, India and South Africa have all signalled – in the IMO or on the side-lines of the UNFCCC – a new willingness to consider a global approach to tackling emissions from shipping, provided such a global scheme would entail “no net incidence” on developing countries.

5..3. The EU is unlikely to change their current policy on reducing emissions from aviation until a suitable global approach is agreed, given the difficulties faced in negotiations on agreeing a global solution to date. Nevertheless, both the UK and the EU can and should reiterate their preference for reaching a global agreement on international transport emissions and champion a fair approach to carbon pricing of shipping, with no net incidence on developing countries and with revenues being used for financing climate change action. Such a position in relation to shipping could have the additional advantage of reinvigorating discussions in the International Civil Aviation Organization (ICAO) on pricing of aviation emissions.

6. Conclusion
6..1. A global and equitable mechanism for carbon pricing of international maritime transport is feasible and agreement on such a mechanism should be pursued actively by the UK and the EU. It would significantly reduce emissions from this sector,\(^{11}\) and is likely to be acceptable to developing countries if it ensures no net incidence on them. It could raise substantial finance to help poorer countries adapt to climate change and build low carbon development. As such, it would constitute real progress towards a functioning global climate regime. The UK should champion such an approach through coordinated action with its EU partners and at the G20, with the aim of reaching agreement at the UNFCCC Summit in Durban, in December 2011.