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FURTHER CONSIDERATION OF THE DEVELOPMENT OF CANDIDATE MID-TERM MEASURE(S) IN THE CONTEXT OF PHASE III OF THE WORK PLAN FOR THE DEVELOPMENT OF MID- AND LONG-TERM MEASURES

Way forwards for a universal mandatory GHG levy acting in combination with a simplified global GHG fuel standard

Submitted by Belize, Fiji, Kiribati, Marshall Islands, Nauru, Solomon Islands, Tonga, Tuvalu and Vanuatu

SUMMARY

Executive summary:	Building on the specification of GHG pricing initially put forward in document MEPC 76/7/12 (Marshall Islands and Solomon Islands), this submission details and updates a universal mandatory GHG price on international maritime bunkers that, in combination with a GHG fuel standard (GFS), would enable the Organization to achieve its GHG reduction ambitions and wider objectives as detailed in the 2023 IMO GHG Strategy. The submission includes detailed explanations for why the identified specifications are the only way forwards.
Strategic direction, if applicable:	3
Output:	3.2
Action to be taken:	Paragraph 22
Related documents:	Resolution MEPC.377(80); MEPC 60/INF.6, MEPC 60/INF.9; MEPC 76/7/12; MEPC 77/7/4; MEPC 80/17; ISWG-GHG 13/4/7: ISWG 13/4/8; ISWG-GHG 14/2/3; ISWG-GHG 14/3; ISWG-GHG 15/3, ISWG-GHG 15/3/1; ISWG-GHG 15/3/2, ISWG-GHG 15/3/4, ISWG-GHG 15/3/6, ISWG-GHG 15/3/7 and ISWG-GHG 16/2

Introduction

1 The *2023 IMO Strategy for the reduction of GHG emissions from ships* (2023 Strategy) identifies the development and finalization of a basket of mid-term measures comprised of a technical element, namely a goal-based marine fuel standard and an economic measure to effectively promote the energy transition of shipping and provide a needed incentive while contributing to a level playing field and a just and equitable transition (resolution MEPC.377(80), paragraph 4.5).

2 The co-sponsors note the extreme urgency with which science concurs that the world must phase out fossil fuel if the existential threat immediately facing their States is to be ameliorated. Given the deepening climate emergency and the timeframes needed to achieve the 2023 Strategy, including agreement on the specification of the economic measure and finalization of the necessary regulatory amendments to begin practical implementation of those measures by no later than 2027, the co-sponsors contend that the Working Group needs to now recommend a hard definition of those measures to the Committee at MEPC 81.

3 In the co-sponsors' opinion, having listened carefully to all advice from ISWG-GHG and MEPC, and assuming adoption alongside a goal-based fuel standard, the only specification of an economic element capable of delivering the 2023 IMO Strategy is:

.1 a GHG pricing mechanism, namely a universal mandatory levy on WtW GHG emissions collected on bunker following the calculation methods in the LCA Guidelines, and established through amendment to MARPOL Annex VI;

.2 a price initially set at no less than \$150/t CO_2-eq, subject to a 5-yearly review and ratchet clause[1];

.3 to minimize the administrative burden, all data needed for confirmation of compliance will be based on data reported into the Organization's existing DCS system (amended to include reporting in line with any fuels and fuel production pathways described by the LCA Guidelines);

.4 all GHG emitting ships will be required to make ongoing contributions to a GHG fund system at the point of bunkering. Periodic validation of contributions would be provided by issuance of a Statement of Compliance that can be presented as required to authorities. No contributions from ships will be collected by governments or maritime administrations;

.5 revenue disbursement should be guided by the 2023 Strategy, particularly the objectives for mid-term measures stated in paragraph 4.5[2]:

.1 effectively promote the energy transition of shipping;

.2 provide the world fleet with a needed incentive; and

.3 contribute to a level playing field and a just and equitable transition;

[1] On the analysis undertaken to that date, document MEPC 76/7/12 (Marshall Islands and Solomon Islands) recommended an entry price of no less than \$100/t/CO_2-eq assuming the measure would be operational by no later than 2025. As the new timeframes of the GHG Strategy now no longer allow this measure to be effective in 2027, it follows that the entry price now needs to be increased.

[2] This is further reinforced in paragraph 5.3, "when developing candidate mid- and long-term GHG reduction measures, due account should be taken to ensure a just and equitable transition that leaves no country behind".

.6 to further minimise administrative burdens, revenues raised will be disbursed through existing fund architectures where possible; and

.7 fully operational in 2027.

4 The detailed reasoning for why this specification of the economic measure is the only specification available for enabling the Organization to achieve its stated objectives is provided below in paragraphs 5 to 21.

GFS measure specification

5 The IMO's 2023 Strategy is clear that both economic and technical measures are required. The choice of technical measure has been determined, a goal-based GFS. A specification of this measure, coherent with an economic measure must now be agreed.

6 The GFS is a crucial component of the basket of measures because it can provide high certainty of GHG emission reductions and create the longer-run signals needed to unlock investment. To maximise its clarity to all stakeholders and minimise its administrative burden, it needs to be simple, transparent, enforceable and not be confused with an economic measure.

7 The best model of the GFS is the proven 2020 Standard for sulphur content reduction. The issue with applying such a stringent mandate immediately is the current lack of commercially available solutions at the required scale and global distribution. Development of the supply chain and infrastructure for zero emissions fuel/energy across a broad range of geographies must be incentivised before it can be regulated with a mandate to switch to new energy technology. To do otherwise is to generate endless and probably unsolvable debates around enforcement and penalty regimes whilst generating a plethora of Fuel Oil Non-Availability Reports (FONAR) issued.

8 Further, an energy transition led strongly by fuel standard regulation will create major risks for equitable transition through some or all of the following unintended consequences:

.1 as it is often the less efficient ships that largely service the climate most vulnerable and lower income economies, it can be expected that they will attract a disproportionate amount of any penalties involved in enforcement (e.g. (G)RU's), adding only cost without any of the benefit of technology change in lower income countries;

.2 early adoption would likely occur disproportionately in developed countries offering other national/regional incentives as already available, for example in the EU and US, and leaving the climate most vulnerable and lower income countries behind technologically; and

.3 policy solutions to address disproportionately negatively impacted countries would be limited to route-type exemptions which would likely also leave climate most vulnerable and lower income countries behind technologically.

9 The need for a simple, transparent technical measure to provide long-term clarity, but also the challenge of using the measure on its own to 'effectively promote the energy transition of shipping' and 'contribute to a just and equitable transition' justifies the need for this to be accompanied by a levy designed to address these specific shortcomings. The effective, just and equitable solution is for high stringency fuel standard implementation to be preceded by a universal mandatory levy at a sufficiently high entry price and design to stimulate the supply of new technologies, fuels and infrastructure in the widest range of geographies.

10 This paper is focused on the economic measure and does not propose a detailed specification for a GFS. However, we make the following observations on current GFS proposals:

.1 the co-sponsors note the stated requirement for a simple and transparent technical measure is not currently satisfied by the proposals by the EU (ISWG-GHG 15/3/2) and China (ISWG-GHG 15/3/4). Their proposed designs of flexibility mechanisms (FCU/SRU) reduce clarity and add complexity whilst also being unlikely to stimulate early investment in long-run solutions. Rewarding overperformance with the required GFI is not necessary if the GFS is operated in combination with a levy/revenue system. Separately, the co-sponsors recognize that a (G)RU may be required as a practical solution to compliance and enforcement under the required high stringency, but remain open to equivalent solutions; and

.2 as described in the ICS and IBIA submission ISWG-GHG 16/2, a simplified GFS which is not reliant on the use of the IMO Fuel Oil Data Collection System (DCS), makes it possible to extend the application of the GFS to ships of 400 GT and above, consistent with other provisions for fuel standards under MARPOL Annex VI. This could provide uniformity, consistency and greatly simplified administrative burden. However, the proposal's acceptance of FONAR (to report non availability of compliant fuel oil and justify exemption from the required stringency) poses a critical weakness that would undermine the certainty of demand required for a fuel standard to be effective at driving investment and securing the 2023 Strategy's GHG reduction objectives.

Economic measure specification

11 Turning to the economic measure, now referred to as a GHG pricing mechanism in the 2023 Strategy. It is noted it is now 21 years since the Organization adopted resolution A.963(23) setting out policies and priorities for reducing GHG emissions from ships and directing the Committee to prioritise its consideration of market-based solutions. Fifteen years ago, in its 2009 report to UNFCCC, the Organization found MBMs to be an essential component of the requisite basket of measures needed to reduce GHG emissions[3]. Six years ago, in document ISWG-GHG 4/2/3 (Antigua and Barbuda et al.), the Pacific requested inclusion of MBMs under the STM agenda. Noting the steps still required to set up collection and disbursement of revenues, we cannot keep delaying decisions and action and must now agree key specifications so we can deliver the timeframes agreed in the 2023 Strategy. The deepening climate emergency does not allow further time for ambiguity or delay.

12 The choice of GHG pricing specification comes down primarily to choices around level (e.g. price), coverage (e.g. inclusion of all emissions, or only emission above the GFI limit), and the decisions made on use of revenues. Notwithstanding the outcome of the CIA process, the-co-sponsors can already draw clear analysis of different specifications that are needed:

[3] MEPC 60/INF.9, United Nations Climate Change Conference 2009, IMO submissions and activities, includes: "the development of technical and operational measures for new and existing ships, as well as market based instruments to, inter alia, act as an incentive for the shipping industry to invest in more fuel-efficient technologies, and also serve other purposes such as raising funds for climate change mitigation and adaptation activities, research and development and the offsetting of emissions".

.1 **Level (GHG price)** - The levy entry price originally proposed in document MEPC 76/7/12 was based on the analysis available from all literature sources assessed in 2019 and assumed the measure to be operational by 2025. The delay in bringing this measure to operation and the loss of time in allowing an equitable transition to be programmed lead to an increased entry price of at least \$150/ton/CO_2-eq being needed in 2027.The review and ratchet process is essential to correct this figure upwards in 2032 should the evidence show the market has not responded as needed in the initial period;

.2 **Coverage** – document MEPC 76/7/12 proposes a mandatory universal price, paid on all GHG emissions (WTW) regardless of how a ship is in compliance with GFS. There are currently several other proposals for all ships to contribute on the basis of their total GHG emissions (e.g. ISWG-GHG 15/3 from Japan, ISWG-GHG 15/3/6 from ICS). On the contrary, document ISWG-GHG 15/3/4 proposes that contributions to a fund would only come from "Remedial Units", the emissions that occur above the GFI limit of GFS and that remain uncovered by Surplus Reward Units. As well as being both opaque, complex and lacking in clarity of signal, this partial/conditional coverage means there is large uncertainty on the magnitudes of the fund. The detailed policy design would have to choose between there being high compliance with the GFI limit and minimal or no revenues in the fund (high RU price), or there being low compliance with GFI limit, failure to achieve targeted GHG reduction objectives, but significant revenues (low RU price). These shortcomings are why partial/conditional coverage is not an option and the fairest and most effective way to deliver the IMO's 2023 Strategy is a mandatory and universal price paid on all GHG emissions; and

.3 **Use of revenues** - Revenues are required for mitigation of GHG emissions from shipping at source and reparation of the damage resulting to the environment, including people and communities to meet all three of the 2023 Strategy wider objectives set out in Paragraph 4.5; promoting the energy transition, providing incentive and contributing to a level playing field and a just and equitable transition, as reasoned below. Further discussion on how revenue disbursement best achieves these objectives is included in document ISWG-GHG 16/2/5.

Effectively promote the energy transition of shipping

13 This objective should be satisfied through significant revenue deployment on RD&D and/or reward payments or equivalent incentivisation for early use of zero/near-zero solutions. A critical enabler of the energy transition of shipping is a policy framework that incentivises early-use of the long-run solutions. Or in other words, the technologies that will be needed at large scale by 2040, will need to be incentivized at least for small scale use by 2030. The GFS, on its own cannot do this – it will only incentivise incremental improvements over time, and does not provide any incentive for 'over compliance', regardless of whether specified with or without the additional administrative burden of flexibility mechanisms (as in documents ISWG-GHG 15/3/2 and ISWG-GHG 15/3/4).

14 The extent to which this objective is addressed is a function of the total revenues raised (price and coverage), and the allocation of spending to RD&D and reward across a wide geography, and whether that spending is prioritised on the long-run energy solutions or transition solutions. GHG pricing in combination with revenue use is central to delivering this stated objective of the IMO Strategy. To be effective, promotion of the energy transition needs to apply globally and in recognition of the differing barriers faced by lower income and remote economies in accessing and resourcing uptake of new energy solutions.

15 The combination of a universal levy with a mandatory review and ratchet mechanism, followed by a GFS without flexibility mechanisms and with increasing stringency is the only combination that provides market certainty to the industry and its investors of the irrevocable direction of transition to complete decarbonisation, the level of revenues available to support the investment needed in mitigation of the industry's pollution and the support to enable an equitable transition to allow all States to transition in the short timescales now available. All States have concurred that an effective energy transition can only be achieved if it leaves no State behind. Without dedicated funding for climate adaptation and mitigation, developing countries, notably SIDS and LDCs, may not be able to join the urgent energy transition in shipping, jeopardising the GHG emission reduction objectives of the 2023 Strategy.

Provide the world fleet with a needed incentive

16 Achieving the 2023 Strategy levels of ambition, especially the 2040 interim target, requires a global fleet operating almost exclusively on near-zero and zero GHG emission technologies and fuels in 2040 - in 17 years' time[4]. That rate of technology change means that all new builds need to be near-zero and zero GHG emissions compatible from now, and there needs to be a business case for retrofitting (or prematurely scrapping) any of the existing fleet that are still active in 2040. The incremental change induced by a GFS risks leaving this fleetwide technology change too late, either dooming the transition or creating a period of disruption. The proposed levy and revenue use as a key incentive of a growing portion of early adoption of near-zero and zero GHG emission fleet over this accelerated period - both new builds and then increasingly retrofits.

Contribute to a level playing field and a just and equitable transition

17 The co-sponsors reaffirm their previous contention that both measures should be implemented without recourse to exemptions and agree with the analysis of the World Bank and the summary of UNCTAD that a "universal regulatory framework applicable to all ships should be supported, (...) to avoid a two-speed decarbonization process (...) given that fragmented solutions and exemptions in international shipping can lead to suboptimal outcomes whereby developing countries could end up being serviced by high-carbon shipping"[5]. We concur with ICS and IBIA in document ISWG-GHG 16/2 that exemptions in regard to the GFS "also lead to unfair competition and perverse incentives".

18 A level playing field is enabled through ensuring that policies are flag neutral. This means that we cannot apply differentiation that recognises the needs and circumstances of different countries through the way ships of different flags are regulated (e.g. GFI stringency in a GFS, GHG price payments or revenue/reward). The proposal of the co-sponsors that GHG pricing is universal, and that revenues are distributed by a third party independent from IMO and its structures, is fully compliant with this stated objective.

19 The co-sponsors fully support the need for the transition to ensure that the human workforce that is the backbone of the industry and primarily from the poorer and climate most vulnerable states, is provided all assistance necessary and is supported in this transition. A just transition is only enabled if there is a widespread investment in reskilling of the labour force (both at sea and on land), and if the transition is performed with the utmost attention to safety. Whilst much of that reskilling effort may be private sector or national government funded, only revenues deployed from a global fund, as we propose, can ensure a globally inclusive and just transition. A just transition is a small but critical subset of a wider equitable transition.

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4 The 2023 strategy requires cuts in emissions *per ship* of up to 60% by 2030 and as much as 91% by 2040.https://theconversation.com/why-the-shipping-industrys-increased-climate-ambition-spells-the- end-for-its-fossil-fuel-use-209321

5 https://unctad.org/news/decarbonizing-shipping-how-speed-transition-and-ensure-its-fair

20 While a rapid technology revolution requires an incentivised market that rewards first movers and repays investments in efficiencies, an equitable transition requires investment on a broader basis: on the priority needs of disproportionately negatively impacted States as well as on the needs of climate vulnerable States. Both priorities are required for an effective transition and must now be incorporated in the specification of the measures and their implementation enabled via the disbursement of revenues. The cost of a truly equitable global transition and the scale of shipping's contribution have not been quantified but both are assumed to be significant.

Possible revised draft amendments to MARPOL Annex VI

21 Revised draft amendments to MARPOL Annex VI were proposed in document MEPC 77/7/4 to accommodate the levy proposal by Marshall and Solomon Islands at that time. The co-sponsors also note and see useful drafting suggestions for amendment of certain regulations within documents ISWG-GHG 14/3 and ISWG-GHG 15/3. Specifically, the co-sponsors broadly support the concepts these proposals suggest around collection and issuance of Statement of Compliance. However, the co-sponsors think that it is premature to finalize language on the way the fund is structured, and revenue disbursed. The co-sponsors are confident that an evolution of their existing proposal, in combination with an integration of the ICS/IBIA and Japan proposed amendments could be achieved by MEPC 82, assuming further focused debate time on the subject of revenue disbursement, as proposed in document ISWG GHG 16/2/5.

Action requested of the Working Group

22 The Working Group is invited to consider the information contained in this document and recommend this definition of a GFS and GHG pricing measure to the Committee at MEPC 81, and as a focus for the Steering Committee on CIA's further analysis.