INTERNATIONAL MARITIME ORGANIZATION

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INTERSESSIONAL MEETING OF THE WORKING GROUP ON GHG EMISSIONS FROM SHIPS
3rd session
Agenda item 3

GHG-WG 3/3/3
25 February 2011
ENGLISH ONLY

REVIEW OF PROPOSED MBMs

The IMO, global MBMs that reduce emissions and the question of Principles

Submitted by Clean Shipping Coalition (CSC) and World Wide Fund for Nature (WWF)

SUMMARY

Executive summary:	This document suggests returning to the question of the application of Market-Based Measures (MBMs) and analyses options for establishing an MBM that is based on the IMO principle of non-discrimination (no more favourable treatment) and also accounts for the UNFCCC principle of common but differentiated responsibilities and respective capabilities (CBDR). The document examines four ways in which differentiated application could be achieved, and conclude that all have serious drawbacks. The co-sponsors suggest that the UNFCCC allows for a global shipping measure, provided that developing countries do not incur net incremental costs, and that a rebate mechanism could achieve this. The report of the UN High-level Advisory Group on Climate Change Financing endorses the concept of a global scheme with a rebate mechanism to ensure "no net incidence" on developing countries. Finally, the co-sponsors request that these matters be discussed at the GHG-WG 3 itself, with a view to recommending that MEPC prepare a resolution for the IMO Assembly.
Strategic direction:	7.3
High-level action:	7.3.2
Planned output:	7.3.2.1
Action to be taken:	Paragraph 30
Related documents:	MEPC 58/4/32, MEPC 58/23; MEPC 60/4/55; MEPC 61/5/33, MEPC 61/INF.2; and MEPC 62/INF.3

Introduction

1 During the course of debates in IMO regarding greenhouse gas (GHG) emissions from international shipping, many States have maintained the view that MBMs must be consistent with the UNFCCC principle of (CBDR). Other States advocated that this contradicted IMO principles.

2 There has, to date, been little attempt to bridge the two positions. In our view, a substantive debate is now required to determine how shipping sector MBMs can be designed in a manner that is consistent with the IMO framework of no more favourable treatment, accounts for the principle of CBDR, does not distort competition, and minimizes or eliminates carbon leakage.

3 While further work is certainly required on the details of the proposals for MBMs that have been submitted to IMO, CSC and WWF believe that all have reached a stage of development where Member States and observers are able to understand their broad implications. On the other hand, the debate on the application of MBMs has, for the most part, become simplified and polarized between those that insist on global measures, and those that insist that such measures should not be applied to ships registered in developing countries.

4 In this document, CCS and WWF examine a number of ways in which MBMs applied to the shipping sector could be designed to account for CBDR. Broadly, these options fall into two categories: those that attempt to define "developed country shipping" so that an MBM could be applied only to this subset of shipping activity (1 to 4 below), and those that would apply the MBM to all international shipping, and distribute revenues raised in a differentiated way, i.e. to the benefit of developing countries (5 to 6 below). The options analysed here include:

.1 Differentiation by flag;

.2 Differentiation by country of Genuine Control (Beneficial Ownership);

.3 Differentiation by route of ship;

.4 Differentiation by final destination of cargo;

.5 Global application with revenue used for climate change action in developing countries; and

.6 Global application with a rebate mechanism to ensure no net incidence on developing countries, and remaining proceeds used for climate change action in developing countries.

Differentiation by Flag

5 It is widely agreed that it would be ineffective to apply a policy only to ships flying the flag of developed countries. Already over three-quarters of the world's ships are registered in developing countries, and the remaining quarter would quickly follow if it allowed them to escape an MBM. This would also be a clear violation of the IMO principle of flag neutrality as provided in Article 1 (b) of the IMO Constitutive Convention.

Differentiation by country of Genuine Control

6 In document MEPC 58/4/32, China and India proposed that ships of developed countries could be identified according to the country of domicile of the shipowner ("Country of Genuine Control"). They noted that UNCTAD's Review of Maritime Transport 2007 (RMT 2007) provides relevant statistics, using data supplied by Lloyd's Register-Fairplay. According to this data, developed countries controlled about 65.9% of the world's Deadweight Tonnage (dwt) in January 2007, while developing countries and countries in transition controlled 31.2% and 2.9% respectively.

7 At first sight, this appears attractive, given that approximately two-thirds of shipping activity would be covered. However, UNCTAD in RMT 2007 noted that the data is not comprehensive, and that "determining [the country of Genuine Control] has required making certain judgements". While data requirements could perhaps be met, it seems likely that less scrupulous shipowners would respond to such a policy by changing their country of domicile, or creating subsidiary companies domiciled in developing countries to act as the legal owner of their ships. Such practices are common in certain industries to gain taxation benefits, and are notoriously difficult to control.

8 Furthermore, such a policy could result in two ships competing for the same cargo on the same route, one subject to an MBM and one not. This would create a clear competitive distortion and violate the principle of no more favourable treatment of ships.

Differentiation by route of ship

9 A different approach is to apply a policy equally to ships of all nationalities, but on a subset of routes. On the basis that an importer is, in general, likely to bear any increased costs of shipping, discussion of this option has usually been of a policy applied to emissions generated on routes to developed countries.

10 This option would not distort competition between operators, but could lead to evasion, and thus carbon leakage. For instance, a ship sailing from Asia destined for Europe could make an extra port call at a North African port, just outside European waters, with the result that the "route" included in the MBM would in fact be just the last leg of the ship's journey. CE Delft has carried out preliminary calculations that suggest that such a strategy would be economically worthwhile for ship operators at a carbon price of $30/tonne.[1]

Differentiation by final destination of cargo

11 Another option that has been suggested is to differentiate the application of an MBM based on final destination of the goods. Ships transporting goods to developed countries would be covered, while ships transporting goods to developing countries would not. Ships transporting goods to both developed and developing countries would be partially covered (MEPC 58/23, annex 9, pages 25 and 26).

12 However, the approach based on the final destination of goods, although relatively simple for tankers and dry bulk carriers, proved complex for ships carrying multiple goods, particularly for container ships. It would require obtaining a verifiable share of goods transported to developed countries by each ship or company worldwide. Given the tens of thousands of ships operating worldwide, collecting and validating such information would require significant administrative efforts.

Global application with revenue used for climate change action in developing countries

13 With the exception of the Ship Efficiency Credit Trading (SECT) proposal by the United States, all proposed MBMs would implement some sort of carbon price for shipping and raise revenue. Figures are given in the table on pages 11 and 12 of the MBM Expert Group report (MEPC 61/INF.2). In some proposals (GHG Fund, ETS as proposed by Norway and by France) it is explicitly envisaged that the revenue raised would be used for climate change mitigation and adaptation actions in developing countries, both inside and

[1] CE Delft's report "Left on the High Seas: Global Climate Policies for International Transport", page 34, available at www.ce.nl.

outside the shipping sector. Apart from SECT where no revenue is raised, and the UK ETS proposal where national governments retain control of the proceeds of the ETS, all MBMs could easily be amended such that revenues were distributed in this way.

14 Strategy and funding for additional in-sector mitigation could be administered by a scaled-up version of the IMO Technical Co-operation Fund or a successor body, and could include the following activities:

.1 funding for port upgrades in developing countries, with a focus on environmentally-beneficial technologies such as renewably-powered cold-ironing facilities, efficiency improvements including data systems to enable voyage optimization practices such as virtual arrival, and so on;

.2 knowledge transfer through funding of developing country students to undertake energy efficiency research projects;

.3 funding for research and development into energy efficiency technologies in developing countries or through developed-developing country partnerships; and

.4 funding of energy efficiency awareness training for mariners in developing countries.

15 The list above is far from exhaustive. Many other possibilities could be imagined that would assist the shipping industry as a whole, and developing countries in particular, contributing to the sustainable development of the maritime sector.

16 Out of sector mitigation and adaptation to climate change could be financed by transferring revenue to the appropriate channels under the UNFCCC, likely the Green Climate Fund forming part of the UNFCCC Cancún Agreements in December 2010. The funds would be used for the exclusive benefit of developing countries, with a focus on those most vulnerable to the adverse effects of climate change.

17 A first-order estimate of the costs resulting from an MBM would be the total amount by which the cost of shipping goods increases. On this measure, the majority of the costs of a global MBM would be borne by developed countries (around two-thirds, their share of imports). The vast majority of revenues would be transferred to developing countries.

18 Two main objections have been raised to this proposal. Firstly, although developing countries as a group would be net beneficiaries, there would be individual winners and losers, as not all countries will receive substantial climate change finance, and some countries may receive less than their costs from a shipping MBM. Secondly, there is an objection in principle to the idea that developing countries should contribute a share of climate financing, given the provisions of the UNFCCC.

Global application with a rebate mechanism to ensure no net economic incidence on developing countries, and revenue used for climate change action in developing countries

19 Both of the concerns cited in paragraph 18 above can be met by adding a further element, namely a rebate mechanism to developing countries, as proposed by IUCN in documents MEPC 60/4/55 and MEPC 61/5/33. Further details can be found in these documents, but briefly, all ships would participate in a scheme, with revenues collected in a

central fund. Each developing country would automatically receive a rebate of a proportion of the revenues, calculated according to that country's share of global imports. The remainder of revenues, representing the costs to developed countries, would be disbursed to developing countries for the climate change purposes described in paragraphs 14 to 16 above. A developing country could voluntarily forego its rebate and would receive recognition for doing so.

20 The next step in the analysis is to consider how such a scheme would fit with the relevant provisions of the UNFCCC. Paragraph 4.1 of the Framework Convention, which provides for co-operative trans-boundary approaches says that:

> *All Parties, taking into account their common but differentiated responsibilities and their specific national and regional development priorities, objectives and circumstances, shall:*
>
> > *(c) Promote and cooperate in the development, application and diffusion, including transfer, of technologies, practices and processes that control, reduce or prevent anthropogenic emissions of greenhouse gases not controlled by the Montreal Protocol in all relevant sectors, including [...] transport ...*

A global sectoral mechanism for shipping would be a process, undertaken by all Parties, that controls emissions of GHG from transport. The UNFCCC therefore allows for global application, under the scope of 4.1(c).

21 Paragraph 4.3 sets out arrangements for funding such approaches:

> *The developed country Parties and other developed Parties included in Annex II shall [...] provide such financial resources, including for the transfer of technology, needed by the developing country Parties to meet the agreed full incremental costs of implementing measures that are covered by paragraph 1 of this Article and that are agreed between a developing country Party and the international entity or entities referred to in Article 11, in accordance with that Article.*

22 The rebate mechanism is constructed specifically so that developing countries incur no net incremental costs. Financial assistance for the transfer of clean technologies would be provided, out of developed countries' revenues, such as via the activities described in paragraphs 14 and 15 above.

23 Consequently, under the rebate mechanism, developing countries would not be contributing to climate change finance (although they could do so voluntarily). The revenues that remained in the fund after the rebate had been implemented would come from developed countries, complying therefore with the principles and provisions of the UNFCCC.

The report of the UN High-Level Advisory Group on Climate Finance

24 In 2010 the UN Secretary General convened a High-Level Advisory Group on Climate Finance (AGF), tasked with investigating so-called "innovative sources" of finance for climate change that could contribute towards the $100 billion per year by 2020 pledged in the Copenhagen Accord. The Group was chaired by the Heads of State of Norway and Ethiopia, and included Ministers from Brazil, Mexico, the United Kingdom, France, South Africa, Australia, Japan, Singapore, the United States of America, India, China, and senior representatives from intergovernmental organizations, business and academia.

25 The AGF took the view that any measures applied to international shipping (and aviation) should be constructed to ensure "no net incidence" or burden on developing countries. This concept is functionally equivalent to the concept contained in the UNFCCC that developing countries should not incur incremental costs of climate change actions. The group recommended the establishment of a carbon-pricing system for international shipping emissions, and identified the rebate mechanism (from document MEPC 60/4/55, outlined in paragraphs 19 to 23), as a way to ensure that the principle of "no net incidence" on developing countries was respected.

26 In the scheme envisaged by the AGF, between $4 billion and $9 billion would be available for climate change finance, after the rebate mechanism had been applied. The range is based on the assumption that between 25% and 50% of revenues would be made available for climate change.

27 It is for Governments to decide the distribution of revenues in negotiation. However, it is clear from the figures provided in the AGF report that there could be sufficient revenues to ensure no net incidence on developing countries, and make a significant contribution both to the sustainable development of the maritime sector in developing countries, and the wider fight against climate change, to the benefit of developed and developing countries.

28 The AGF Report is available as document MEPC 62/INF.3. The AGF also published a work stream paper on international transport, which includes further investigation into the possible costs of a maritime MBM[2].

Conclusions

29 There are various proposals for differentiated application of an MBM for international shipping, but all raise concerns over data, enforcement or competitive distortion. A global mechanism avoids these concerns and could respect the principle of CBDR if it resulted in no net incidence on developing countries. A rebate mechanism could be applied to any revenue-raising MBM, is technically feasible, and if correctly designed, could ensure no net incidence on developing countries.

Action requested of the Intersessional Meeting

30 The Intersessional Meeting is invited to consider the issues provided in this document with a view to recommend to MEPC to develop a draft Assembly resolution on the development of a global maritime MBM that reduces emissions from the maritime sector, results in no net incidence on developing countries, and does not distort competition.

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[2] The AGF documents are also publicly available; the AGF Report at: http://www.un.org/wcm/webdav/site/climatechange/shared/Documents/AGF_reports/AGF%20Report.pdf; the AGF's International Transport work-stream paper at: http://www.un.org/wcm/webdav/site/climatechange/shared/Documents/AGF_reports/Workstream_2_International_Transport_Revised.pdf