What is the European bloc's position on the use of revenues from a price on international shipping's GHG pollution?

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Abstract

Europe's IMO proposed mid-term measures revenue use will not result in a just and equitable 1.5 degree aligned transition, its approach to using revenues to meet the agreed objectives of the 2023 IMO Strategy is regressive, unbalanced and inadequate. It is also inconsistent with the precedent and process it has already established at home for disbursement of international shipping emissions revenues. However, Europe's regional revenue allocation model, if it were scaled to a universally applied international program, is much more consistent with the position advocated for by the 6PAC+ alliance in ISWG-GHG 17/2/13. If applied universally rather than regionally it would also eliminate the current issues of both trade and carbon leakage to neighboring jurisdictions currently experienced by EU states.

As proponents of the various measures now negotiate in the lead up to the IMO's decision-making point at MEPC83, it would appear sensible for those seeking convergence with the European-championed proposal to suggest Europe amend its current international revenue disbursement narrative to one that mirrors its regional approach

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The IMO is due to agree on a combination of measures for achieving its 2023 Strategy for reducing GHG emissions from ships to net zero by 2050 at MEPC83 in April 2025.[1] Central to the effectiveness of such measures is the question of how the potentially significant revenue generated is to be used.[2,3,4] Despite its obvious critical importance, the subject has yet to be formally debated in any depth at IMO. Repeated requests by the 6PAC+ bloc of small islands States to have dedicated agenda time and a dedicated expert workshop on this subject having been thus far largely ignored.

As the timelines for agreement are now desperately short, it is likely that this key feature will now be traded out via politically-charged negotiations bilaterally and during the intersessional working group meetings leading up to MEPC83 over the legal drafting of the requisite amendments to MARPOL, including a new Chapter 5 to Annex VI.

There are four main proposals on the table. The most ambitious of these, promoted by the 6PAC+ bloc, has consisently called for revenues to be allocated under the Polluter Pays Principle to both mitigating the source of the pollution and making fair reparation for the damage caused, with a majority of all revenues diverted to the priority needs of climate vulnerable developing states, particularly SIDS and LDCs. The industry-championed proposal from ICS supported by two major open-registry states, Bahamas and Liberia, would see a much lower GHG price and revenue stream primarily dedicated to incentivizing the industry. The emerging economies/petro-States bloc wants almost all revenues from their low ambition proposal used for a complicated credit and compliance trading regime on a limited range of emissions also primarily recycling revenues within the industry. The fourth proposal is from the European bloc.

At ISWG-GHG 17/2/2 Europe set out, with relative clarity, it's position on the use of revenues in the event IMO agrees to a pricing mechanism.[5] In this narrative, the main portion of revenues would be used to incentivize the fleet via a flexible compliance/credit scheme and a 'feebate'/reward scheme, augmented by a $100/ton CO2-e levy proceeds going to a capped $1billion p.a. R&D fund and additional (but of unspecified quantum) tightly prescribed funds to enable the labour transition of seafarers and investment in the 'maritime related' needs of developing countries, particularly SIDS/LDCs, via a competitive project funding pool. A staggered formulae is offered for the latter funds to be used for prescribed in-sector only uses, on a project-by-project basis and delivered via an IMO controlled process through a graduated mix of grants and loans determined by the World Bank's ranking of developing countries' economic status. Funds would not be made available directly to the government of such States to deploy at their own discretion and according to nationally determined priorities.

However, Europe's position at IMO is not consistent with the regime it has already established for the use of international shipping emission revenues it collects under its existing regional fuel standard and expanded EU ETS that came into effect on 1 January 2024.[6] In that funds are directed to two sources, 60% going directly to the EU member States whose authorities use the revenues for their own determined 'climate related' activities and 40% to the EU which then allocates its portion, minus administration and related costs, to three 'green maritime' related EU funds, with some portion allocated differentially to poorer member States, based on disparities in member States needs and economic status.

Europe's IMO position appears in direct contrast to its own regional use of funds. Under their regional scheme, as with their IMO proposal, the revenues are derived from two sources; credit/compliance trading revenues accrued from penalties on the fuel standard (FuelEU) and active funds from a price on emissions (but from credit trading rather from a flat rate levy).[7] But here the similarities cease.

At IMO Europe does not favor direct funding being delivered directly to governments and has the greater part of the revenues returned to the industry via credit and compliance trading. The use of funds beyond this purpose is tightly prescribed to a limited number of activities directly associated with the industry. It is hard not to see this as anything but a double standard. At home, EU member

[1]https://www.imo.org/en/MediaCentre/PressBriefings/pages/MEPC-82-makes-progress-IMO-netzero-framework.aspx
[2]Ranging from estimates of $10's to $100's billion p.a. and potentially active from 2027.
[3]https://papers.ssrn.com/sol3/papers.cfm?abstract$_i d$ = 4940789
[4]https://www.mcst-rmiusp.org/index.php/news/latest-science/1311-disbursement-of-revenues-generated-by-imo-s-emission-reduction-measures
[5]ISWG GHG 17/2 contains the European position on the parameters for operating an IMO Fund and ISWG17/2/2 sets out how revenues from measures should be allocated.
[6]https://climate.ec.europa.eu/eu-action/transport/reducing-emissions-shipping-sector
[7]Labelled as 'contributions', presumably because of perceived acceptability of the term levy at IMO

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States are empowered and almost completely in control of the use of the majority of revenues and able to allocate these across a broad range of nationally determined uses, loosely defined as 'climate related activities' (even including subsidization of national electricity tariffs). States are expected to *endeavour* to use the €100/tonne/CO2e windfall revenues they collect from the fuel standard penalties on a range of in-sector maritime emission reduction activities, but this is not mandatory. The States are then generously supported by regional funding for research, development and 'innovation' including targeted use of maritime emission reduction related activities and more general climate response measures, including dedicated funding to offset the 'social costs' of the measures.

All in all, Europe's regional use of funds appears a win-win all round if you are lucky enough to be a member of the Union. Not so good if you are a non-union State trading with the Union where it's all lose unless you're an adjourning State and can benefit from the trade and bunker leakage.[8] Any costs to the industry are simply passed to the consumers, Union and non-Union alike, and the shippers, receiving rewards for over-compliance and, for the good ones, income from credit/compliance trading. They even get to earn windfall profits off the exchange.[9] The majority of the income, which goes directly to EU member State treasuries, is also windfall earnings. No question of these States having to loan all or a portion of this funding through intermediary financial institutions or find match funding from internal sources. As long as a link can be made to a rather loosely defined list of eligible activities (including electricity and roading subsidization) the State is free to spend it as it sees fit, determine what balance should exist between in and out of sector spending and whether the funds should be further disbursed as grants or loans. All done on a post-allocation reporting basis. And it allows for consideration of compensation for the 'social cost' of measures. It even provides for a degree of differential allocation to accommodate the economic inequity between EU members.

The biggest negative of Europe's regional scheme would appear to be that it is regional. This poses five main issues for the Union to resolve prior to the plenary session at MEPC83:

1. 1. Even though significant income is generated to EU member States, this isn't necessarily sufficient to offset the lost income from leaking trade, port/bunker fees, employment opportunities, etc to non-EU neighboring jurisdictions not subject to the EU measures.[10] This problem would be resolved if the regional regime was replaced by a universal global scheme.
2. The EU's regional regime cannot avoid the issue of carbon leakage to non-EU neighboring jurisdictions not subject to the EU measures.
3. The double tax that around 40% of international trade will be subject to if IMO adopts a price on GHG pollution, unless IMO grants exemptions to emissions accounted for under the EU regime, or the EU withdraws or substantively revises its regime by 2027. Although the issue of exemptions has not been fully resolved at MEPC, the concept generally has not been supported in IMO negotiations to date. While the EU has committed to reviewing its regime in the event IMO adopts a complementary regime, there is no hard commitment to withdraw or fundamentally reframe it. The EU review process would not be triggered until IMO adopts the requisite MARPOL amendments and the subsequent review, recommendation of changes and then their enactment through the Union's decision-making processes strongly implies that an overlap will exist at 2027 affecting a large portion of global shipping. The response to any review would likely be determined as much or more by European domestic, as opposed to international, political imperatives present at the time, providing even less certainty as to how the Union would resolve this conflict. The situation could be worse if other nations or trading blocs were to bring additional national or regional shipping emissions charging regimes into play.
4. There is obvious inconsistency in its regional and IMO positioning. As it currently stands, the optic is a) that the world's largest trading bloc/largest economic beneficiary of the industrialization-colonial era/largest historical emitter/major current emitter is earning windfall income from penalties on international shipping that directly benefit the Union and b) that it has imposed on itself a highly progressive and flexible revenue disbursement scheme for use of funds in the region but is proposing a highly prescriptive and predominately regressive scheme for similar funding at IMO.
5. The entirety of the EU ETS, including the new maritime provisions, is predicated on it being based on the principle that the polluter should pay. This is clearly stated on all relevant EU websites and was repeatedly referred to in the deliberations on this matter by the European decision-making bodies and is, of course, rational and consistent with international legal and economic opinion. Yet, thus far, the European bloc at IMO has consistently refused to name the polluter pays principle or agree to its acceptance as the primary basis for allocating IMO generated revenues.

There is potentially a 6th issue of note. In terms of administering the regional funds, all real costs of managing and reporting are met from the fund, both the passively managed trading components and the active funds. In their IMO proposal however, the costs of the trading schemes would be met by the schemes but the remaining funds would be subject to a maximum of a 1-2% administration overhead. It is not clear whether the EU funds are managed within this constraint, but it is expected to be higher.

Europe's IMO proposed revenue use will not result in a just and equitable 1.5 degree aligned transition, its approach to using revenues to meet the agreed objectives of the 2023 IMO Strategy is regressive, unbalanced and inadequate. It is also inconsistent with the precedent it has already established at home for revenue disbursement. However, Europe's regional use of funds, if scaled to a universally applied international regime, is much more consistent with the position advocated for by the 6PAC+ alliance in ISWG-GHG 17/2/13. If applied universally rather than regionally it would also eliminate the current issues of both trade and carbon leakage to neighboring jurisdictions currently experienced by EU states.

As proponents of the various measures now negotiate in the lead up to the decision-making point at MEPC83, it would appear sensible for those seeking convergence with the European championed proposal in regard use of revenues to suggest Europe first amend its current international revenue disbursement narrative to one that mirrors its regional approach.

Annex I - Key characteristics of Europe's regional GHG shipping emissions pricing regime and related revenue use

There are two core revenue generating components to the EU's maritime emission regime: penalties for non-compliance with the regional Fuel Standard, and credits purchased from the regional ETS.

The Fuel EU Maritime Regulation (FuelEU) is a complementary regulation to the EU ETS, ensuring that the greenhouse gas intensity of fuels used by the shipping sector will gradually decrease over time by setting maximum limits on the yearly greenhouse gas intensity of the energy used by a ship.[11] Ships that are not compliant must purchase compliance units (FCUs). EU registered shipping agents can buy, bank, borrow or sell credits. There is no central registry

[8] https://thebftonline.com/2024/01/15/ghana-to-lose-e90m-per-annum-to-eu-ets-shipping-carbon-tax-2/

[9] https://www.transportenvironment.org/articles/shipping-majors-profiteering-from-eu-carbon-emissions-charge-study

[10] https://theloadstar.com/congestion-fears-as-box-lines-plan-to-dodge-eu-carbon-tax-with-uk-first-call/

[11] https://www.emsa.europa.eu/reducing-emissions/fuel-eu-maritime-regulation.html

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for compliance units.[12] Ships are allowed to pool their compliance balance with one or more other ships.

Ships that are non-compliant and without FCUs pay penalties to the port State. According to Article 23, paragraph 11, of FuelEU Maritime Regulation, Member States shall endeavour to ensure that the revenue generated from the FuelEU penalties is used to support:

- the deployment and the use of renewable and low-carbon fuels in the maritime sector by stimulating the production these fuels for the maritime sector,
- facilitating the construction of bunkering facilities or infrastructure in ports,
- development, testing and deployment of the most innovative technologies in the fleet to achieve significant emission reductions.

The EU Emissions Trading Scheme. The EU ETS was expanded from 2024 to include all domestic and 50% of international shipping GHG emissions.[13] Its core characteristics include:

1. A Polluter Pays based emissions cap and credit trading scheme. GHG polluters need to purchase credits to offset their pollution. The number of available credits is reduced over time causing the price at market to increase.
2. It operates in all EU countries plus Iceland, Liechtenstein and Norway , and is linked to the Swiss ETS (since 2020).[14]
3. The addition of shipping is expected to add around €4.5 billion between 2025 and 2030.[15] The EU ETS revenue primarily flows to national budgets and since the 2023 reform, Member States have to spend EU ETS revenues on climate-related activities pursuant to Article 10 (3) of the EU ETS Directive (with the exception of money used to pay indirect carbon costs to some energy-intensive producers). Climate-related activities are defined as any activities aimed at reducing emissions, avoiding deforestation, fostering renewables and related infrastructure, energy efficiency, scaling up cleaner technologies for mobility and heating, as well as deploying carbon capture and storage and carbon removals, not to mention protecting vulnerable households affected by increased costs of electricity.
4. The remaining EU ETS revenue is currently split between EU funding mechanisms supporting the financing of clean technology and the energy transition:
   a The Innovation Fund supports the scaling up of innovative clean technology through grants and auctions. It is expected to raise over €57 billion between 2021 and 2030 to be invested in technologies related to the decarbonisation of heavy industries, the harnessing of renewable energy sources and infrastructure, carbon capture and storage, sustainable mobility and buildings. The list of these purposes has been expanded to explicitly cover measures to decarbonise the maritime sector, including ports. The list also includes the financing of climate action in vulnerable third countries, including adaptation to the impacts of climate change.[16] €1.7 billion is allocated to the maritime sector through to 2030.
   b The Modernisation Fund supports 13 lower-income member states with their energy transition, including investments in lower-income Member States aimed at modernizing energy systems, improving energy efficiency, and supporting a socially just transition to climate neutrality. It is one of the solidarity mechanisms of the EU ETS, which addresses Member States' different starting points in the decarbonization challenge. In 2021-2030, the fund is expected to raise and invest €69.5 billion.
   c The Social Climate Fund (SCF) has been created to address the social impact of carbon pricing, making sure vulnerable citizens are not left behind in the green transition. The SCF will mobilise €86.7 billion in the 2026-2032 period. Starting from 2026, a small portion of the revenues of the original ETS (power, industry, aviation and shipping) will fund the Social Climate Fund (SCF), with the majority of funding coming from the ETS for road transport and buildings and from member state contributions.
   d Horizon Europe, the EU's €93 billion research and innovation funding program has also been expanded to include maritime related investment.

[12] https://transport.ec.europa.eu/transport-modes/maritime/decarbonising-maritime-transport-fueleu-maritime/questions-and-answers-regulation-eu-20231805-use-renewable-and-low-carbon-fuels-maritime-transport The 50% charge on intentional emissions is being introduced progressively; 40% being charged in 2024, 70% in 2025 and 100% in 2026.

[13] https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/what-eu-ets

[14] Interestingly, Norway is not a co-sponsor of the European IMO proposal but has co-sponsored the proposal of China et al.

[15] https://theicct.org/publication/shipping-emissions-under-eu-ets-dec23/. A number of industry websites carry the estimate of the EU ETS costing shipping between €8-10 billion per annum once fully operational. https://www.socialeurope.eu/maritime-needs-stronger-wind-to-cut-its-emissions

[16] Details of this part of the mechanism are sparse but are assumed to assist facilitating European investment in large scale renewable energy projects in, for example, African countries. https://www.bloomberg.com/news/features/2024-06-06/renewable-energy-in-africa-namibia-plans-to-become-a-green-hydrogen-hub

Annex 2 - Key characteristics of Europe's IMO revenue use position

Embedded in ISWG-GHG 17/2/2 is Europe's position on the use of revenues. Revenues are generated through trading compliance credits (RCUs) under the proposed global fuel standard (GFS) and a "GHG contribution" (or levy). 6 revenue uses are outlined:

1. a minor administration element [1-2%] for all the elements in the combination

The use of GFS compliance trading revenues is also bracketed as providing reward for over compliant ships:

1. "The revenues of RCU sales will be earmarked exclusively for purposes which balance out the shortfall in reduction in the emissions, which the RCU represent, to reward ships."

The GHG contribution/levy revenues would be directed to four purposes

1. The "feebate"/reward for the use of eligible Zero-Near Zero GHG emission fuels by shippers
2. Research, Development and Innovation (R,DI) related to the energy transition of shipping, available on a project basis and capped at $1billon p.a.[17]
3. An "appropriate" part of the revenues will be used for capacity-building, seafarers' training and similar projects.
4. Support for the energy transition within the value chain of energy (fuels and technologies) for shipping in all countries with an emphasis on developing countries, in particular in SIDS and LDCs and to address potential DNI. This could include investments in fuel production, port infrastructure, bunkering facilities, energy efficiency investment schemes at ports and on vessels, and electrification of ferry routes, etc. Funds could also target the development of the infrastructures and fuel transport chain in maritime shipping routes.

The revenues for supporting the energy transition in the developing world would be managed by an IMO controlled fund and allocated differentially dependent on the World Bank's country income ranking as a mixture of grants, low interest loans and co-financing. Disbursement would be subject to a positive project assessment and a credit assessment as appropriate. Funds could be disbursed in a competitive manner via different funding purposes and potentially via existing funding institutions and funding mechanisms.

[17] The R,D&I fund would specifically not extend to deployment, the European submission arguing this would lead to market distortion.