

# A supra-regional tax



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**IN JUST FIVE** months, shipping will be included in the European Union's emissions trading system (ETS). To put it more simply, shipping will be subject to a carbon tax in the EU. This will have a series of ramifications for carriers and shippers not only in the EU but also globally.

Inclusion in the ETS will affect not only the cost of shipping to and from the EU but also the cost of shipping elsewhere, and it will likely put upward pressure on pricing for cargo that doesn't touch the EU at all.

At first glance, this might seem counterintuitive. Why would a tax in the EU have any effect on trade that has nothing to do with the EU?

First, the EU carbon tax also includes shipments to and from the EU. Technically speaking, the ocean carrier will be required to pay a carbon tax for 50% of the emissions on the journey from the last port of call before arriving in the EU to the first port of call in the EU and vice versa. In addition, the carrier is on the hook for 100% of the emissions for any journey between EU ports.

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It is also critical to note that the tax is levied on the vessel performing the journey, not on the individual containers loaded on the vessel.

So, how would this impact shippers moving goods solely between non-EU ports?

Some liner services move through the EU. CMA CGM's Turkey US Express (TUX) service, for example, links three ports in Turkey with the US East Coast, calling at other ports in the Mediterranean along the way. The carrier even markets the TUX loop as offering "dedicated coverage from Turkey and West Med to the US East Coast."

Neither Turkey nor the United States is part of the EU carbon tax regime. However, because the TUX service calls several Mediterranean ports in the EU in both directions, as currently designed, it would incur the following penalties under the EU ETS:

- 50% carbon tax from Istanbul to Piraeus;
- 100% carbon tax from Piraeus to Algeiras;
- 50% carbon tax from Algeiras to New York;
- 50% carbon tax from Savannah to Algeiras;
- And 50% carbon tax from Algeiras to Iskenderun.

The entire round-trip journey is 13,000 nautical miles, and only 1,700 of those nautical miles would not be subject to the ETS, 2,000 would be subject to a 100% tax and 9,300 would be subject to a 50% tax. In effect, this means the round-trip service will be subject to 51% of the EU carbon tax.



As a result, shippers using this service to move cargo exclusively between Turkey and the US would be required to pay a share of EU carbon tax. There are only two ways to avoid this. CMA CGM could remove all EU port calls from the rotation, but this will limit the amount of cargo it can carry, resulting in a downsizing of the vessels and higher per slot costs.

The other option would be to pass the full cost of the EU carbon tax onto shippers with cargo being picked up or delivered in the EU. This would increase costs significantly for those shippers, however,

and could prompt them to switch to competing services or carriers with more favorable terms.

And the TUX is just one example; there are multiple "cross-EU" services that will be similarly impacted by the ETS from January 2024.

On a larger scale, the effect will be a slow skewing of vessel deployments. Because the EU is presently the only region with such a carbon tax, carriers have an economic incentive to shift their most fuel-efficient vessels to services that touch the EU. This will result in reduced carbon emissions in the EU, and when measurements show this to be the case, it will likely also be heralded as success for the environment, not only by the carriers but also the politicians.

But in reality, when carriers shift the most efficient vessels to the EU, the fleet deployed elsewhere will become slightly less efficient on average. After all, the global fleet does not change just because you shift the deployment locations. And those slightly less efficient vessels will translate to slightly higher fuel costs and, in turn, upward pressure on freight rates in the non-EU trades.

The largest ships in the world, which are also the most efficient on a per TEU basis, are already deployed in the EU trades. But the largest impact will be on smaller vessels. A sizeable part of the fleet of smaller vessels is quite old and, therefore, also relatively inefficient. There will be a strong incentive to shift older regional and feeder vessels out of the EU in favor of newer vessels currently deployed in other trade lanes.

The global effect of the EU ETS will be relatively slow, partly because the EU tax is implemented gradually, with a 40% implementation rate in 2024, 70% in 2025 and full implementation from 2026. In addition, it will take time — and money — to reconfigure carrier networks and redeploy vessels, and vessels will need to come off charter contracts before being shifted. *JOC*

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