



# Regulatory Overview of Carbon Pricing & Trading in Indonesia

23 December 2022

## 1. SUMMARY

This article provides a regulatory overview of carbon pricing and trading in Indonesia following the **issuance over the past year of 2 initial framework regulations**: Presidential Regulation No. 98 of 2021 on Implementation of Carbon Pricing for the Purpose of Achieving Indonesia's Nationally Determined Contribution and the Control of Greenhouse Gas Emissions in National Development (**PR 98/2021**) and Ministry of Environment and Forestry Regulation No 21 of 2022 on the Guidelines for the Implementation of Carbon Pricing (**MOEF 21/2022**) which was issued as an implementing regulation of PR 98/2021.

MOEF 21/2022 is an extensive regulation structured around 12 chapters. The **main measures** are presented below and include:

- (a) the requirements for domestic and international carbon trading;
- (b) result-based payments;
- (c) carbon tax and levies; and
- (d) greenhouse gas Carbon Credits.

The two new regulations follow similar trends in other jurisdictions which are attempting to regulate their carbon markets and are integral to the Indonesian Government's efforts to transition its energy needs and achieving its Nationally Determined Contribution (**NDC**) of greenhouse gas emissions reduction target ahead of the first global NDC stocktake in 2023.

## 2. A YEAR OF REGULATORY DEVELOPMENTS

Through the issuance of PR 98/2021 and MOEF 21/2022, Indonesia is proposing to implement both the "cap and trade" and "cap and tax" mechanisms, whereby the Government will progressively introduce mandatory "emission caps" and a carbon tax for certain sectors/businesses to govern emission levels and enable carbon pricing.

MOEF 21/2022 also regulates other related measures such as (i) the stipulation of a greenhouse gas emissions cap (**Emissions Cap**) which will be applied across key sectors such as energy, transportation and industrial processes; and (ii) the certification of efforts in reducing greenhouse gas emissions. The Emission Cap is a key feature of the new regulatory regime which imposes a strict obligation for businesses to reduce their greenhouse gas emissions below a stipulated threshold. Businesses will be expected to come up with mitigants and solutions to comply with the Emission Cap, including participating in carbon trading.

Pursuant to MOEF 21/2022, the following sectors and sub-sectors will be subject to an emissions threshold:



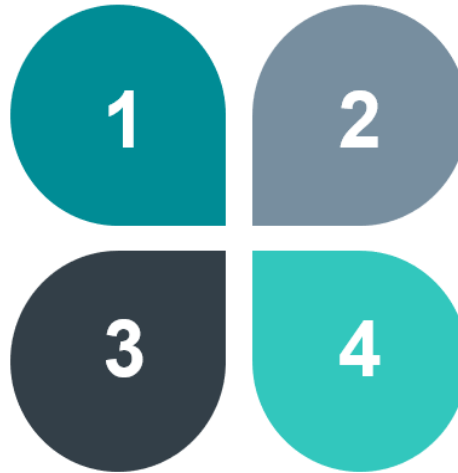
Carbon pricing instruments come in various forms, but in general, they require greenhouse gas emitters to pay for their emissions. MOEF 21/2022 regulates **four possible carbon pricing instruments** as follows:<sup>1</sup>

#### Carbon Trading

Market-based mechanism for the reduction of GHG emissions through sales and purchase of carbon units through: (i) emission trading or (ii) emission offset. Both domestic and international carbon trading are allowable in MOEF 21/2022.

#### Carbon Tax and Levies

Taxation imposed by the Government to carbon emitting entities and purchases of goods containing carbon footprint. MOEF 21/2022 also provides that the Government could potentially also impose additional carbon levies on top of the generally applicable carbon tax.



#### Result-Based Payments

A mechanism where payments are made to entities (including private sector) which are successful in reducing GHG emissions pursuant to a performance standard. Result-based Payments are typically arranged internationally through donor arrangements with developed countries or multilateral institutions.

#### Other Instruments

MOEF 21/2022 also provide an umbrella provision for other carbon pricing instruments which can be introduced by the Government in the future.

### 3. CARBON TRADING

Article 4 of MOEF 21/2022 provides that carbon trading can be conducted both onshore (in the domestic market of Indonesia) and offshore (in the international market) and may take place either through:

- (a) the Indonesian carbon market; and/or
- (b) direct trading between business entities.



<sup>1</sup> Article 3(2) of MOEF 21/2022.

The following requirements apply for business entities participating in carbon trading:<sup>2</sup>

Requirement	Onshore Trading	Offshore Trading
Must be carried out in accordance with the <b>carbon trading roadmap</b> (which consists of either sectoral & sub-sectoral roadmaps issued by relevant Ministries after coordination with the MOEF)	✓	✓
Must <b>apply carbon reserves</b> for reduction of emissions (i.e. buffers) as determined by MOEF	✓	✓
For cross-sectoral trading, the trading instrument must be in the form of an emission reduction certificate ( <b>Carbon Credit</b> )	✓	✓
Trading can only be carried out <b>after</b> the relevant Ministries have determined and announced a <b>plan and strategy for achieving the NDC target to MOEF</b>	-	✓
The subsector or sub-subsector of the relevant industry <b>must have already achieved the NDC target</b>	-	✓
Trading must be <b>authorized by MOEF</b>	-	✓

The **key difference between domestic and international carbon trading** lies with how credits are allocated to fulfilling Indonesia's NDC. International trading can, in certain circumstances, allow Carbon Credits to be transferred to another country and Indonesia to then be able to register a "corresponding adjustment" pursuant to art. 6 of the 2016 Paris Agreement Under the United Nations Framework Convention on Climate Change (**Paris Agreement**).

Effective carbon trading relies heavily on having a transparent and authenticated form of carbon credits. For onshore trading, MOEF 21/2022 provides that Carbon Credits (i.e. Emission Reduction Certificates) are the main type of carbon credit trading instrument to be recorded in the Indonesian carbon market. Carbon Credits are issued by the MOEF to business entities which have succeeded in reducing their emissions level below the stipulated threshold (for sectors with a determined maximum amount of emission) and/or baseline (for sectors without a determined maximum amount of emission).

<sup>2</sup> Article 4(2) of MOEF 21/2022.

## Onshore / Domestic Carbon Trading

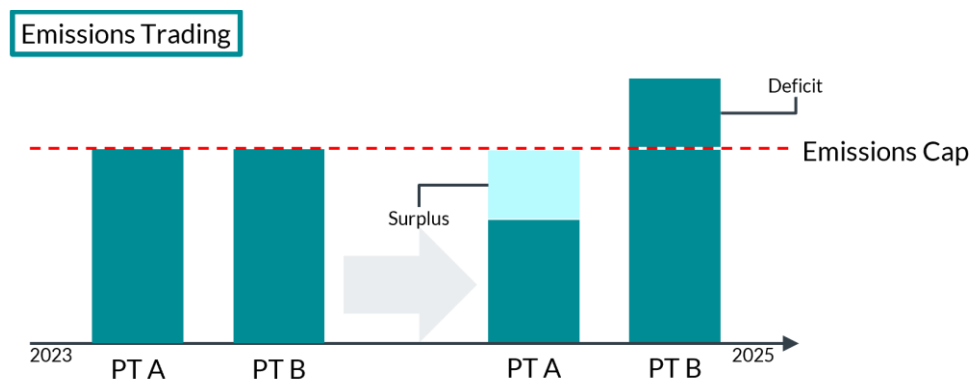
MOEF 21/2022 provides that onshore (domestic) carbon trading is conducted through either emissions trading or greenhouse gas emissions offsets.<sup>3</sup>

Emissions trading is applicable to sectors/businesses with a pre-determined Emissions Cap stipulated by the relevant sector Ministry.<sup>4</sup> Business entities succeeding in reducing and meeting the Emissions Cap will be entitled to apply for the Carbon Credit which can then be traded on the carbon market.<sup>5</sup>

In case a business entity is unable to reduce its emissions below the Emissions Cap, MOEF 21/2022 also allows the entity to meet the Emissions Cap by offsetting its emissions through the purchase of carbon units from other parties (as will be explained below).

The determination of a businesses' compliance with their Emissions Cap is performed throughout the calculation period (*periode penataan*) which is determined by the relevant line ministries of each sectors.

Below is an illustration of the **emissions trading mechanism as regulated in MOEF 21/2022**<sup>6</sup>



On the other hand, greenhouse gas emissions offsets (**Emissions Offsets**) are only applicable for businesses that:<sup>7</sup>

- (a) do not have an Emissions Cap and for which instead a baseline and emissions reduction target (the **Baseline**) determined by MOEF or relevant provincial government will apply; and
- (b) have an emissions surplus or deficit pursuant to the Baseline.

In order to participate in emissions offsetting, the relevant business entity must prepare a Climate Change Mitigation Action Plan (or *Dokumen Rencana Aksi Mitigasi Perubahan Iklim - DRAM*). The DRAM will be used to test whether the relevant business entity has effectively reduced emissions below the Baseline. MOEF will verify the DRAM against the actual emissions reduction levels.

<sup>3</sup> Article 5 of MOEF 21/2022

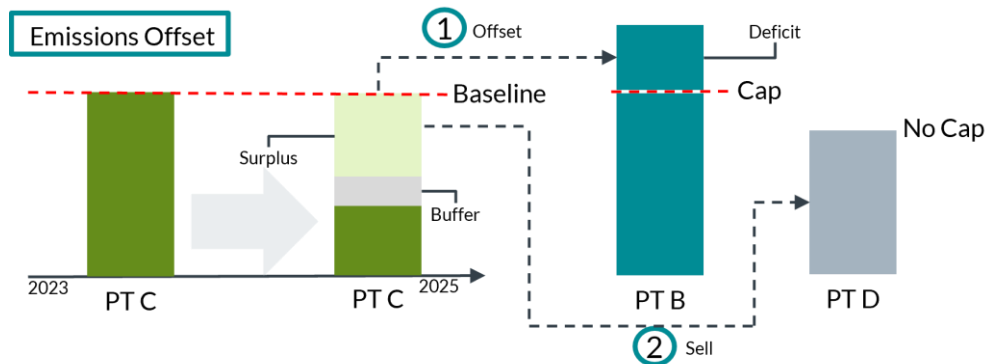
<sup>4</sup> Article 9 of MOEF 21/2022

<sup>5</sup> Article 13(4) of MOEF 21/2022

<sup>6</sup> . Please note that the time assumption used in the below chart is for illustrative purposes only.

<sup>7</sup> Article 14 of MOEF 21/2022

Business entities with an "emissions surplus" (i.e. emissions below the relevant Emissions Cap) will be entitled to receive Carbon Credits which can then be sold to other entities requiring to offset their emissions level. Businesses with an Emissions Cap which are unable to reduce emissions below their cap may also participate in offsetting their emissions levels through purchases of emissions surplus.



MOEF 21/2022 further requires businesses to comply with a mandatory "emissions buffer" before carrying out an emissions offset:

- (a) for domestic greenhouse gas emissions offsets, 0 to 5% of emissions buffer from the applicant's total Carbon Credits;
- (b) for international greenhouse gas emissions offsets within the NDC framework, no less than 10% of emissions buffer from the applicant's total Carbon Credits; and
- (c) for international greenhouse gas emissions offsets outside the NDC framework, no less than 20% of emissions buffer from the applicant's total Carbon Credits.

### International Carbon Trading

International carbon trading is possible under MOEF 21/2022, provided that the **following 3 cumulative conditions** have been met:<sup>8</sup>

- (a) the relevant sectoral ministries have determined and submitted a plan and strategy for the achievement of NDC for the respective sectors and subsectors to the MOEF;
- (b) the relevant subsectors or sub-subsectors have achieved the determined NDC; and
- (c) prior approval from the MOEF.

International trading of Indonesian Carbon Credits does not automatically grant a "**corresponding adjustment**" to the purchasing country. Pursuant to MOEF 21/2022, a corresponding adjustment will first need to be recognized by Indonesia's Designated National Authority, in this case the Director General of Climate Change of the MOEF. An MOEF approval is also required to be obtained before a corresponding adjustment can be counted towards the purchasing country's NDC. This is in-line with the principles of no "double counting" provided in art. 6 of the Paris Agreement.

<sup>8</sup> Article 4(3) of MOEF 21/2022

## 4. RESULT-BASED PAYMENTS

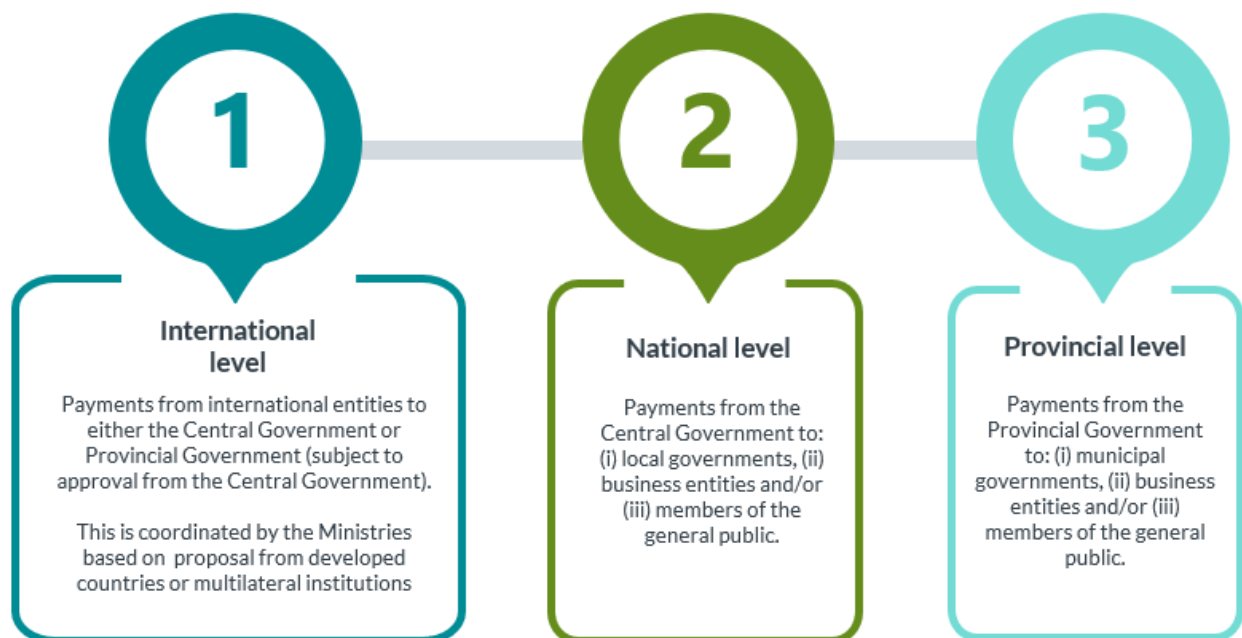
In addition to the trading of Carbon Credits, MOEF 21/2022 also provides for ministries/agencies, local governments or businesses to receive result-based payments from the central government or multilateral institutions for the performance of verified and/or certified performance of greenhouse gas emissions reduction and validated non-carbon benefits.<sup>9</sup>

**Result-based payments** can be made subject to verification that the recipient entity has<sup>10</sup>:

- (a) achieved a certain level of greenhouse gas emissions reduction; and/or
- (b) successfully conserved or increased the level of carbon reserves.

The application of result-based payment is designed to facilitate multilateral (G2G) cooperation between Indonesia and other countries or multilateral institutions. For example, in November 2022, Indonesia received a payment of USD 20.9 million which was carried out under the framework of the Emissions Reduction Payment Agreement between Indonesia and the World Bank's Forest Carbon Partnership Facility (FCPF). In addition to G2G cooperation, MOEF 21/2022 also provides a way for businesses and Indonesia's local governments to receive payments from the central government or from international sources under this scheme.<sup>11</sup>

Based on MOEF 21/2022, the following schemes can be applied for result-based payments:



<sup>9</sup> Article 28 of MOEF 21/2022

<sup>10</sup> Article 29 of MOEF 21/2022

<sup>11</sup> Article 30 – 31 of MOEF 21/2022

## 5. TAXES AND LEVIES ON CARBON

In October 2021, the Government issued Law No. 7 of 2021 on Tax Harmonisation, which included a so-called "carbon tax" on individuals or entities that are purchasing goods with a carbon content and/or carry out activities which emit carbon. Originally, the Government planned to enforce the carbon tax only on coal-fired power plants as from April 2022. However, subsequently the Government announced that it was postponing the implementation of the carbon tax until further notice, noting the lack of preparation from the Government's side and the need for further socialization with the private sector.

Pursuant to Article 35 of MOEF 21/2022, taxes and levies on carbon are implemented in the form of a tax/levy collection on carbon emitting businesses based on the **following factors**:

- (a) the **amount of carbon content**, depending on the level of carbon content present throughout the business;
- (b) **potential carbon emissions** from its business activities;
- (c) amount of **actual carbon emissions**; and/or
- (d) fulfilment of activities in line with the **Climate Change Mitigation Action Plan**.

The MOEF will issue further regulations on the implementation of the carbon taxes and levies after coordination with other relevant Ministries.



## 6. CARBON CREDITS

Having an established, transparent and authenticated form of Carbon Credit is important to the success of the implementation of carbon pricing. In this regard, Article 58 of MOEF 21/2022 provides that Carbon Credits shall be used in the implementation of carbon pricing as an instrument for:














- (a) proof of performance of greenhouse gas emissions reduction;
- (b) carbon trading;
- (c) means of payment for performance of Climate Change Mitigation Action Plan;
- (d) greenhouse gas emissions compensation; and
- (e) proof of performance for environmentally friendly businesses/activities to obtain financing from bond or *sukuk* schemes.

Each Carbon Credit represents a greenhouse gas emissions reduction or increase in greenhouse gas absorption which is equal to 1 tonne of CO<sub>2</sub>. The MOEF has appointed a Measurement, Reporting and Verification Team to process any request to issue a Carbon Credit.<sup>12</sup>

To obtain a Carbon Credit, MOEF 21/2022 requires that the reduction of greenhouse gas emissions must satisfy the **following cumulative criteria**:

- (a) must be actual, permanent, measurable, monitored and reported;
- (b) is achieved through climate change mitigation actions;
- (c) cannot be cross-registered as other carbon instruments; and
- (d) must be transparent, accurate, consistent, comprehensive and comparable.

Carbon Credits can be issued for activities carried out to fulfil an Emissions Cap and greenhouse gas emissions reduction performance (for businesses without an Emissions Cap). The process for registration and obtainment of a Carbon Credit is as follows:<sup>13</sup>

1 Fulfilment of an Emission Cap	2 Performance of Emission Reduction (no Emission Cap)
 Registering in the Indonesian carbon market system	 Registering in the Indonesian carbon market system
 Submitting a low emission activity plan and/or a DRAM	 Submitting the DRAM
 Reporting the results of the fulfilment of the Emission Cap	 Validation of the DRAM by a validator
 Verification of the emission reduction levels by a verifier	 Implementation and monitoring of the DRAM
 MOEF issues either (i) obligation to meet the remaining emission reduction (in case of failure to meet) or (ii) the Carbon Credit (in case of ability to meet)	 Verification on the implementation of the DRAM by a verifier
	 MOEF issues the Carbon Credit and registration in the Indonesian carbon market system

<sup>12</sup> Article 59 of MOEF 21/2022

<sup>13</sup> Article 61 of MOEF 21/2022

## 7. CONCLUSION

Carbon trading (both domestic or international) from Indonesian sources and projects was already undertaken by businesses long before the issuance of the initial carbon pricing regulatory framework through PR 98/2021 and MOEF 21/2022. The introduction over the course of the past year of an initial set of regulations may be considered disruptive from the point of view of existing carbon players given the additional requirements for carbon trading that they will now need to fulfil. However, this new development is in line with similar trends in other markets which are all aiming to support each country's fulfilment of its NDC and to contribute to climate change mitigation.

The success of the current nascent scheme will depend to a large extent on the capacity of the Government (i.e. the MOEF and line ministries) as regulator and supervisor of the carbon market and the instruments provided for under MOEF 21/2022. Also further detail is required to complete the current framework established by PR 98/2021 and MOEF 21/2022 and we understand that the Government is currently preparing additional regulations which will be issued in the near future, including:

- MOEF regulation on implementation of sectoral, subsectoral and sub-subsectoral NDC;
- MOEF regulation on guidelines for carbon pricing in the forestry sector;
- Minister of Energy and Mineral Resources regulation on Emissions Cap and carbon pricing for coal-fired power plants; and
- Minister of Finance regulation on the implementation of carbon taxation.

With 2023 on the immediate horizon, there is hope amongst industry participants that these additional regulations will further clarify and fill any gaps in the current regulatory landscape and provide certainty for both domestic and international trading initiatives.

# Key Contacts

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