

INDONESIA

Walalangi & Partners
(in association with Nishimura & Asahi)



Luky I Walalangi and
Rendi Prahara Septiawedi

Indonesia's carbon trading system: Challenges and opportunities

Luky I Walalangi and Rendi Prahara Septiawedi of Walalangi & Partners discuss the challenges and opportunities faced by Indonesia's carbon market

Through the ratification of the Paris Agreement, the Government of Indonesia (GoI) shows its strong commitments to climate change issues. To implement the Paris Agreement in Indonesia, the GoI has enacted Law No. 16 of 2016 on Ratification of the Paris Agreement to the United Nations Framework Convention on Climate Change and further set the so-called 'Nationally Determined Contributions' (NDC), containing Indonesia's national commitments to achieve the goals of the Paris Agreement.

To reduce national carbon emissions, the GoI has issued Presidential Regulation No. 98 of 2021 (PR 98/2021) as a specific climate financing instrument to achieve Indonesia's NDC, providing the GoI with effective control over the right to carbon by introducing several carbon pricing mechanisms, including carbon trading.

As regulated under PR 98/2021, carbon trading is a market-based mechanism to reduce greenhouse gas emissions (GHG emissions) through buying and selling of carbon units, whether domestically or internationally, through the emissions trading scheme or GHG emissions offsetting scheme, by means of either (i) the carbon market mechanism via the carbon exchange or (ii) direct trading.

PR 98/2021 refers the term 'carbon units' as evidence of carbon ownership in the form of a certificate or technical approval, expressed in one ton of CO₂, as recorded in the National Registry System on Climate

Change Control (locally known as *Sistem Registri Nasional Pengendalian Perubahan Iklim* — SRN PPI).

The implementation of the carbon pricing strategy, however, is not without its challenges. The carbon exchange have yet been established, pending issuance of the implementing regulations by the relevant government authorities. Whereas on the direct trading, certain aspects remain unclear particularly on the specific legal requirements to legally effect the transfer of ownership of the right to carbon from one party to another.

PR 98/2021 only generally stipulates that the domestic transfer of the right to carbon must be carried out through the registration mechanism of the SRN PPI and that the offshore transfer must be done through the recording mechanism of the SRN PPI and the authorisation of foreign carbon trade. This is contrary to the general rules of the Indonesian law requiring specific legal instruments for the transfer of, for lack of a specific proper term, 'goods/titles' from a transferor to a transferee. To avoid risks of future challenges on the transfers, practitioners now expect the GoI to issue implementing regulations to regulate the specific requirements and rules on the matter.

Another tough challenge in carbon trading is the price determination of carbon. In 2021, the GoI ran a pilot project involving 32 coal-fired power plants using the cap-and-trade scheme, setting out the carbon price at IDR 30,000 per ton of CO₂, which was considered by many to be way too low, especially compared to the global benchmark price of approximately IDR 508,300 per ton of CO₂. Despite the heavy criticism, the GoI has decided to adopt the same price for carbon tax purposes at IDR 30 per kg of CO₂. Several stakeholders suggest that the upcoming regulations on carbon trading should adjust the carbon price to keep the carbon market attractive and prevent greenwashing practices.

Despite the above challenges, many believe Indonesia's carbon market offers significant opportunities. For example, in the forestry sector, there is great potential for 'green' investment, such as peatland restoration and sustainable timber industries. In the energy sector, market players expect the transaction value of carbon trading could reach up to \$300 billion per year once it has been fully implemented and further stimulate energy

transition into the low-carbon path such as more investment in renewable energy resources.

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Luky I Walalangi
Partner, Walalangi & Partners
E: lwalalangi@wplaws.com

Rendi Prahara Septiawedi
Associate, Walalangi & Partners
E: septiawedi@wplaws.com