

EU Emissions Trading Scheme enters phase II; Switzerland strays off course for reduction

Samuel Indermühle

1. Background

The signatory states of the Kyoto Protocol¹, including the EU and Switzerland, committed to reducing greenhouse gas emissions by 2012. This is to be done using (among other things) economic mechanisms, in particular trading in emission rights. In the European Union a trading scheme was started in 2005.

The first phase of the EU Emissions Trading Scheme, during which companies could trade certificates that were allocated to them for free, concluded at the end of December 2007. The scheme for trading in emission certificates, which embody the quantity of carbon dioxide (CO₂) a company is allowed to emit, has proven to be essentially workable. However, market prices for emission rights fell steadily throughout 2007 as it became clear that more certificates were in circulation on the market than were needed to cover European firms' expected CO₂ emissions. On 1 January 2008, the scheme moved into phase II, in which the permitted volume of emissions was reduced. This is likely to cause trading in the certificates to pick up.

The Swiss parliament had decided that Switzerland's reduction goals were to be met primarily through voluntary measures and that levies on CO₂ emission were only to be introduced if those measures did not provide for a sufficient decrease in emissions. It has become apparent that Switzerland will not be able to meet its reduction target through voluntary measures alone. Parliament's decision to introduce a CO₂ tax was the first step towards creating a basis for emissions trading, which will be anchored in law by the Ordinance on the National Emissions Trading Register².

¹ cf. for legal background BRIQUE-LUISIER/INDERMÜHLE, p. 171 et seq.

² DETEC Ordinance of 27 September 2007 on the National Emissions Trading Register (Emissions Trading Register Ordinance, SR 641.712.1).

2. Experience from the first phase of the EU Emissions Trading Scheme

The EU Emissions Trading Directive³ entered into force on 25 October 2003. It required EU member states to introduce EU-wide emissions trading as of 1 January 2005. Since 2005, EU member states must also present a national allocation plan at the start of each emissions trading period in which they state the volume of greenhouse gases that may be emitted during a given period by companies with an especially large carbon footprint. Companies were allocated certificates for their expected CO₂ emissions free of charge. If a company emitted more than it was allowed, it had to buy additional emission rights from another company or broker or on an energy exchange. In order to ensure that a country's CO₂ emissions genuinely fall, the number of emission rights is to be gradually reduced going forward.

Since 2005, approximately 12,000 industrial facilities, including large incineration plants and especially power stations, oil refineries, iron and steel works and cement and paper factories, had registered to trade in CO₂ certificates. The total permitted volume of CO₂ emissions has proven to be too high, resulting in an oversupply of CO₂ emission certificates on the market to the value of 120 million tonnes of emissions. Market prices for emission rights have consequently fallen sharply from just under EUR 30 per tonne at the start of 2006 to EUR 0.05 per tonne at the end of 2007⁴.

3. Tighter controls in phase II

The national allocation plans for the period from 2008 to 2012 had to be submitted by 30 June 2006, but some countries were late. The European Commission therefore initiated proceedings for breach of contract against Austria, the Czech Republic, Denmark, Hungary, Italy and Spain. The number of certificates allocated in the national allocation plans will be reduced compared with phase I, with the result that emission rights for just under 1.9 billion tonnes of CO₂ per year will be issued from 2008 after the 22 national allocation plans have been approved. This equates to an undersupply equivalent to 111 million tonnes of CO₂, which is intended to reduce emissions by 5.7 percent compared with 2006 levels. The probable demand surplus is expected to lead to higher market prices for emission certificates. Companies will thus have to decide whether they want to buy additional emission rights or take steps to reduce their CO₂ emissions. A shortage of CO₂ emission rights in

³ Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC.

⁴ cf. European Energy Exchange, <<http://www.eex.com/en/>>.

phase II can also be offset by reduced emissions in other countries, with each EU member state being free to determine exactly how much its companies are allowed to offset.

4. Switzerland off course for reduction

According to the latest forecasts, Switzerland is set to stray off course for reducing emissions because voluntary measures, in particular the "Climate Cent", will not be enough to meet the overall reduction target stipulated in the CO₂ Act. In fact, the specific target for reducing CO₂ emissions caused by burning fuel will be missed by a considerable margin⁵.

Since the voluntary measures have not led to the desired reductions, parliament decided in March 2007 to introduce a CO₂ tax on heating fuels, amounting to CHF 12 per tonne of CO₂, on 1 January 2008. Vehicle fuels are not affected by this tax. Since the reduction target for 2007 (CO₂ emissions at least 10 percent lower than in 1990) has not been met, the tax will be increased to CHF 24 per tonne of CO₂ with effect on 1 January 2009. If the 2008 target (at least 13.5 percent lower than in 1990) is not met, it will be increased to CHF 36.

CO₂ emissions from vehicle fuels are massively above target. Whereas the aim is to achieve a reduction of 8 percent by 2010, an increase of 9.1 percent was recorded at the end of 2006. Owing to this huge discrepancy with regard to fuels, the Department of the Environment, Transport, Energy and Communications will present the Federal Council with a proposal for introducing a CO₂ tax on vehicle fuels.

5. Swiss trading separate from international exchanges

Companies can be exempted from the CO₂ tax if they enter into a binding agreement to reduce or offset their emissions⁶. These companies are allowed to offset any emission rights they buy against their emissions. If a company emits more CO₂ than is covered by its certificates, it is punished by being forced to pay the CO₂ tax after the fact⁷.

To facilitate trading in emission rights, a national register of all emission credits and transactions has been introduced. The Ordinance on the National Emissions Trad-

⁵ DETEC media release, 28 September 2007.

⁶ Art. 9 of the Federal Act on Reducing CO₂ Emissions (CO₂ Act; SR 641.71).

⁷ Art. 9 para. 6 CO₂ Act.

ing Register⁸, which entered into force on 15 October 2007, governs the management of this register and trading in emission certificates in Switzerland. It sets out the principle that companies and persons allocated emission credits or intending to trade in such credits must have a business or personal account for this purpose and that the emission certificates must be freely tradable⁹.

Both companies and private individuals are entitled to take part in emissions trading. The freely tradable certificates have been entered in the register and allocated to their owners¹⁰. Emission rights to be offset against actual emissions by companies that have committed to a reduction target have also been entered. Trading is open to anyone, regardless of whether or not they are liable for the CO₂ tax.

To ensure compatibility with the international registers from a technical point of view, the Swiss register has been checked for compliance with the International Transaction Log. While the Swiss system is technically compatible with the EU Emissions Trading Scheme, there are two significant obstacles to its membership of the latter. Firstly, it would require a state treaty with the EU, which would take some time to finalize. Secondly, there is a substantial difference with regard to the sanctions imposed on companies that exceed their emissions allowance. While Swiss companies simply have to retrospectively pay the CO₂ tax of CHF 12 to CHF 36, European companies are threatened with a fine of EUR 100 per tonne of CO₂.

To sum up, it is true to say that Switzerland can hardly be held up as a model of proactive climate policy. Emissions trading starting three years after the EU, a dogged insistence on ineffectual voluntary measures and sanctions that are not effective in deterring companies from breaching their reduction obligations represent relatively weak climate protection measures on an international comparison.

6. Opportunities and Risks

There is an opportunity for both large companies and SMEs in the form of a CO₂ audit that reveals potential savings within the company and possibilities for exemption from the CO₂ tax. SMEs can also gather together into larger groups in order to achieve joint savings. Depending on how the planned CO₂ tax develops, it may also become attractive for companies to invest actively in Swiss and foreign climate protection projects in order to offset the savings made there against their emissions.

⁸ cf. fn 2.

⁹ Art. 1 Emissions Trading Register Ordinance.

¹⁰ Art. 6 para. 1 Emissions Trading Register Ordinance.

It may be worthwhile for both private individuals and companies to consider trading in emission certificates. The biggest risk here probably lies in the fact that the Swiss register is not linked to European trading, which makes international trading in certificates difficult.

Selected literature

BRIQUE-LUISIER ANNE/INDERMÜHLE SAMUEL, Implementation of the Kyoto Protocol: creation of a Swiss market for CO₂ emission rights, in: Opportunities and Risks from Developments in the Law 2006/2007, Zürich, Basel, Genf 2007, p. 171 et seq. ("BRIQUE-LUISIER/INDERMÜHLE")

Further reading

Die Volkswirtschaft, Das Magazin für Wirtschaftspolitik, St. Gallen 2007, Vol. 9, monthly theme: emissions trading