Coupling GEMINI-E3 and MARKAL-CHRES to Simulate Swiss Climate Policies

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December 2008

[1]This work has been undertaken with the joint support of FOEN and NSF-NCCR climate grants.

Contents

Chapter 1

Introduction

This report collects two studies hat have been performed in the Research group on the Economics and Management of the Environment of EPFL to assess the Swiss post-Kyoto climate policy with a focus on the residential sector. We couple two existing top-down and residential bottom-up models in order to carry out a integrated assessment of various post-2012 climate policies for Switzerland.

Currently there is an important discussion about what will be the shape of the international climate policies that will be enacted after 2012. Among the important issues being discussed, countries will have to decide upon the level of abatement they can achieve and the extent to which they allow the use of flexibility mechanisms like global GHG emissions certificates markets. The decision to commit to a emission reduction target and to use or not flexibility mechanisms depends mainly on the expected welfare costs of the policies and on the short and long terms environmental objectives of the country.

The current Swiss climate policy will meet the objectives fixed in the Kyoto Protocol, though it may not be sufficient to meet the objectives of the current CO_2 Law that prescribes a further emissions reduction. The Law provides for a reduction of 2.9 million tons of CO_2. According to current estimates, there will be an excess emissions of 0.5 million tons of CO_2 with respect to the objective fixed by the Law. Considering the post 2012 climate policy, in February 2008, the Swiss Federal Council decided to launch a revision of the CO_2 Law. It decided to follow similar targets as the European Union, i.e. at least 20% reduction of GHG by 2020 and 50% by 2050. A consultation procedure on this revision was launched in December in order to compare various envisaged instruments: a pure incentive tax (the revenue of which would be redistributed to households), a tax financing national or international abatement or adaptation measures as well as technical regulations.

In many industrialized countries, the residential sector accounts for an important and increasing share of greenhouse gases (GHG) emissions. For instance, in 2005, the Swiss residential sector was responsible for 22.3% of total GHG emissions. These emissions are mainly due to the combustion of light fuel oil used for room and water heating. When we add the emissions from transport to those of the residential sector, they represent more than half of the total GHG emissions, a huge proportion when we consider that industry was only responsible for 21.6%. This Swiss specificity is mainly due to two factors. First, the major part of high energy goods are imported into Switzerland; indeed, the Swiss economy is more based on services than on heavy industry. Secondly, electricity is produced at almost 95% hydro and nuclear powerplants. Residential sector presents some of the more interesting low hanging fruits with regard to GHG abatement. Energy saving investments like insulation will become increasingly profitable if energy prices keep on rising. Moreover, efficient technologies for space and water heating, e.g. heat pumps and solar, are available today for both houses and apartment buildings. With that in mind, it makes perfect sense for policy makers to target the residential sectors when devising climate policies.

This report was written before the details of the two variants for Swiss climate policy after 2012 which are currently under consultation were known (they are described in chapter 6). Nevertheless, the policies that are simulated are very close to those proposed and allow to assess further declinations of the two variants. Thus, the first part presents an integrated assessment of different levels of CO_2 and GHG taxes, akin to the one foreseen in variant one of the proposal under consultation, and the second part simulates more ambitious reduction targets and climate neutrality of a fashion similar to variant two. Both parts place special focus on the residential sector, where the greatest reductions of CO_2 emissions are likely. Each part is self-standing, with a description of the models used and especially of the original procedure for coupling a top-down CGE with a bottom-up Markal model developed in the context of this research. Each part also has its conclusions, which are summarized in a general conclusion at the end of the report.

Part I

Integrated Assessment of Swiss GHG Mitigation Policies After 2012 — Focus on the Residential Sector

Chapter 2

Introduction

The objective of this paper is to assess some of the instruments envisaged for the the revision of the Swiss CO_2 Law. We focus on the residential sector given its potential when it comes to GHG abatement. To attain our objective we devise a coupled model, combining a global economic model (GEMINI-E3) with a Swiss residential energy use model (MARKAL-CHRES). The benefit of coupling a top-down Computable General Equilibrium (CGE) with a bottom-up energy use models is twofold. On the one hand, it allows to estimate the consequences of global or national policies on the Swiss economy and more specifically on the Swiss residential sector. On the other hand, the coupled model allows to test policies targeting energy use in the Swiss residential sector with a very detailed representation of the energy technologies both used and available in that sector, and to asses the impact of those policies on the overall economy.

The coupling between top-down and bottom-up models has already been explored in the literature (see, among other, Böhringer (1998); Drouet et al. (2005); Löschel and Soria (2007); Manne and Richels (1992); Pizer et al. (2003); Schäfer and Jacoby (2006); Wing (2006)). We have nevertheless followed an approach relatively different from those used by these authors. In Pizer et al. (2003), Schäfer and Jacoby (2006) and Löschel and Soria (2007) the coupling has been mainly carried out in the calibration phase of the modeling; bottom-up models were used to calibrate some of the parameters in the top-down models. Different from them, we have linked the models in the simulation phase. In Böhringer (1998) and Wing (2006), technology details have been directly incorporated into a CGE model. In contrast, we have worked with existing bottom-up and top-down models and tried to keep them as close as possible from their original formulation. Therefore, both models have been kept separate, while linking them with a coupling module. Manne and Richels (1992) incorporated a reduced CGE model in a bottom-up model. In contrast, we tried to keep our CGE as complete as possible, allowing for a more complete and realistic interpretation of the results for the current consultation procedure on the future of the Swiss CO_2 law. Finally, until now, the only coupling paper specifically targeted to the Swiss residential sector is Drouet et al. (2005). They have devised an hybrid model where the residential sector is completely removed from the top-down model and replaced by an exogenous and separate bottom-up model.

This paper aims at further developing the coupling methodology, dynamically integrating the results from the bottom-up model into the top-down model without touching the interactions between the residential sector and the rest of the economy. The coupling procedure we have implemented allows for estimating CO_2 or GHG taxes in response to national emission targets. Furthermore, it allows for simulating technical regulations in the residential sector. Finally, the coupled model allows an integrated analysis of the implications of the policies on the Swiss and the global economy as well as on the Swiss residential sector. From our analysis, we find that in Switzerland, without emissions trading mechanisms, the rapid implementation of a progressive GHG tax reaching more than 200 USD per ton of CO_2 equivalent (USD/tCO_2eq) would be necessary in order to achieve a GHG abatement of 50% in 2050. With such levels of taxation, we also find that technical regulations do not bring additional incentives to abate emissions.

The paper is organized as follows: section 2 presents both the GEMINI-E3 and MARKAL-CHRES models, section 3 explains how the baseline scenario of the models has been calibrated, section 4 presents the coupling procedure and a sensitivity analysis of the coupled model, section 5 presents the policy scenarios, section 6 the numerical results and section 7 concludes.

Chapter 3

Models

3.1 GEMINI-E3

The complete GEMINI-E3 is a dynamic-recursive CGE model that represents the world economy in 28 regions (including Switzerland) and 18 sectors. It incorporates a highly detailed representation of indirect taxation (Bernard and Vielle, 1998). For this study, we use an aggregated version of the model in 6 regions, i.e. Switzerland (CHE), European Union (EUR), other European and Euro-asian countries (OEU), Japan (JAP), USA, Canada, Australia and New Zealand (OEC) and other countries, mainly developing countries (PVD). The model is formulated as a Mixed Complementarity Problem , which is solved using GAMS and the PATH solver (Ferris and Munson, 2000; Ferris and Pang, 1997). GEMINI-E3 is built on a comprehensive energy-economy data set, the GTAP-6 database (Dimaranan, 2007), that provides a consistent representation of energy markets in physical units and a detailed Social Accounting Matrix (SAM) for a large set of countries or regions and bilateral trade flows between them. Moreover, we have completed the data from the GTAP database with information on indirect taxation and government expenditures from the International Energy Agency (International Energy Agency, 2002a,b, 2005), the OECD (OECD, 2005, 2003) and the International Monetary Fund (IMF, 2004). For Switzerland, we used data from the 2001 input-output table devised at the Swiss Federal Institute of Technology (ETH) Zürich (Nathani et al., 2006), which we transformed into the GEMINI-E3 format (Sceia et al., 2007). All the data on emissions and abatement costs for non CO_2 GHG come from the U.S. Environmental Protection Agency (United States Environmental Protection Agency, 2006). For a complete description of

GEMINI-E3 see Bernard and Vielle (2008).

Various versions of the model have been used to analyze the implementation of economic instruments allowing for GHG emissions reductions in a second-best setting (Bernard and Vielle, 2000). The following studies are examples of various analyzes carried out with GEMINI-E3: assessment of the strategic allocation of GHG emission allowances in the enlarged EU market (Viguier et al., 2006), analysis of the behavior of Russia with regard to the ratification process of the Kyoto Protocol (Bernard et al., 2003), assessment of the costs of implementation of the Kyoto protocol in Switzerland with and without international emissions trading (Bernard et al., 2005), or assessment of the effects of an increase of oil prices on global GHG emissions (Vielle and Viguier, 2007).

Apart from a comprehensive description of indirect taxation, the specificity of the model is that it simulates all relevant markets: commodities (through relative prices), labor (through wages) as well as domestic and international savings (through rates of interest and exchange rates). Terms of trade (i.e. transfers of real income between countries resulting from variations of relative prices of imports and exports) and "real" exchange rates can also be accurately modeled.

Time periods are linked in the model through endogenous real interest rates, which are determined by the equilibrium between savings and investments. National and regional models are linked by endogenous real exchange rates resulting from constraints on foreign trade deficits or surpluses.

In order to allow the coupling of GEMINI-E3 with MARKAL-CHRES, we have replaced the Stone-Geary utility function by a nested constant elasticity of substitution (CES) function. The nesting structure is shown in Figure 3.1. The σ_x refer to the elasticity parameter of each node. The version of GEMINI-E3 we use for this research only uses petroleum products as input in the transportation energy nest.

Finally, in order to better match the actual Swiss taxation scheme, we have differentiated excise taxes for heating oil from those of petroleum products used as transportation fuels. In order to do so, we introduced a base excise tax ($ExTax_{base}$), fixed at the level of the 2001 residential excise tax, and a supplementary excise tax ($ExTax_{sup}$) applied only in the transportation sector. Therefore, in the residential sector, we use a final consumption price equal to $PC = (PB + ExTax_{base}) \times (1 + vat)$, where PB is the production price and vat the rate of value added tax. In the transportation sector, we add the supplementary excise and therefore $PC_{trans} = PC + ExTax_{sup}(1 + vat)$. This is equivalent to $PC_{trans} = (PB + ExTax_{base} + ExTax_{sup}) \times$

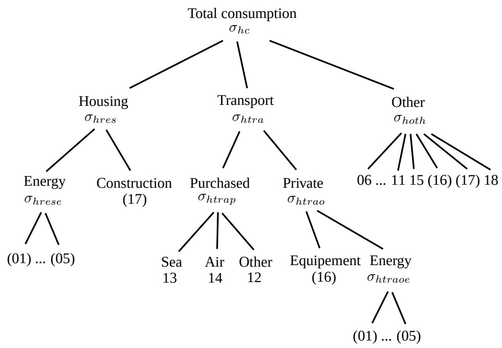

Figure 3.1: Structure of the households' nested CES utility function

$(1+vat)$.

3.2 MARKAL-CHRES

The MARKAL-CHRES is an energy model describing the Swiss residential energy system. It is based on the Swiss MARKAL model witch was recently taken over and further developed by researchers at the Paul Scherrer Institute (PSI) where is has been used, among other, to analyze the Swiss 2000W society initiative (Schulz et al., 2008). The MARKAL-CHRES is a subset of the complete Swiss model. It is restricted to technologies related to the residential sector and considers final energies as being imported with exogenous prices. The model contains 173 technologies using different energies sources, i.e. coal, oil, gas, electricity, wood, pellets, heat pumps and district heat.

The model base year (2000) is calibrated to the International Energy Agency (IEA) and Swiss General Energy statistics of the year 2000. The model has a time horizon of 50 years and is divided into eleven time periods each with a duration of five years except the base year (2000, 2001–2005, 2006–2010, ..., 2046–2050). The residential energy sector of the model includes 14 energy demand segments (see Table 3.1). The most important segments are the Room-Heating (RH) segments which represent more than 70% of final energy demand. We distinguish four different demand categories for RH: Single and Multi Family Houses as well as existing and new buildings. In the model we assume that dwellings constructed after the year 2000 are new buildings.

Table 3.1: MARKAL-CHRES Demand segments

RC1	Cooling
RCD	Cloth Drying
RCW	Cloth Washing
RDW	Dish Washing
REA	Other Electric
RH1	Room-Heating Single-Family Houses (SFH) existing building
RH2	Room-Heating SFH new building
RH3	Room-Heating Multi-Family Houses (MFH) existing buildings
RH4	Room-Heating MFH new buildings
RHW	Hot Water
RK1	Cooking
RL1	Lighting
RRF	Refrigeration

The model uses USD_{2000} as currency, therefore all monetary value are discounted to year 2000 values using a 5% discount rate. In 2000, 1 USD = 1.70 CHF.

One of the particularities of the MARKAL-CHRES model is to describe precisely a set of technologies which allow for energy savings in various processes. The idea behind those technologies is to take into account the reduction of energy demand which follows certain types of investment. For example, installing double windows increases insulation and therefore reduces heating demand.

For a more detailed description of the technologies used in the MARKAL-CHRES model, see Schulz (2007).

Chapter 4

Baseline

4.1 Assumptions

In order to perform a first coupling attempt we have assumed that world energy prices are only slightly affected by changes in the energy use in Switzerland and are therefore kept fixed at the baseline levels in the MARKAL-CHRES. Moreover, the total households' consumption (energy and non energy), which could be used as a proxy for the useful energy demands in the the residential sector, does not greatly vary from the baseline to the counterfactual. Therefore, the useful energy demands in MARKAL-CHRES are kept constant.

Furthermore, in the MARKAL-CHRES model, population and economic estimates (e.g. GDP) together with construction estimations are used in order to estimate the Reference Energy Area (REA), i.e. the total useful surface of all heated rooms. The heating demands or useful energy used for heating (TJ/year) is equal to the Specific Room Heating Demand (MJ/m^2year) multiplied by REA (Mio m^2).

The Swiss Federal Office of Energy provides estimates of the REA until 2035. Values until 2050 are extrapolated. With regard to energy prices, we assume an annual increase of 1%.

In GEMINI-E3 population assumptions are based on the United Nations' medium scenario. The Swiss population is expected to grow until 2030 at a level of approximately 7.4 million people and then slowly decrease to reach 7.25 in 2050. Finally, according to the projections by State Secretariat for Economic Affairs

(2004), the annual average GDP growth rate is expected to be 1.2% from 2001 to 2020, and 0.6% from 2020 to 2050. We also use the projections from DOE (2006) for oil, gas and coal prices.

4.2 Aligning the baselines emissions

We import the fuel mix from MARKAL-CHRES into GEMINI-E3 in order to align the emissions in the residential sector between the two models. The annual variation of the total energy consumption in GEMINI-E3 Swiss residential sector is aligned to the variation of the total use of energy in MARKAL-CHRES. Moreover, the shares between the different energies are defined using the fuel mix. Furthermore, we set the growth of technical progress in the private transport energy nest and of general technical progress in the use of fossil fuels to 1.25% in order to have the total CO_2 emissions baseline decline by 13% between 2000 and 2035 as forecasted by Swiss Federal Office of Energy (2007). Figure 4.1 shows the baseline CO_2 and other GHG emissions calculated by GEMINI-E3 using the fuel mix from MARKAL-CHRES. Emissions of other GHG are transformed into CO_2 equivalent (CO_2eq) for comparison and and summing requirements. They represent the amount of CO2 that would have the same global warming potential, when measured over a specified timescale. The natural decline of emissions is partly due to the availability of costless abatement measures, but also to the existing energy and climate policy instruments (R&D, fuel taxes, regulation,...).

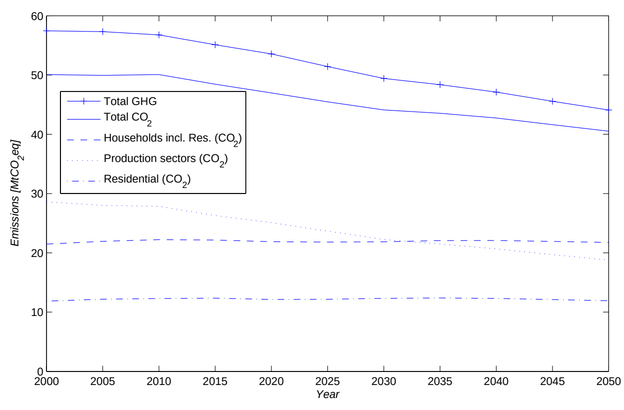

Figure 4.1: Baseline CO_2 and GHG emissions

Chapter 5

Coupling

CGE models allow for an explicit representation of the economy and are based on sound micro-economic foundations. From highly aggregated formulations it is always possible to disaggregate some parts of the model but they, nevertheless, fail to depict precisely the evolution of substitution among technologies or the actual energy use, respecting the physical energy conservation principles. In that respect, bottom-up models perform much better. At the opposite, because bottom-up models focus mainly on rich technology representation and cost minimization objectives, they fail to represent the complex market interactions which are dealt with by top-down models.

With that in mind, we have used the MARKAL-CHRES model to calculate the fuel mixes in the residential sector and used them in GEMINI-E3 to calculate emissions as well as all other macroeconomic variables. In order to do so, the share parameters in the residential energy nest are defined using the values calculated by the MARKAL-CHRES and the elasticity σ_{hrese} is set to 0. In other words, we use a Leontief formulation in the residential energy nest. When relative fuel prices change, the substitutions for the housing sector are therefore computed by MARKAL-CHRES.

5.1 Coupling method

Let fm, the fuel mix matrix in the residential sector calculated by MARKAL-CHRES, defined as follows:

$$fm = \begin{pmatrix} fm_{coal,2000} & fm_{coal,2005} & \cdots & fm_{coal,2050} \\ fm_{gas,2000} & fm_{gas,2005} & \cdots & fm_{gas,2050} \\ fm_{petr,2000} & fm_{petr,2005} & \cdots & fm_{petr,2050} \\ fm_{elec,2000} & fm_{elec,2005} & \cdots & fm_{elec,2050} \end{pmatrix},$$

where $fm_{coal,t}$, $fm_{gas,t}$, $fm_{petr,t}$ and $fm_{elec,t}$ are respectively the energy consumptions of coal, gas, petroleum products and electricity in the year t.

In this paper we use a simple dichotomic procedure, which is sufficient in the case of a single control variable, in our case the CO_2 or GHG taxes. Indeed, in our coupled model, emissions in the target year are monotonic decreasing with respect to the tax. This ensures that our simple coupling module finds the unique optimal tax for each abatement target.

The coupling module functions as follows: we first initialize the minimum and maximum bounds for the tax (t_{min} and t_{max}), the tax level (tax), the emission target ($\bar{e}$) and the initial emissions calculated by GEMINI-E3 ($e = G(tax, fm)$). So long as the difference between emissions in the target year and the emission target is greater than a defined threshold ($|e - \bar{e}| > 0.01$) and the tax variation between two runs in greater than another threshold ($|tax_{-1} - tax| > 0.01$), we run MARKAL-CHRES to calculate the fuel mix ($fm = M(tax)$) and then GEMINI-E3 to calculate the total emissions in the target year ($e = G(tax, fm)$). If the total emissions are lower than the target we redefine the upper bound of the tax ($t_{max} = tax$); otherwise we redefine the lower bound ($t_{min} = tax$). We store the tax level for future comparisons ($tax_{-1} = tax$) and define the new tax ($tax = t_{min} + (t_{max} - t_{min})/2$).

Figure 5.1 presents this coupling schema, where the tax is the variable that allows to control both models, the residential fuel mix is the coupling variable ensuring that GEMINI-E3 calculates emissions on the basis of the MARKAL-CHRES simulations and the total emissions in the target year are the optimization variable ensuring that the coupled models converge to the target defined by policymakers.

5.2 Sensitivity analysis of the coupled model

Figure 5.2 shows the sensitivity of the model to various levels of taxation. The lines represent taxes of 0 (plain), 50 (dash-dot), 100 (plus), 150 (star) and 200 USD/tCO_2eq (circles); colors are used to differentiate between the various types

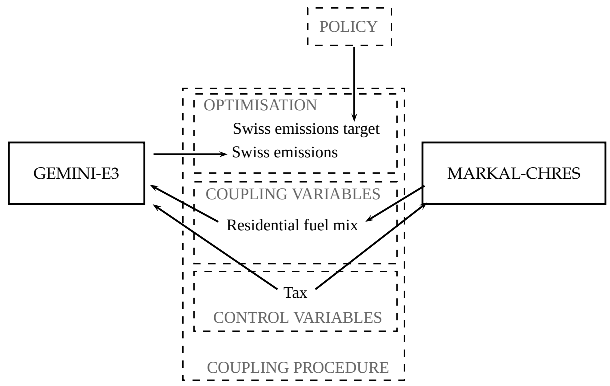

Figure 5.1: Coupling structure

of emissions (see legend). The figure shows that both the total CO_2 and total GHG emission decline strongly when the progressive tax is set up to reach 150 USD/tCO_2eq by 2050. With such taxation levels, the residential sector, which presents high substitution potentials in this coupled framework, exhausts all its abatement potential as early as 2035. The figure also demonstrates that private transportation, the other part of households' emission, is quite inelastic. This is a consequence of having only petroleum products as source of energy for households private transportation as well as having incorporated the existing differentiation in the taxation of petroleum products according to their use. The CO_2 tax affects more the relative prices of heating oil than those of gasoline or diesel.

Figure 5.3 shows the additional abatement in 2020 and 2050 at various levels of tax for both the original GEMINI-E3 and the coupled model. It is interesting to notice that a pure CGE model like GEMINI-E3 allows for stronger abatement than the coupled model when it comes to relatively small taxes. Nevertheless, it is not able to model the substitution to future efficient but expensive technologies when taxes over 100 USD/tCO_2eq are introduced. Therefore, only the coupled model enables us to reach the high levels of abatement we are expecting in 2050 with realistic taxation levels. We observe in Figure 5.2 that the abatement possibilities in the residential sector tend to be exhausted quickly when the tax level reaches 150 USD/tCO_2eq. As a consequence, in 2050, the total additional abatement tends to stabilize after having reached 16 [MtCO_2eq].

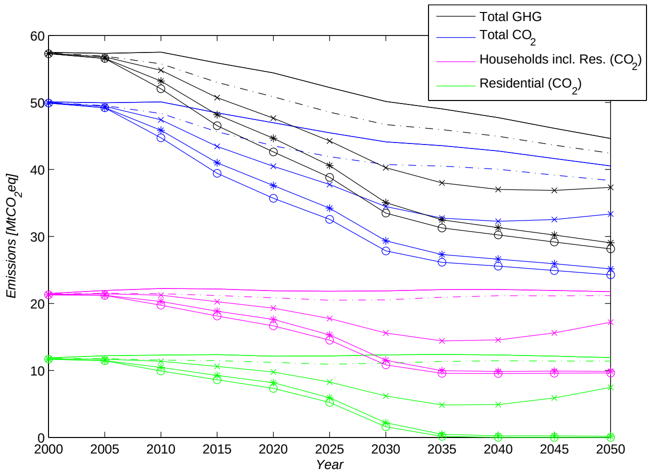

Figure 5.2: Impact on CO_2 and GHG emissions of the model to various levels of progressive taxes (0, 50, 100, 150 and 200 USD/tCO_2eq)

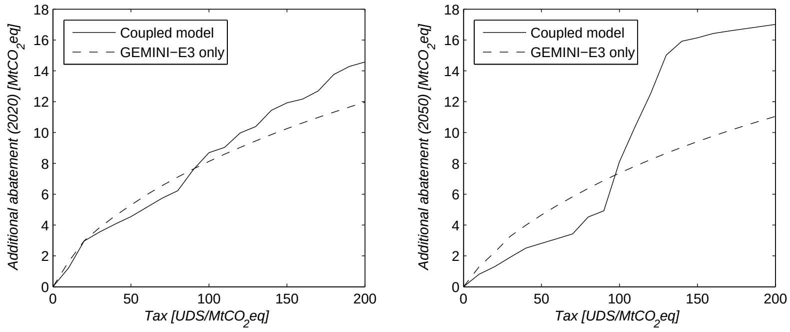

Figure 5.3: Comparison of GEMINI-E3 with the coupled model - Additional total abatement in 2020 (left) and 2050(right)

Chapter 6

Policy scenarios

In 2007, the Swiss Federal Council had decided that Swiss energy policy would be based on four pillars: the increase of energy efficiency, the promotion of renewable energy, the replacement and construction of electric power plants and international energy policy. These four pillars will support the climate policy targets and they should also support action plans aiming at a reduction of the use of fossil fuels by 20% by 2020, an increase of 50% in the use of renewable energy by the same year and a limit of 5% on the growth of electricity consumption between 2010 and 2020.

In December 2008, the Swiss Federal Council launched a three-month consultation on two variants for revising the existing CO2 law after it expires in 2012:

(a) the same reduction targets as the European Union, i.e. 20% reductions of GHG emissions relative to 1990 by 2020 and 50% by 2050; a pure incentive tax on all fossil fuels would be set to meet those targets, i.e. it would be responsive to economic growth, fossil fuel prices and the effects of other energy conservation and substitution measures; the revenues of the tax could be redistributed to households and firms or used to subsidize energy conservation measures; firms that reduce their emissions by as much as under the tax would get it refunded; they may purchase compensation abroad so long at it does not exceed one fourth of total reductions.

(b) a 50% reduction target for 2020 and full climate neutrality after 2030, provided the international community agrees on an ambitious climate regime; 17.8% of the reduction would be obtained by energy conservation and substitution measures, without specific tax; 32.2% would be obtained through the purchase of emissions certificates on world markets by the importers of fossil fuels; in order to make sure that they purchase the certificates, they would have to pay into a guarantee fund 36 CHF/tCO2 (21 USD_{2000}), which they would recover when they prove the compensation of 50% of the imported CO2; this puts a ceiling of 42 USD_{2000} on the price fossil fuel importers would pay for emissions certificates; if world prices exceed that ceiling, there would be no compensation and the target would be missed.

In this report, we do not simulate exactly these policies but rather more stylized variants. In this part we simulate GHG taxes of the type foreseen under variant (a). In the second part of this report, we simulate climate neutrality policies akin to variant (b).

In order to facilitate the transition between the current CO_2 Law, which targets only CO_2 emissions, and the future policies which will encompass all GHGs, we have decided to consider objectives for both CO_2 and all GHG emissions. Among the policy instrument and measures under consideration, we have selected those which either focus on the residential sector or have a wide impact on the economy. As a consequence, we have decided to analyze pure incentive GHG and CO_2 taxes as well as technical regulations enforced in the residential sector. We study the potential abatement and the consequences following the implementation of both instruments separately as well as jointly. In this study, the tax revenues of the so-called pure incentive taxes are redistributed to households through lump sum transfers. Further studies could analyze the influence of various redistribution schemas or specific uses of the tax revenue.

We test three scenarios. In the first scenario, we implement emission taxes applied across the whole Swiss economy, influencing both the production sectors and the households by changes in relative prices. We analyze two type of taxes, first a progressive tax that increases linearly up to the target year and, secondly, a uniform tax, which has a fixed value from 2008 till 2050. We also compare CO_2 taxes with a tax covering all GHG.

In the second scenario, we consider the implementation of technical regulation which aims at restricting the investments in technologies considered inefficient. For the purpose of this paper, we consider technical regulations only in the residential sector. We compare the energy efficiency of each technology with the average efficiency of all technologies allowing for satisfying the same final energy demand (see Table 3.1). Then, as of 2015, we restrict households' investments to those technologies having an energy efficiency superior or equal to the average. Technologies not using fossil fuels or electricity were not restricted, and in the case of residential heating, we do not consider heat pumps, neither in the calculation of the average efficiency nor in the list of restricted technologies. Examples of inefficient technologies falling in the restricted list are incandescent and halogen lamps.

Finally, the third scenario considers the joint use of both instruments. The next section presents the integrated assessment of those policies.

Chapter 7

Results

In this section we present the results of the scenarios described above from the perspective of their environmental effectiveness as well as their consequences on the Swiss economy and on the residential sector in particular.

7.1 Pure incentive tax

The results in Table 7.1 show that the 20% emissions reduction of GHG emissions by 2020 requires a 97.9 USD/tCO_2eq progressive tax on all GHG gasses and the tax should reach 201.6 USD/tCO_2eq to allow a 50% abatement by 2050. The level of those taxes could obviously be reduced if the taxes were set uniformly across periods. Furthermore, when only CO_2 emissions are taxed, similar abatement levels require higher taxation levels, which could go up to almost 220 USD/tCO_2eq to abate GHG emissions by 50% in 2050. These results confirm that without emissions trading, achieving substantial abatement levels in Switzerland requires a significant level of taxation. In comparison, these levels of taxation are much higher than the CO_2 tax introduced in 2008 on heating and process fuels, which amounts to 12 CHF/tCO_2 and should grow to 36 CHF/tCO_2 in 2010.

In the case of a 50% abatement target, the model faces rigidities in private transportation where little substitution is possible even with distant horizons such as 2050. Modeling the transportation sector using an energy use model would allow for a better representation of the substitution possibilities and therefore would allow reaching similar targets with lower taxes. The figures in italic, the intermediate (2020) or final (2050) abatement levels associated with the taxes, show that the taxation levels set out to reach the 2020 target would not allow to reach the 2050 objectives. Similarly, taxes allowing to reach the 2050 targets are either insufficient, if implemented in a progressive way, or too restrictive, when implemented uniformly across the whole period. If both the 2020 and 2050 objectives need to be met, the tax could be implemented progressively but not linearly. The annual increase in the first phase (before 2020) should be stronger than in the second phase.

Table 7.1: Abatement and pure incentive taxes USD/tCO_2eq

	CO_2 tax		GHG tax	
Target	Progressive	Uniform	Progressive	Uniform
20% by 2020	105	93	98	89
% in 2050	*37*	*28*	*35*	*32*
50% by 2050	220	157	202	134
% in 2020	*18*	*27*	*18*	*25*

7.2 Technical regulations

We find that the use of technical regulations of the type we have described and limited to the residential sector alone has a limited impact on Swiss CO_2 and GHG emission. Figure 7.1 compares the baseline emissions with (lower line) and without (upper line) technical regulations in the residential sector. The impact of the technical regulations is slightly more important on CO_2 emissions than on total GHG emissions due to the targeting of the regulations on CO_2 intensive technologies. The maximum impact of the regulation is of about 2% around 2020, but only in the case where no taxes are implemented simultaneously. The next section shows how taxes further diminish the usefulness of technical regulations of the types we have implemented them in this paper.

Other measures than those we have modeled could have a greater impacts on emissions and would deserve further consideration. Among those, we can mention: financing a program promoting the energetic renovation of buildings, implementing technical regulations on vehicles, strengthening research on energy efficiency or accelerating technological transfer.

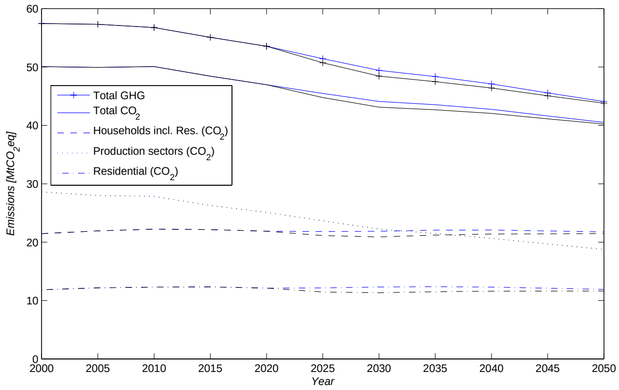

Figure 7.1: Impact of the technical regulations on the baseline CO_2 and GHG emissions

7.3 Joint use of technical regulations and taxes

When the coupled model takes into account the implementation of the technical regulations, the CO_2 and GHG taxes allowing for achieving the abatement target are not significantly different from those calculated without technical regulations. This is mainly due to the fact that the less efficient technologies are naturally abandoned by households since CO_2 or GHG taxes further reduce their competitiveness. As a consequence, for the rest of the analysis we focus on the first scenario, which, in our framework, allows to reach the emission targets without requiring additional technical regulations.

7.4 Impacts on the Swiss economy

Table 7.2 shows the impacts on GDP of the pure incentive taxes defined in Table 7.1. If technical regulations are combined with the taxes, we saw that the taxes only differ marginally from the case without regulations and the same applies for their impacts on the GDP. The figures show that the impact of emission taxes on the Swiss economy is limited and, in all cases, would reduce GDP growth by less than half a percent, even with taxes as high as 200 USD/tCO_2eq. Moreover, GHG taxes have a smaller impact on GDP than CO_2 taxes. The effects on GDP might be a little stronger if we forced the CGE part of the model to mimic the increased spending on equipment suggested by the MARKAL-CHRES. Indeed, the tax has an incidence on consumer investment strategy, he invests in less polluting but more expensive technologies.

Table 7.2: GDP variations without technical regulations (in %)

Gas	Target	Tax	2020	2050
GHG	20% by 2020	Progressive	-0.17	-0.21
		Uniform	-0.16	-0.17
	50% by 2050	Progressive	-0.11	-0.41
		Uniform	-0.24	-0.36
CO_2	20% by 2020	Progressive	-0.19	-0.26
		Uniform	-0.17	-0.18
	50% by 2050	Progressive	-0.12	-0.44
		Uniform	-0.28	-0.39

In our assessment, only uniform taxes set to meet the 2050 targets allow to meet both 2020 and 2050 targets. Progressive taxes have nevertheless a higher chance to be accepted since their cumulated impact on GDP is smaller. Figure 7.2 shows the impacts on the production sectors of a 219.7 USD/tCO_2 tax on CO_2 and a 201.6 USD/tCO_2eq tax on all GHGs. The only sector that strongly benefits from the introduction of the taxes is the electricity sector, due to the increased demand for electricity which is produced mainly CO_2 free in Switzerland. In the case that current nuclear power plants were replaced by combined cycle gas turbines, emission taxes would have to be higher and the electricity sector would not benefit as much from the introduction of the tax. The petroleum products sector is the most affected by the introduction of the taxes, together with other energy intensive sectors such as mineral products, agriculture and air transport. Not surprisingly, in our modeling framework, other transport (transport nec), which includes commercial road transport and rail, is not that much affected by the tax in view of the substitution between private and purchased transport.

Table 7.3 presents the contributions of households and economic sectors to CO_2 abatement as well as the contributions of the different greenhouse gases to total abatement. The major contribution to the CO_2 abatement effort is attributed to households with a share of 35%, followed by road and rail transport which accounts for 16.5% of the emissions reductions between 2001 and 2050. If we consider that in the baseline scenario a certain level of abatement is already achieved as a consequence of policies already adopted, the share of households in the additional abatement is as high as 74%. The share of households would be even higher if the private transportation were coupled to a transportation energy use

Table 7.3: Contributions to the change in emissions between 2000 and 2050 after progressive taxation

Sectors / Gases	GHG tax	CO_2 tax
Households	35.11	37.78
Transport nec	16.55	16.86
Services	8.64	8.92
Air Transport	4.90	5.06
Mineral Products	4.25	4.29
Consuming goods	3.25	3.29
Equipment goods	2.13	2.16
Petroleum Products	2.09	2.13
Paper products publishing	1.91	1.93
Metal and Metal products	1.86	1.87
Agriculture	1.09	1.10
Chemical, rubber, Plastic	0.99	1.01
Electricity	0.92	0.93
Forestry	0.34	0.34
Dwellings	0.00	0.00
Sea Transport	-0.04	-0.02
CO_2	83.97	87.66
CH_4	9.33	7.88
N_2O	7.25	6.62
Fluorinated gases	-0.55	-2.16

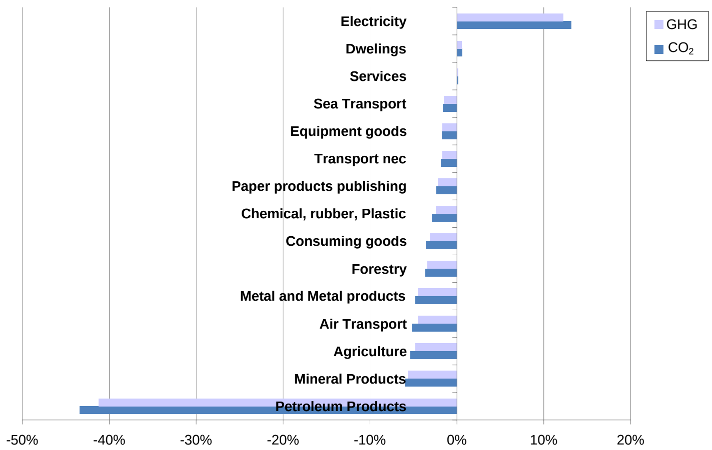

Figure 7.2: Variation of production in 2050 relative to baseline

model, similarly as we do it for the residential sector. Except for the emissions of fluorinated gases, which still increase despite the high levels of taxation mainly because of an increase in SF_6 (sulfur hexafluoride) emissions from electric power systems, all GHG contribute substantially to the overall abatement, in particular in the case of GHG taxation.

Finally, the estimations confirm our initial assumption stating that the prices of energy would only vary slightly compared to the baseline due to the limited impact of Swiss energy demand on world prices.

7.5 Impacts on the residential sector

As we saw earlier, the implementation of emissions taxes has strong consequences on the residential sector. The bottom-up part of the coupled model shows, as presented in Figure 7.3, that the residential sector reacts to the introduction of the taxes by a strong switch to electricity between 2020 and 2035. A uniform tax of 156.5 USD/tCO_2eq would even have an earlier and stronger impact and would even trigger an almost CO_2 free residential sector.

Figure 7.4 presents the evolution of installed capacity of various room heating technologies following the implementation of a progressive GHG tax allowing to reach 50% abatement by 2050. It clearly indicates that, in all building types,

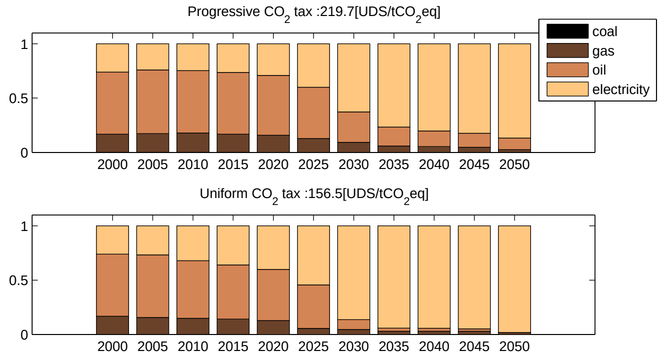

Figure 7.3: Residential fuel mix

heat pumps will have a rapidly growing share and, as of 2030, be the dominant technology used for room heating. This is due to to the fact that heat pumps have a high energy efficiency and that they only consume electricity, which is, to a large extent in Switzerland, not produced from fossil fuels. Finally, the figure also shows that an important part of the final energy demand is met by installing energy saving technologies, in particular in new single family houses where almost a fourth of the energy is saved by using appropriate insulation and other energy efficiency standards.

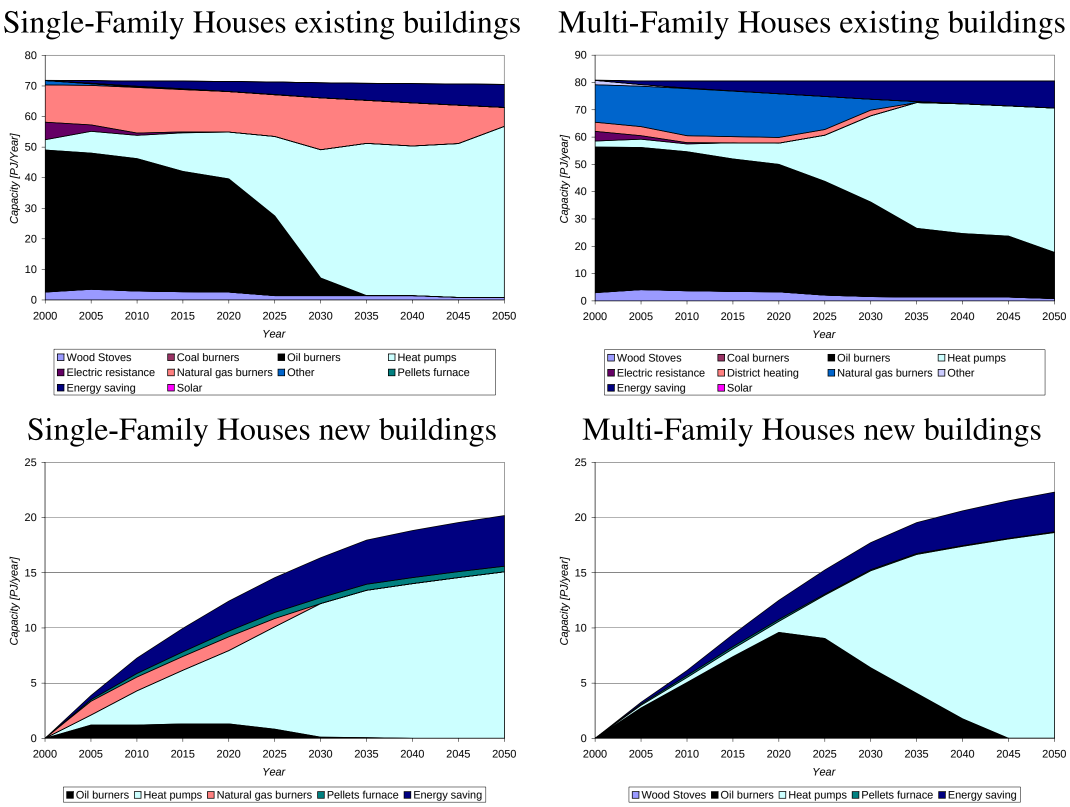

Figure 7.4: Installed capacity of room heating technologies

Acknowledgements

We also would like to thank the Energyăteam of the Paul Sherrer Instute, especially Thorsten Shulz who is co-author of the paper. We also thank Dr. Kasten Nathani and Markus Wickart for providing us with a disaggregated 2001 Swiss input-output table.

Part II

Sustainability, neutrality and beyond in the framework of Swiss post-2012 climate policy

Chapter 8

Introduction

In this paper, we analyze four ambitious emission targets for Switzerland.

First we consider an abatement of 50% by 2050 with respect to 2000 emissions level; a reference target for developed countries since it has been extensively discuss in the European Union.

Secondly, a sustainable approach that reflects the fact that the ultimate goal of post-Kyoto climate policies will be to stabilize greenhouse gas (GHG) emissions at sustainable levels. Recent international studies (IPCC, 2007) state that concentrations of 450ppm would limit the increase of temperature to acceptable levels (around 2°C) and, therefore, could be considered as sustainable. In order to limit the concentrations to those levels and taking into account the approach of contraction and convergence policies (ETHZ, 2008; Meyer, 2000), GHG emissions per capita would have to be globally limited to 1 tCO_2eq per annum by 2100. For developed countries, such a target is far from current levels of emissions per capita (7.2 tCO_2eq/cap in Switzerland in 2004), and for developing countries, it means that their development could not be based on the technologies that contributed to the development of industrialized countries.

Thirdly, the neutrality approach advocates the offset of the totality of the emissions generated by a person, a company or a country. This idea is increasingly accepted among individuals and companies, however, it would represent a major step forward to extend the idea to a whole country. In the framework of the revision of its Swiss CO_2 tax, Switzerland has already mentioned climate neutrality as a potential option for the future of Swiss climate policy (FOE, 2008). This neutrality could be mainly achieved by means of large purchases of CO_2 certificates.

Fourthly, the zero-footprint approach which includes offsetting emissions embodied in imported goods. Supporters of a "neutral" Switzerland state that the transfers generated by the purchase of certificates will allow developing countries to achieve a more sustainable development path, in particular when considering that developing countries are producing an important share of high energy goods. In Switzerland, the share of embodied emissions in the Swiss net trade represents about 80% of the domestic emissions (Jungbluth et al., 2007). Going one step further and taking embodied emissions into account for setting emissions targets could revolutionizes the current approach to international climate negotiations, since, so far, the GHG emitted to produce goods are accounted in the producing countries, not in the consuming ones.

Moreover, regardless of how ambitious the Swiss emission target will be, if the abatement is mainly achieved through the purchase of GHG emissions certificates and that global price of the certificates is low, the country might not start the necessary upgrading of its infrastructures or see changes in the consumption patterns. Without a minimal domestic abatement, the four approaches above may sound like a solution which could only bring economic benefits in the short term. With that in mind, we also analyze policies that follow the same approaches but include the additional requirement to have a 50% reduction of domestic emissions by 2050 relative to 1990.

The objective of this paper is to assess the economic consequences of such polices on the Swiss economy, considering as illustrative example the residential sector. In order achieve the various objectives above, we combine the implementation of a linearly progressive Swiss GHG emissions tax with a global GHG emissions certificates market. In view of the size of Switzerland, the price of the certificates assumed to be influenced solely by the emissions targets decided by in other regions. Therefore, we have considered three different international scenarios. In each of them, the Swiss tax is either used to achieve a domestic abatement target or to collect the revenue that would allow for the purchase of foreign GHG emissions certificates.

We use a coupled top-down bottom-up model that allows for a precise technological specification of the Swiss residential sector, which encompasses a great potential for GHG emissions abatement, without loosing the national and global economic picture. A literature reviwe on the coupling between top-down and bottom-up models can be found in the first part of this document (see section2). Finally, until now, the only coupling papers specifically targeted to the Swiss residential sector are Drouet et al. (2005) and Sceia et al. (2008). Drouet et al. (2005) have devised an hybrid model where the residential sector is completely removed from the top-down model and it is replaced by an exogenous and separate bottom-up model. Sceia et al. (2008) developed the earlier version of the model we use in this paper. We brought various improvement to the coupling procedure, the models as well as the calibration procedure.

We find that if international agreements aim at limited emission reductions, Switzerland could afford very stringent abatement targets without substantial welfare losses. In the case where developing countries would start contributing significantly to the abatement effort, even as late as in 2030, the impact of highly stringent policies becomes important, but getting on the track of sustainability could be affordable with a progressive GHG tax reaching around 140 USD_{2001}/tCO_2eq.

The paper is organized as follows: section 2 presents the models and the methodology, section 3 presents the policy scenarios, section 4 the results and section 5 concludes.

Chapter 9

Models and methodology

9.1 GEMINI-E3

We use an aggregated version of GEMINI-E3, a dynamic-recursive CGE model with a highly detailed representation of indirect taxation, that represents the world economy in 6 regions and 18 sectors[1]. We defined the regions as follows: Switzerland (CHE), European Union (EUR)[2], other European and Euro-asian countries (OEU)[3], Japan (JAP), USA, Canada, Australia and New Zealand (OEC) and other countries, mainly developing countries (DCS). The model is formulated as a Mixed Complementarity Problem , which is solved using GAMS and the PATH solver (Ferris and Munson, 2000; Ferris and Pang, 1997). GEMINI-E3 is built on a comprehensive energy-economy data set, the GTAP-6 database (Dimaranan, 2007), that provides a consistent representation of energy markets in physical units and a detailed Social Accounting Matrix (SAM) for a large set of countries or regions and bilateral trade flows between them. Moreover, we have completed the data from the GTAP database with information on indirect taxation, energy balances and government expenditures from the International Energy Agency (International Energy Agency, 2002a,b, 2005), the OECD (OECD, 2005, 2003) and the International Monetary Fund (IMF, 2004). For Switzerland, we used data from 2001

[1]The complete GEMINI-E3 represents the world economy in 28 regions (including Switzerland) and 18 sectors (see table B.1 in appendix B for the detailed classification). All information about the model can be found at http://www.gemini-e3.net, including its complete description (Bernard and Vielle, 2008).

[2]refers to the European Union member states as of 2008

[3]includes other European countries, Russia and the rest of the Former Soviet Union excluding Baltic states

input-output table devised at the Swiss Federal Institute of Technology (ETH) in Zürich (Nathani et al., 2006) which we transformed in the GEMINI-E3 format (Sceia et al., 2007). All the data on emissions and abatement costs for non CO_2 GHG come from the U.S. Environmental Protection Agency (United States Environmental Protection Agency, 2006).

Previouly, GEMINI-E3 has been used to study the strategic allocation of GHG emission allowances in the enlarge EU market (Viguier et al., 2006), analyze the behavior of Russia with regard to the ratification process of the Kyoto Protocol (Bernard et al., 2003), assess the cost of implementation of the Kyoto protocol in Switzerland with and without international emissions trading (Bernard et al., 2005), or assess the effects of an increase of oil prices on global and GHG emissions (Vielle and Viguier, 2007).

Apart from a comprehensive description of indirect taxation, the specificity of the model is that it simulates all relevant markets: commodities (through relative prices), labor (through wages) as well as domestic and international savings (through rates of interest and exchange rates). Terms of trade (i.e. transfers of real income between countries resulting from variations of relative prices of imports and exports) and "real" exchange rates can also be accurately modeled. GEMINI-E3 also calculates the deadweight loss for each region on the basis of the consumers' surplus and the gains or losses from the terms of trade.

Time periods are linked in the model through endogenous real interest rates, which are determined by the equilibrium between savings and investments. National and regional models are linked by endogenous real exchange rates resulting from constraints on foreign trade deficits or surpluses.

In order to allow the calibration and the coupling of GEMINI-E3 with MARKAL-CHRES, we have replaced the Stone-Geary utility function by a nested constant elasticity of substitution (CES) function. The nesting structure is shown in Figure 9.1. Numbers in the figure refer to the products as presented in appendix B table B.1. The σ_x refer to the elasticity parameter of each node. The version of GEMINI-E3 we use for this research only uses petroleum products as input in the transportation energy nest.

We have also introduced an emission certificates market that allows for modeling a global cap and trade system. Each region receives annually an endowment of emission certificates, equal to the emission policy target. In Switzerland, we have also implemented an exogenous progressive GHG tax, independent from the global price of certificates that allows for higher domestic abatement.

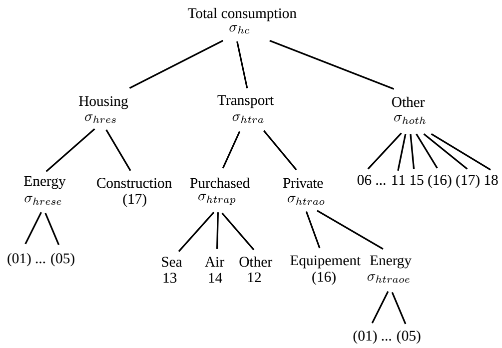

Figure 9.1: Structure of the households' nested CES utility function

Measuring the cost of GHG abatement

Climate policies are devised in order to avoid future welfare losses induced by the potentially costly damages and adaptation measures entailed by changes in climate if no mitigation effort is undertaken. It is not the aim in this paper to consider the tradeoff between adaptation and mitigation measures but rather to measure the costs for the society to abate GHG emission. Measuring the costs of climate policies and comparing their efficiency can be done in various way. A simple approach consists in analyzing the variation of macroeconomic aggregates such as GDP or households' final consumption (HFC). Unfortunately, the variation of GDP and HFC does not account for the variation of relative prices induced by the introduction of a GHG tax. The households' surplus, either based on the compensating variation of income (CVI) or the equivalent variation of income is a more consistent and complete measure of the costs of climate policies (Bernard and Vielle, 2003). The households' surplus or total welfare gains (WG_t) at each period t can therefore be expressed as

$$WG_t = \Delta R_t - CVI_t, \tag{9.1}$$

where ΔR is the variation of income, mainly due to transfers through international trade. The welfare gains vary greatly from the theoretical case of a closed economy, where they are equal to the deadweight loss of taxation (DWL), to the case of an open economy having access to an emissions certificates trading market. In this later case, the total welfare gains can be expressed as

$$WG_t = DWL_t + GTT_t + EC_t, \tag{9.2}$$

where GTT and EC are respectively the gains or losses of the terms of trade and the net revenue from trading emission certificates. Assuming that trade balances are indeed balanced at each period and for each region, the GTT can be calculated as follows,

$$GTT = \sum_i (X^0_{i,t} \cdot \Delta P^X_{i,t} - M^0_{i,t} \cdot \Delta P^M_{i,t}), \tag{9.3}$$

where, for sector i and period t, $X^0_{i,t}$ represents baseline exports, $M^0_{i,t}$ the baseline imports, $\Delta P^X_{i,t}$ the export price variation between the baseline and the scenario and $\Delta P^M_{i,t}$ the import price variation. The sums of GTT and EC over all regions equal zero, since the global economy may be thought of as a closed economy. As a consequence, the world consumer surplus equals the world deadweight loss of taxation.

In order to present the total effect on the welfare of a specific scenario, we represents the sum of the various discounted values as a percentage of the sum of the discounted households' final consumptions, using a 5% discount rate.

9.2 MARKAL-CHRES

MARKAL models are perfect-foresight bottom-up energy-systems models that provide a detailed representation of energy supply and end-use technologies under a set of assumptions about demand projections, technology data specifications and resource potential (Loulou et al., 2004). The backbone of the MARKAL modelling approach is the so-called Reference Energy System (RES). The RES represents currently available and possible future energy technologies and energy carriers. From the RES, the optimization model chooses the least-cost combination of energy technologies and flows for a given time horizon and given end-use energy demands.

The MARKAL-CHRES is an energy model describing the Swiss residential energy system. It is based on the Swiss MARKAL model developed at the Paul Scherrer Institute (PSI) and previously used to analyze the Swiss 2000 Watt Society concept (Schulz et al., 2008), among others. MARKAL-CHRES comprises only a part of the complete Swiss model, being restricted to technologies related to the residential sector and treating final energy as being imported with exogenous prices. The model still contains 173 technologies using different energy sources (coal, oil, gas, electricity, wood, pellets and district heat). Resource costs and potentials as well as technology costs, potentials and characteristics vary over time.

Base year (2000) energy demand in MARKAL-CHRES is calibrated to International Energy Agency (IEA) and Swiss statistics. The model has a time horizon of 50 years until 2050, divided into eleven time steps each with a duration of five years (except the base year). The residential energy sector of the model includes 14 energy demand segments (see appendix B table B.2). The most important segments are the Room-Heating (RH) segments which represent more than 70% of final energy demand. We distinguish four different demand categories for RH: Single and Multi Family Houses as well as existing and new buildings. In the model we assume that dwellings constructed after the year 2000 are new buildings. The model uses USD2000 as currency, and a 5% discount rate. One of the specific features of the MARKAL-CHRES model is that it includes a representation of a set of technologies which allow for energy savings. The idea behind those technologies is to take into account the reduction of energy demand which follows certain types of investment. For example, installing double-glazed windows increases insulation and therefore reduces heating demand. For a more detailed description of the technologies used in the MARKAL-CHRES model, see Schulz (2007).

9.3 Baseline calibration

Both models are calibrated to produce a common baseline. In GEMINI-E3, we use the projections from Energy Information Administration (2008) to estimate future prices for oil up to 2030 (70.5 USD_{2006}/bbl) and assume a constant increase of 2% up to 2050 so that oil price reaches 109.6 USD_{2006}/bbl. Based on various studies (Awerbuch and Sauter, 2006; Siliverstovs et al., 2005), we assume an indexation of gas prices to the price of oil at 0.75 (i.e. the price of gas increases by 7.5% when the oil price increases by 10%). For the MARKAL-CHRES model, we aligne the variation of energy prices, using the growth rates of energy prices in GEMINI-E3. Furthermore, population and economic estimates (e.g. GDP) together with construction estimations are used in order to estimate the Reference Energy Area (REA), i.e. the total useful surface of all heated rooms. The heating demands or useful energy used for heating (TJ/year) is equal to the Specific Room

Heating Demand (MJ/m^2year) multiplied by REA (Mio m^2).The Swiss Federal Office of Energy provides estimates of the REA until 2035. Values until 2050 are extrapolated. Assuming a constant per capita energy demand for all other demand segments, we define them using the growth rate of the Swiss population. The Swiss population is expected to grow until 2030 to a level of approximately 7.4 million people and then slowly decrease to reach 7.25 in 2050. Finally, according to the projections by the State Secretariat for Economic Affairs (2004), the annual average GDP growth rate is expected to be 1.2% from 2001 to 2020, and 0.6% from 2020 to 2050.

We use the baseline fuel mix from MARKAL-CHRES in GEMINI-E3 in order to align the emissions in the residential sector between the two models. The shares between the different energies are set to the shares of the fuel mix. Moreover, we define the technical progress in the residential energy nest so that the variations of the total residential energy use in GEMINI-E3 follows the same growth we observe in MARKAL-CHRES. Finally, we also define the growth of the technical progress in the private transport energy nest and of the general technical progress on the use of fossil fuels to 1.25% in order to have the total CO_2 emissions baseline decline by 13% between 2000 and 2035 as forecasted by Swiss Federal Office of Energy (2007).

With regard to total GHG emissions, our baseline scenario is in the average of studies published since the SRES (IPCC, 2007). The world GHG emissions reache approximately 72 $GtCO_2eq$ in 2050, which is also in line with the baseline emissions anticipated in OECD (2008). Our baseline assumes a great diversity in the regional evolution of GHG emissions (see figure 11.1). CHE and JAP emissions decline by 24% in 2050 compared to 2001 levels. EUR and OEC see an increase in emissions of 9% and 21% whereas OEU and DCS have higher baseline emission growths and reach by 2050 113%, respectively 212%, of 2001 emission.

9.4 Coupling

Post-2012 policies should aim at strong abatement targets which could hopefully ensure a sustainable solution to the climate change issue. Global CGE models are well suited to analyze market based solutions to the problem, in particular when trying to globally equate marginal abatement costs through the implementation of carbon markets or world taxes. When it comes to strong domestic abatement efforts, which will be required in developed countries before the end of the century, CGE models do not precisely depict all technological options and therefore all abatement possibilities. In Switzerland, for instance, the residential sector accounts for a an important share of the total GHG emissions and seems to allow for important abatement possibilities at reasonable costs (see Sceia et al. (2008)). In general, coupling top-down with bottom-up models allows to benefit from the technological richness of the latter without loosing the global economic picture (Böhringer, 1998; Böhringer and Rutherford, 2008). Therefore, in order to analyze thoroughly future Swiss climate policies within a global framework, we couple a CGE model, GEMINI-E3, with a Swiss residential energy model, MARKAL-CHRES.

Coupling method

We have further developed the coupling module that links GEMINI-E3 and MARKAL-CHRES. The coupling module researches the Swiss GHG tax in 2050 that allows to meet the policy objectives while ensuring that the energy use and the investments in the residential energy models is adequately taken into account in GEMINI-E3. The coupling method that we have implemented allows for setting simultaneously total and domestic emission targets for Switzerland as well as emissions certificates endowments in all regions. We consider that domestic targets have to be achieved by actual emissions reductions within the country, whereas total emissions target account for both domestic emissions and net trade of GHG certificates. In line with these definitions, when no domestic target is defined, the coupling procedures set a Swiss tax at a level that ensures that the tax revenue allows for purchasing enough certificates on the global carbon market in order to achieve the total emission target. If both domestic and total targets are defined, the coupling procedure ensures that the tax allows for achieving at least the domestic target and ensures that the tax revenue is sufficient to purchase enough emissions certificates to meet the total emissions target. In all cases, when the tax revenue exceeds the amount required to purchase the certificates, the difference is returned to households through a lump sum transfer.

Figure 9.2 presents the coupling schema. The GHG progressive tax vector, defined by the value of the tax in 2050, is the variable that allows to control both models. The residential fuel mix and the annualized investments over the whole time frame are the coupling variables ensuring that GEMINI-E3 calculates emissions and adjusts the residential investments in GEMINI-E3 on the basis of the MARKAL-CHRES simulations. The fuel shares are used as a proxy for the variation of the share parameters in the residential energy nest, with an elasticity of substitution (σ_{hrese}) is set to 0, whereas the variation of the total fuel consumption and the variation of annualized investments are used, respectively, to update the values of the technical progress on energy and on construction in the residential nest, which is also transformed into a Leontief function ($\sigma_{hres} = 0$). Furthermore, total Swiss emissions and world price of GHG certificates in 2050 are the variables used for ensuring that the coupled models converge to the targets defined in the scenarios. Finally, the international policy scenarios are set exogenously, i.e. defining emissions certificates endowments.

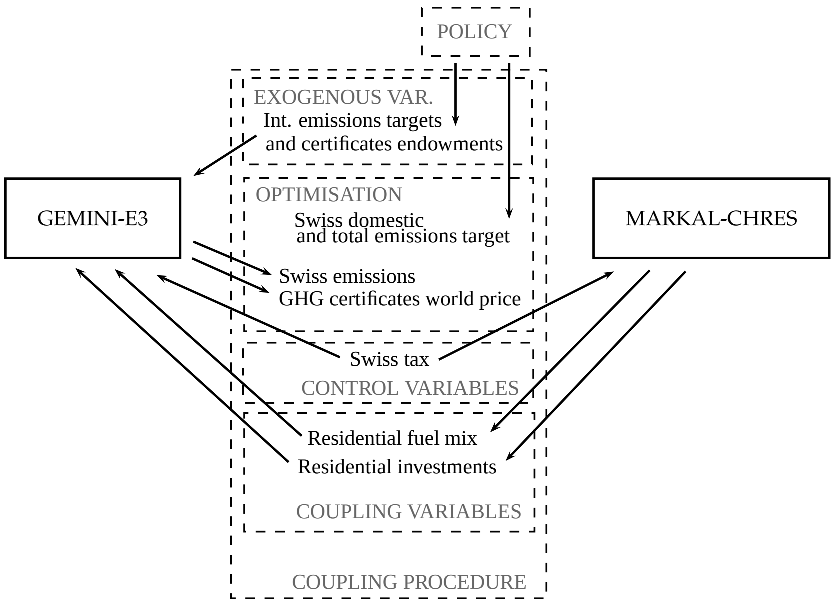

Figure 9.2: Coupling structure

A technical description of the coupling procedure is provided in algorithms 1 and 2 (see appendix A).

Chapter 10

Policy scenarios

Climate change is a global issue which will only be solved through appropriate international agreements (Carraro and Siniscalco, 1993, 1998). It is also a complex issue in which environmental concerns interact with the economic, equity and development issues. Considering the later, the incentive to free ride can be high for some developing countries but it remains the responsibility of wealthier nations to take the lead and show the example. How much would it cost for Switzerland to take that leading role and to implement policies that might go beyond what international agreements target for the next commitment period?

10.1 International scenarios

In order to set a realistic international framework, we have defined 3 scenarios for international policies. We decided, following previous studies (e.g. Sceia et al. (2008); Vuuren et al. (2006)), to focus on policies targeting abatement of all GHG because this allows to lower abatement costs. Table 10.1 presents the different GHG emissions quotas in 2050 for all regions, with the exception of those from Switzerland which will be explained in details below. These emissions targets are implemented progressively from 2008 to 2050 for EUR and JAP, from 2012 to 2050 for OEC and OEU and from 2030 to 2050 for DCS. These emission targets are based on 2001 emissions levels except for those of DCS, which are based on their 2030 baseline emissions. We assume that each region receives annually emissions certificates at the level of its annual target and is then free to trade them within the region as well as with other regions. The "high" scenario is inspired by the recommendations of the Energy Modeling Forum 22 (EMF, 2008) and adapted to the specific regional aggregation that we use in the model. The "mid" and "low"scenarios consider alternatives where climate negotiations would lead to lower emission targets, in particular from the DCS.

Table 10.1: International emissions targets in 2050 (% relative to 2001 emissions)

Scenario	Low	Mid	High
EUR	50	50	50
OEU	10	20	30
JAP	50	50	50
OEC	30	40	50
DCS[a]	-[b]	0	25

[a] % of 2030 emissions
[b] baseline emissions

10.2 Swiss scenarios

In the long run, in order to avoid major climate change, each and every country will have to reduce its domestic emissions. From an equalitarian perspective, global emission will certainly have to be shared on a per capita basis. Taking this into account and considering population forecasts, purchasing emissions certificates does not help industrialized countries preparing to an inevitable change in their production and consumption patterns. With that in mind, we consider two kinds of emissions targets for Switzerland. The first is a domestic emissions target that can only be achieved by actual domestic emissions reductions either in the production or in the consumption of goods. The second is a total emissions target that takes into account not only the domestic abatement but also the purchase and sales of emissions certificates.

In Switzerland, we impose a progressive domestic GHG tax, which grows linearly from 2008 onward and reaches it final value in 2050. The tax revenue collected by the application of the tax is used to purchase GHG emissions certificates to reach the total emission target and the leftover, if any, is redistributed to households through a lump sum transfer. Figure 10.1 shows the case where no minimal domestic emissions target is set and where the tax is set to allow for the purchase of GHG emissions certificates abroad ensuring a total abatement of 50% (including compensation). The area ABCD represents the tax revenue and the area GBEF the purchase of certificates at a price p_W. The level of the tax is therefore set to equalize areas ABCD and GBEF, ensuring that the revenue collected is sufficient to purchase the GHG emissions certificates.

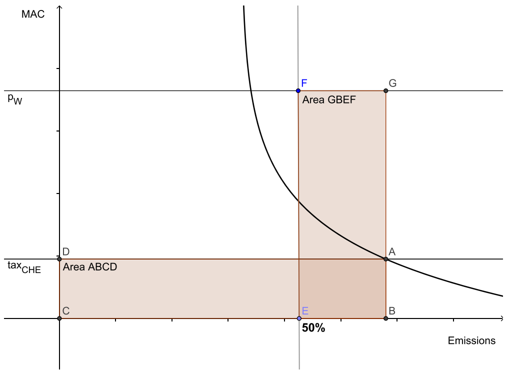

Figure 10.1: Tax revenue used to purchase GHG certificates, for 50% total abatement

We consider 4 scenarios with different objectives and therefore different total emissions targets.

- First, the "50%" scenario is in line with the targets of most European countries. It aims at achieving a 50% reduction of emissions by 2050 compared to the level of 2001.
- Secondly, the "sustainable" scenario aims at globally sustainable per-capita emissions of 1 tCO_2/cap by 2100. We consider, as simplifying assumption and to be in line with the time horizon of the model, that this translates to a 2 tCO_2/cap target by 2050. Considering that the population of Switzerland in 2050 is estimated at approximately 7 millions inhabitants, the emissions reduction should be of approximately 75% when compared to 2001 levels.
- Thirdly, the "neutral" scenario, which follows the climate neutrality idea, aims at a 100% reduction of GHG emissions in 2050, largely through compensation.
- Fourthly, the "zero footprint" scenario takes into account the net emissions embedded in Swiss foreign trade. The net embedded emissions, mainly due to energy imports, represent almost 80% of total domestic emission (Jungbluth et al., 2007). Thus, this scenario aims at offsetting not only the domestic emissions but also those generated abroad to produce goods imported in

Switzerland less the Swiss emissions resulting from the production of exported goods. With the simplifying hypothesis that that the embedded emissions remain constant, we consider that the abatement should reach 180% of 2001 emissions in 2050.

In all four scenarios, we set the Swiss tax at a level such that its revenues are sufficient to purchase the emissions certificates required to offset the Swiss emissions up to the defined target.

Considering that Swiss marginal abatement costs are currently high when compared to world average, the implementation of the previous scenarios might not trigger important domestic abatement in the short run. In order to prepare the Swiss economy for future stringent emissions reductions, a minimum of domestic reductions should be ensured in the forthcoming commitment period. With that in mind, we consider four additional scenarios similar to those described above but with the additional requirement of having a minimum domestic abatement of 50% compared to the emissions of 2001. We name those scenarios "50%+", "sustainable+", "neutral+" and "zero footprint+".

Chapter 11

Results

In this section, we describe and compare the results of the simulations carried out for all the scenarios described earlier. We compare their environmental effectiveness and present their consequences for the economy, in particular for welfare. First, we focus on the different implications of the international scenarios, then on the impacts of all scenarios on the Swiss economy and finally we analyze the contribution of the Swiss residential sector to the overall abatement effort and the evolution of the sector from a technical perspective.

11.1 International framework

The three international scenarios we have defined have significantly different environmental and economic implications. From the perspective of GHG emission, in the "low" scenario, world emissions are still more than 80% higher than in 2001. In the "mid" scenario, the increase of emissions is reduced to 30%, whereas the "high" scenario caps GHG emissions at 34 $GtCO_2eq$, only 2% higher than 2001 levels. Figure 11.1 presents the regional emissions profiles for the three scenarios. In all scenarios, DCS is the main provider of emissions certificates. The abundance of certificates in the first two scenarios, where DCS quotas are attributed according to the baseline emissions or stabilizing at 2030 levels, ensures a low price for CO_2. In contrast, in the "high" scenario, where DCS have to reduce their emissions by 25% relative to 2030, the supply of certificates is significantly reduced and their price increases to almost 300 USD_{2001}/tCO_2eq. It is important to notice that, if we compare the emissions paths with the different IPCC scenarios (IPCC, 2007), even our "high" scenarios is not sufficiently restrictive to ensure a stabilization of GHG concentrations limiting the temperature increase to 2°C.

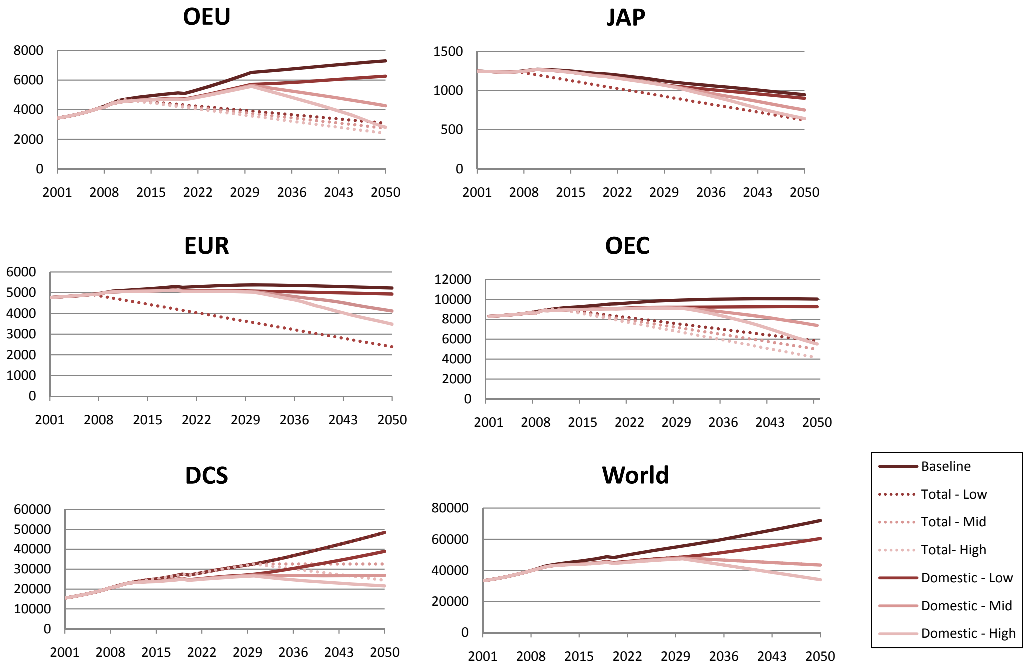

Figure 11.1: International GHG emissions ($MtCO_2eq$)

In order to asses the impact of the three scenarios on the world economy, table 11.1 presents an aggregated welfare decomposition for the period 2008-2050. The welfare, i.e. the consumer surplus calculated on the basis of the CVI, is decomposed into its three components: the gains and losses of the terms of trade (GTT), the net receipt from permit sales and the deadweight loss of taxation. The values in the table represents the sum of the discounted values as a percentage of the sum of the discounted households' final consumptions. The discount rate is set at 5% but increasing or lowering it does not significantly affect the results.

As in other studies (see OECD (2008)), we observe that OEU is the region most affected by climate policies. This is due to the fact that the main exports of this region are energy or energy related but also to the strong efforts they have to undertake in view of their high baseline emissions. Furthermore, they tend to have domestic oil prices below international levels, a framework favoring energy intensive industries, and are therefore more affected in a carbon-constrained world. In the three scenarios, DCS are the main beneficiaries in terms of consumer surplus. This is due to the revenue of the sales of certificates as well as the gains in the

Table 11.1: Welfare decomposition (in % of final households consumption)[a]

Scenarios	Region	WG[b]	GTT[c]	EC[d]	DWL[e]
Low	OEU	-0.28	0.16	-0.28	-0.16
	JAP	-0.03	-0.01	-0.01	-0.01
	EUR	-0.09	-0.03	-0.04	-0.03
	OEC	-0.08	-0.04	-0.03	-0.01
	PVD	0.13	0.07	0.08	-0.02
	World	0.00	-	-	0.00
Mid	OEU	-0.28	0.36	-0.65	-0.58
	JAP	-0.08	-0.04	-0.02	-0.02
	EUR	-0.24	-0.06	-0.10	-0.07
	OEC	-0.22	-0.10	-0.08	-0.04
	PVD	0.25	0.17	0.21	-0.13
	World	-0.04	-	-	-0.04
High	OEU	-3.77	-0.19	-1.31	-2.27
	JAP	-0.08	-0.01	-0.03	-0.05
	EUR	-0.45	-0.05	-0.28	-0.13
	OEC	-0.52	-0.15	-0.22	-0.15
	PVD	0.41	0.28	0.53	-0.41
	World	-0.23	-	-	-0.23

[a] Sum of discounted values as % of the sum of discounted final households consumption (2008-2050) - 5% discount rate

[b] Total welfare

[c] Gains and losses of the terms of trade

[d] Net revenue from the trade of GHG certificates

[e] Deadweight loss

terms of trade. When looking at the deadweight loss of taxation, we realize that DCS are actually also affected, in particular in the high scenario. Concerning the other regions, JAP has limited losses in both consumer surplus and deadweight loss because in the baseline their emissions already declined by almost 25%; a consequence of a slow GDP growth. EUR and OEC face similar deadweight losses, ranging from of 0.01% of aggregated total households consumption in the "low" scenario to 0.10% in the "high" scenario. In view of these results, it appears that even the "high" scenarios would be achievable at reasonable costs. We compare these results with those for Switzerland in the next section.

11.2 Swiss economy

Table 11.2 shows the key results for Switzerland in each scenario. In the international "high" scenario, the "sustainable", "neutral" and "zero-footprint" already achieve the 50% domestic abatement prescribed in their equivalent "+" scenarios. As a consequence, the results of the "sustainable+", "neutral+" and "zero-footprint+" are identical to the non-"+" scenarios and therefore not presented in the table.

The results in Table 11.2 show that, in general, international climate policies have a strong influence on the effect of domestic GHG taxes. In the "low" and "mid" scenario, regardless of the implemented Swiss policy, the DWL caused by the climate policy is not larger than 0.08%. These costs are similar to those of other developed regions despite the fact that they face lower abatement targets. The exceptional case of OEU should be kept in mind and not compared with the other developed countries in view of the sensitivity of their economies to climate policies. In the high scenario, as it may be expected, there are stronger welfare effects. For instance, in the "zero footprint" scenario the DWL is 0.75% - not surprisingly as the level of domestic GHG tax in 2050 exceeds 900 USD_{2001}/tCO2eq. Despite the increasing dead-weight losses, total welfare effects tend to remain positive. The positive levels of households' surplus are mainly due to the fact that GTT offset the adverse effects of the DWL. This counter-intuitive result, already mentioned in previous studies (see, for instance, Babiker et al. (2004); Bernard et al. (2005); Goulder (1995)), can be explained by several factors. First, we know that for energy importing countries like Switzerland[1], the implementation of CO_2 abatement induces a gain of terms of trade coming from the decrease of fossil fuels consumption (Bernard et al., 2005). Secondly, the implementation of

[1] 100% of fossil fuels used in Switzerland are imported

Table 11.2: Summary results for Switzerland

Scenarios		Abatement in 2050[a]		Swiss	GHG	2008-2050[d]			
World	Switzerland	Domestic	Total	tax[b]	price[c]	WG	GTT	EC	DWL
Low	50%	-28	-50	1.2	3.8	-0.01	-0.01	-0.01	0.01
	sustainable	-28	-75	2.5	3.8	-0.02	-0.02	-0.02	0.01
	neutral	-28	-100	3.8	3.8	-0.02	-0.02	-0.02	0.02
	zero-footprint	-29	-180	8.2	3.9	-0.05	-0.02	-0.05	0.02
	50%+	-50	-50	102.4	3.8	0.21	0.29	0.00	-0.08
	sustainable+	-50	-75	102.4	3.8	0.20	0.28	-0.01	-0.08
	neutral+	-50	-100	102.4	3.8	0.19	0.28	-0.01	-0.08
	zero-footprint+	-50	-180	102.4	3.8	0.17	0.27	-0.04	-0.07
Mid	50%	-31	-50	9.7	34.6	-0.05	-0.03	-0.02	0.01
	sustainable	-33	-75	21.7	34.7	-0.05	-0.02	-0.04	0.00
	neutral	-40	-100	34.8	34.8	-0.03	0.03	-0.05	0.00
	zero-footprint	-50	-180	90.6	35.1	0.06	0.20	-0.11	-0.03
	50%+	-50	-50	102.4	34.6	0.18	0.26	0.00	-0.08
	sustainable+	-50	-75	102.1	34.7	0.16	0.25	-0.02	-0.07
	neutral+	-50	-100	101.9	34.7	0.14	0.24	-0.04	-0.06
	zero-footprint+	-50	-180	101.4	35.1	0.06	0.21	-0.11	-0.04
High	50%	-40	-50	50.7	289.2	0.07	0.11	-0.03	-0.01
	sustainable	-50	-75	143.7	289.8	0.12	0.30	-0.06	-0.12
	neutral	-54	-100	290.7	290.6	0.08	0.42	-0.13	-0.21
	zero-footprint	-63	-180	926.5	293.6	-0.25	0.88	-0.37	-0.75
	50%+	-50	-50	149.2	288.8	0.20	0.34	0.02	-0.15

[a] % of 2001 emissions
[b] Swiss tax in 2050 [USD_{2001}/tCO_2eq]
[c] World price of certificates in 2050 [USD_{2001}/tCO_2eq]
[d] Sum of discounted values as % of the sum of discounted final households consumption (2008-2050) - 5% discount rate

international emission trading has ambiguous effects on welfare given its interaction with the terms of trade (Babiker et al., 2004). Thirdly, pre-existing distortions modify the results that could be expected in a first best setting (Goulder, 1995) and this is why CGE models that take into account existing taxes are so useful under these circumstances.

Our results suggest that the options proposed for a future Swiss climate policy are likely to have modest economic impacts - considering that there are no restrictions for minimum levels of domestic abatement. For instance, regardless of the international scenario, when targeting a 50% abatement level (for 2050) and allowing for the purchase of GHG certificates, Switzerland's welfare is less affected than in other regions (e.g. a 0.05% welfare loss in the mid scenario against 0.08% suffered by Japan). This is mainly due to the fact that, similarly as in Japan, the Swiss emissions baseline achieves a significant part of the abatement at no additional costs for the policies analyzed here - as it takes into account the current climate policies. Moreover, Switzerland has a limited impact on the global price of GHG emissions certificates and has technological options to reduce GHG in the residential sector. Consequently, it is more inclined to devise climate policies going beyond the agreements discussed in international fora. Furthermore, the welfare costs supported by Switzerland seem reasonable even for the more ambitious policies. In most scenarios, without taking developing countries into consideration, Switzerland is better off than other regions. Only in the "zero footprint" and "zero footprint+" scenarios does Japan suffer smaller welfare losses than Switzerland under some of the international abatement schemes.

We further observe that when there is mandatory minimum level of domestic abatement, the economic impacts of the climate policies analyzed are favorable for Switzerland. There are welfare gains for all policies but the "zero footprint+". For instance, achieving a 50% reduction of domestic emissions in an international environment aiming at moderate abatement (i.e. the "low" and "mid" scenarios), would require a GHG tax of approximately 102 USD/tCO_2eq. Despite the fact that this tax may seem important when compared to a tax that allows for collecting sufficient money to purchase certificates to achieve the same target, i.e. 1.2 USD/tCO_2eq, the gains in the terms of trade allow for a higher total welfare - as we have explained above.

The effects of the policies on the Swiss economy are more noticeable when we consider the "high" world scenario. The largest welfare loss is of 0.25% for the "zero footprint+" scenario - whether or not there is a restriction for domestic abatement. Furthermore, if international targets are more stringent, as it is the case in the "high" scenario, the tax that allows reducing domestically 50% of the emissions should reach almost 150 USD/tCO_2eq. This 50% increase in the level of the tax, compared to the "low" and "mid" scenarios, is due to the strong decrease in energy demand worldwide which leads to an important reduction of energy prices. An increase in the GHG tax is therefore necessary in order to achieve the same abatement. Interestingly, when aiming at a 75% reduction, the domestic abatement is also of 50% but, due to a large transfer of capitals caused by the purchase of expensive GHG certificates, the economy contracts sufficiently to allow for a lower tax, i.e. 143 USD/tCO_2eq, to achieve the same domestic target. Figure 11.2 schematically represents the effect of a translation of the MAC curve due to the reduced economic activity. The areas BCEF and HCDG represent respectively the tax revenues and the purchase of certificates in value. The figure shows that the tax allowing for 50% of abatement can be higher than the tax (tax') whose revenue is used to purchase GHG certificates to reach a 75% total abatement due to the reduction of the activity. Both taxes achieve a domestic 50% abatement, crossing their respective MAC curves in points A and B. The same effect, but at a lower scale, can also be observed in the results of the "mid" scenario where the taxes allowing for a 50% domestic abatement decrease when the total abatement requirements increase.

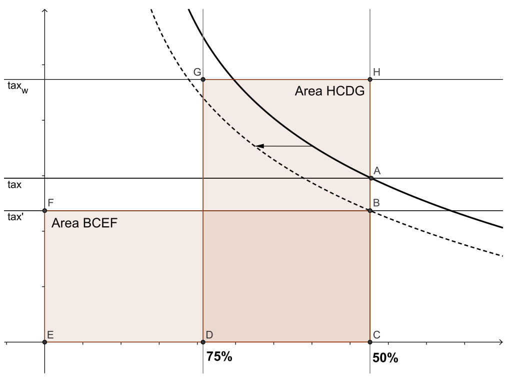

Figure 11.2: Translation of the MAC curve due to activity reduction

On the production side, there are no surprises for the two energy sectors active in Switzerland. On the one hand, Figure 11.3 shows that, in all scenarios, the "Petroleum products" sector, which is rather limited in size in Switzerland, is the major looser since its products are directly taxed. On the other and, the "electricity" sector benefits from the fact that the Swiss energy production is mainly produced from nuclear and hydro. It is important to note that the model assumes a continuity in the current electricity production patterns. Consequently, these results would change significantly if we would assume that nuclear power plants would be replaced by gas turbines.

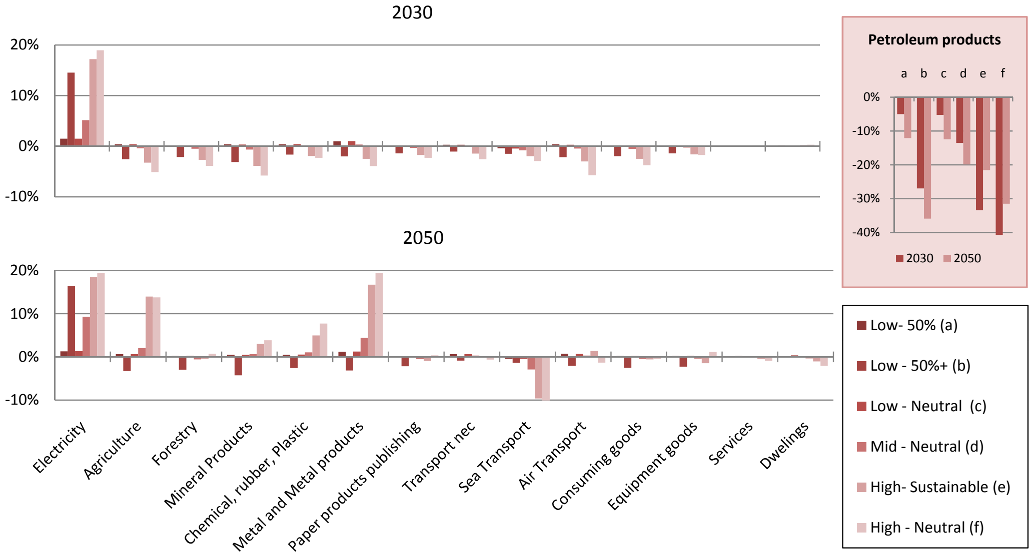

Figure 11.3: Sectoral production change due to the policy scenarios

The impact on the remaining sectors varies. Even strong climate policies have little impact on the "services" sector. Regarding road and rail transport (transport nec), the sector is not strongly affected even in the "high" scenario. In 2050, for those scenarios where the Swiss tax is inferior to the world price of certificates, the reduction of the demand for fossil fuels world wide drives their price down, which directly benefits the sector in Switzerland. For the "neutral" scenario, in which the Swiss tax equals the price of certificates in 2050, the transport sector faces an increase in energy prices of approximately 70% but nevertheless, in view of the low substitutability of transport to other inputs[2], the impact of the tax is low. If rail and road transport were separated sectors, we would certainly have witnessed a switch from road to rail, which, in Switzerland, uses almost exclusively electricity produced without fossil fuels.

The difference between the production patterns in 2030 and 2050 are explained by the non linear variation in the price of the GHG certificates. Domestically, the GHG tax is defined as growing linearly from 2008 to 2050. Nevertheless, when it comes to the total emissions target, the price of certificates in highly influenced by the participation of DCS to the global abatement effort. In the "mid" and "high" scenarios, the price of GHG certificates starts to grow rapidly only as

[2]the elasticity is set to 0.2

of 2030, when DCS start having a constraint on their emission. Figure11.4 shows the difference in prices between the Swiss tax and the international price of certificates, in the “high-neutral” and “high-50%” scenarios. Therefore, the more GHG certificates need to be purchased, the more important are the transfers of money, which drives down the exchange rate, penalizing imports and favoring exports.

As a consequence, some sectors come out surprisingly well in 2050, in particular in those scenarios where the price of GHG certificates is high. Among those, the “agriculture” and “chemical, rubber and plastic” sectors, two sectors know for their dependance on products derived from oil or oil itself, benefit from major changes in the trade patterns. In the “high - neutral” scenario, the “chemical, rubber and plastic” sector sees an increase of exports overcoming the increase in imports and the agricultural imports drop almost 30%, thus stimulating the domestic production. Similarly, the Swiss “Mineral products” and “Metal and metal products” sectors also benefit strongly from the decrease in imports.

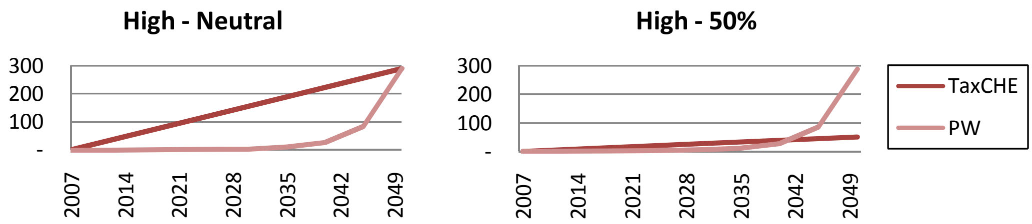

Figure 11.4: Swiss tax vs international price of certificates [UDS_{2001}/CO_2eq]

11.3 Swiss residential sector

Emissions

Figure 11.5 shows to what extent the residential sector can contribute to the abatement, by presenting how the emissions of the residential sector and of the rest of the economy evolve over time, as well as what share of the abatement is undertaken by the residential sector. The dashed lines show the targets of the total net emissions, compensation being deducted. The MARKAL-CHRES, through its explicit modeling of technological options, shows that, without having to implement “backstop” technologies, a strong and natural switch to cleaner technologies takes place in case of high taxes. In order to avoid high costs in the future, households invest in cleaner technologies rapidly. The residential sector starts contributing significantly to the overall abatement when the GHG tax reaches around 30 USD/tCO_2eq (Mid - Neutral), and does the major part of it when the tax gets close to 100 USD/tCO_2eq (Low - 50%+)[3]. In the high scenarios, the residential sector stops emitting CO_2 as early as 2030, switching to technologies using electricity instead of fossil fuels.

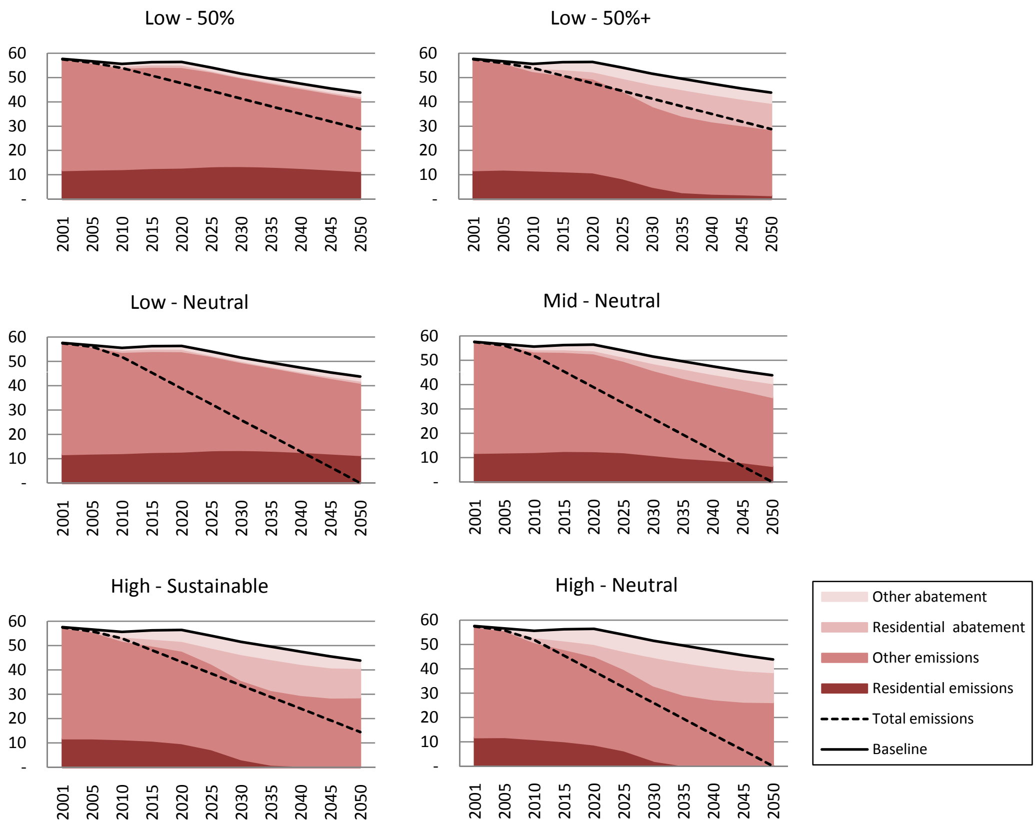

Figure 11.5: Contribution to the abatement of the residential sector (MtCO_2eq)

Energy consumption and technologies

For the evaluation of energy consumption and technologies we concentrate on the residential sector as a whole and more specifically on the residential heating subsector, which in 2000 accounted by far for the largest share of residential energy

[3]We suspect that the private transportation, if modeled similarly to the residential sector, could provide additional abatement opportunities and, therefore, reduce the nedeed tax

consumption. At the same time the residential heating sub-sector appears to offer substantial demand reduction possibilities in terms of available technological options and energy saving measures.

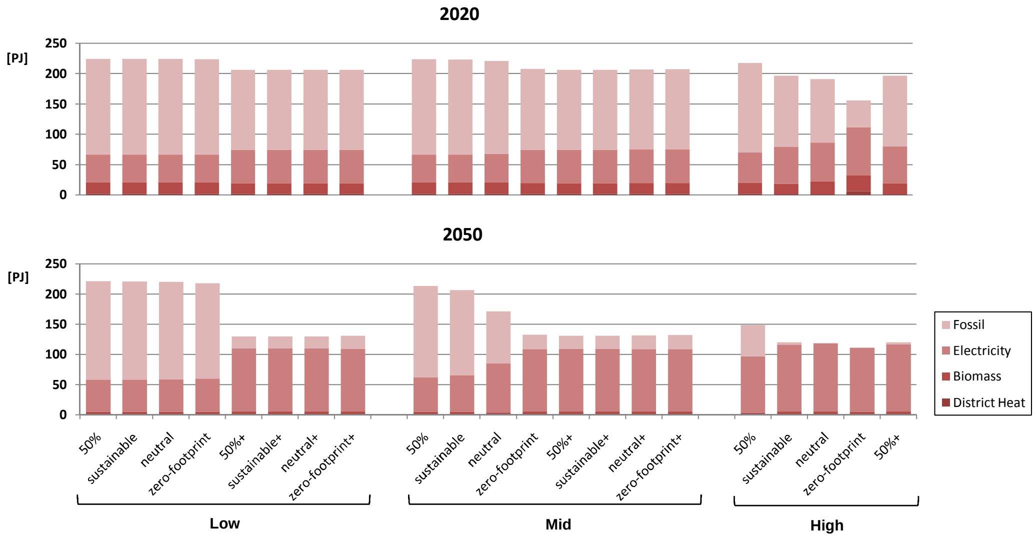

Figure 11.6: Fuel consumption in the residential sector

All scenarios examined here project a reduction, or at least a stabilization in residential fuel consumption from levels in 2000. For instance, according to IEA Statistics, residential energy consumption amounted to 234.6 PJ in 2000, while the highest observed value of all scenarios is 224.4 PJ in 2020 and 221.4 PJ in 2050. A similar trend is observed in the residential heating sub-sector, where even in the scenarios with the low emission reduction targets, energy consumption stabilizes around its year 2000 value of 165 PJ. Considering increases in residential floor area over the next 40 to 50 years, already this observation indicates that substantial improvements are likely to arise without stringent climate policy, even though further reductions in consumption are attainable when appropriate policy measures are implemented. However, these results also show that implementation of mild (low) world-wide emission targets does not achieve significant reductions in domestic fuel consumption when Switzerland is able to meet its emission reduction commitments through the purchase of tradable certificates. In this case, technological change is moderate, with technologies similar to the existing ones and that have slightly higher efficiencies but still consume the same type of fuel. Examples of these technologies include oil and natural gas room heating or combined room and water heating systems.

Table 11.3: Fuel consumption and energy savings for residential heating in PJ

Scenarios		All fuels[a]		Energy Savings[b]	
World	Switzerland	2020	2050	2020	2050
Low	50%	164.7	168.6	9.5	15.9
	sustainable	164.7	168.4	9.5	16.1
	neutral	164.7	167.9	9.5	16.3
	zero-footprint	164.4	165.2	9.8	17.1
	50%+	146.6	76.8	10.9	19.9
	sustainable+	146.6	76.8	10.9	19.9
	neutral+	146.6	76.8	10.9	19.9
	zero-footprint+	146.6	78.1	10.9	19.9
Mid	50%	164.4	160.7	9.8	17.1
	sustainable	163.8	154.3	10.4	18.1
	neutral	161.8	119.1	10.4	18.8
	zero-footprint	148.4	79.6	10.9	19.8
	50%+	146.6	78.1	10.9	19.9
	sustainable+	146.6	78.1	10.9	19.9
	neutral+	147.3	78.5	10.9	19.9
	zero-footprint+	147.9	79.0	10.9	19.9
High	50%	158.1	96.2	10.6	19.0
	sustainable	137.0	67.3	11.1	20.2
	neutral	131.0	65.2	11.3	20.9
	zero-footprint	95.7	57.9	13.4	23.5
	50%+	137.0	67.3	11.0	20.1

[a] Total energy used
[b] Useful energy saved

When low world-wide emissions targets are combined with a requirement to achieve emission reductions with domestic measures, we observe a significant impact on the Swiss residential sector. This impact is twofold. On the one hand such regulations reduce the overall energy consumption. By 2020, residential energy consumption declines to 206 PJ and reduces further to about 130 PJ in 2050. A large share of this reduction occurs in the residential heating sub-sector, where energy consumption halves to about 78 PJ (relative to 2000 levels). On the other hand such regulations trigger fuel switching on a large scale. The consumption of fossil fuel diminishes drastically to around 20 to 25 PJ in 2050, compared to around 160 PJ in the scenarios where Switzerland is able to meet its obligations through the purchase of certificates. This coincides with an increase in the consumption of electricity to more than 100 PJ. In the residential sector this change is triggered by switching from fossil heating installations to heat pumps in single and multi-family houses. New houses are constructed with heat pump and wood pellet heating installations. It is also worth reiterating that the residential sector still uses fossil fuels in all of the low scenarios. Although a minimum domestic abatement of 50% is required in Switzerland, the additional reductions required in the scenarios neutral+ and zero-footprint+ are achieved by purchasing emission certificates.

Only when high (stringent) world-wide emission targets are combined with strong domestic emission targets (corresponding to the neutral and zero-footprint scenarios), does the Swiss residential sector shift completely away from fossil fuels. Instead of purchasing emission certificates, additional electric heat pumps are installed in single and multi-family houses to satisfy the heating demand, which due to their high efficiency lowers the final energy consumption. Additionally, by supporting and implementing enhanced energy-saving standards (i.e., improved insulation), the energy demand (useful energy) can be reduced by up to 23.4 PJ per year. Hence, high performance energy saving technologies contribute to a large share of the reduction in energy consumption. For example, better insulation of the housing stock, such as by using a double or triple-glazed window insulation with a thermal transmission coefficient of 1 W/m2k or less, is important in these scenarios. In addition to these energy saving options, expensive biomass and other renewable technologies (mainly pellet heating but also combined solar systems) also penetrate the domestic market to reduce emissions further.

This analysis of high emission targets indicates that the maximum energy reduction potential amounts to slightly more than 50% in the residential sector (compared to 2000 levels), for the set of technologies included. In the residential heating sub-sector, the energy reduction potential (combining energy saving and efficient heating technology) amounts to two-thirds of the energy consumed in the year 2000.

Part III

Conclusion

The first part of the report provides a new integrated approach to analyzing GHG mitigation policies in Switzerland which provides useful insights relevant for the current revision of the CO_2 law and the elaboration of the post 2012 climate policies. We focused the analysis on the residential sector which is expected to play a major role in future GHG abatement.

We have studied the impacts of CO_2 and GHG taxes as well as technical regulation applied to the residential sector and shown that the latter would not be sufficient to achieve major emissions reductions and loose their *raison d'être* when used in conjunction with emission taxes. This effect might be a little overestimated by the MARKAL-CHRES part of the coupled model, which assumes that consumers adopt perfectly optimizing behavior based on exact investment, maintenance and usage prices for all possible technologies. Furthermore, this study confirms that GHG taxes are more effective than CO_2 taxes, without further jeopardizing the production of the economic sectors. A progressive GHG tax reaching 201.6 USD/tCO_2eq in 2050 would yield a 50% reduction in GHG emissions relative to 1990 and would lower Swiss GDP level by approximately 0.4%. Such a tax would imply, for example, that the prices of light fuel oil used in the residential sector would increase annually by 0.012 USD_{2000}.

Finally, this part also shows that with high emissions taxes, private transportation becomes the principal emitter of GHG. This is in line with a recent proposal for a Swiss energy policy by ETHZ (2008), which states that emissions should be reduced to 1 tCO_2 per capita by 2100, a sufficient condition to render the planet CO_2 neutral if applied globally in a contraction and convergence framework, and that those emissions would be reserved for the transportation sector. In the settings of this paper, the transportation sector remains a big emitter due to the rigidities in the model, which somehow reflects the lack of clean alternative technologies, but also to the fact that the price of petroleum products used for transport already includes high taxes and, therefore, the relative change in prices is much lower than in the residential sector.

The second part of the report places Swiss climate policy in the international context by simulating three scenarios for world climate policy, from a scenario with weak worldwide abatement to one that involves significant reductions even by developing countries. It shows that these scenarios are essential in defining the domestic policies needed to reach domestic emissions targets and in assessing the impacts of those policies. Just to give an example, sizable international abatement efforts will reduce the demand for fossil fuels, which will reduce their world price, calling for higher taxes on fossil fuels in Switzerland if a desired reduction target is sought. Worldwide abatement efforts, in particular in developing countries, are also essential for Swiss emissions compensation through the purchase of international certificates through their influence on the price of such certificates. The analysis shows the importance of terms of trade and exchange rate effects (significantly influenced by the purchase of international emissions certificates) for the welfare impact of Swiss climate policy.

According to the results presented in the second part, Switzerland has the potential and the means to extend its climate policy beyond the 50% target currently under discussion for 2050. It could afford, independently of climate policies in other parts of the world, to achieve a target of 2tCO_2eq/cap while ensuring at least 50% domestic abatement through the implementation of a domestic progressive GHG tax reaching 144 USD/tCO_2eq in 2050. At first glance, ensuring domestic abatement through the implementation of a domestic tax may seem unreasonably expensive because of the current prices of CO_2. Nevertheless, our simulations show that through gains in the terms of trade, Switzerland would actually benefit in terms of total welfare from setting targets to domestic GHG emissions. Those gains would obviously be reduced when global emissions targets become tighter due to higher prices for international emissions certificates. The tax would even have to be increased in case that the world target would go beyond our high scenario due to the drop in fossil energy prices that would follow the reduction in demand.

When looking at the investments made in the residential sector, we can see that when economic agents have the certainty that fossil fuels will become more expensive in the future, they can avoid excess costs by investing strategically and rapidly in existing technologies. Important technology options in this context include energy saving technologies (such as improved insulation), and efficient electric heat pumps, which reduce energy demand and facilitate a shift away from fossil fuels. In addition, for more stringent policies, biomass and other renewables play an additional role. Regardless of this, this study shows that the technological alternatives to replace the fossil fuels in the residential sector exist, and those technologies become profitable when GHG taxes are implemented. Using our coupling procedure for other parts of the economy, e.g. private transportation, commercial buildings and industry, would bring additional technological options which are not taken into account in this study. They would provide additional flexibility in reducing emissions, thereby reducing abatement costs. In the framework of the coupling, the energy model somehow provides a similar feature as the implementation of an arbitrary backstop technology, but with a realistic technological description. This provides additional insights by identifying specific technologies and enhances the overall modeling framework.

In the future, this research could be developed with a more detailed modeling of the private transportation sector, possibly using another energy use model, which would allow us to take into account the realistic hypothesis that, before 2050, energies other that petroleum products could represent an important share in the private transportation fuel mix. These additional substitutions potentials would allow Switzerland to reach its emission targets with lower taxes than those presented in this report.

Appendix A

Coupling algorithms

The algorithms below use the the following nomenclature:

$\bar{e}$	Total target on Swiss emissions
$\bar{e_d}$	Minimal target on Swiss domestic emissions
t_{min}	Minimum value of the Swiss GHG tax
t_{max}	Maximum value of the Swiss GHG tax
fm	fuel mix
ai	Annualized investments
$M()$	run of MARKAL-CHRES
e	Swiss GHG emissions
$target$	Variable indicating which of the domestic or total target is binding
p_W	World price of GHG certificates
$G()$	run of GEMINI-E3
$crit_d$	Swiss domestic criteria
$crit$	Swiss total criteria
$criteria$	Overall criteria
tax	Swiss GHG tax
Δtax	Variation of the tax between two iterations

Algorithm 1: GMC-1.8 Coupling procedure without minimum domestic target

Input: Total target on Swiss emissions $\bar{e}$
Output: Swiss tax tax

$t_{min} = 0$; $t_{max} = 100$;
$(fm, ai) = M(t_{max})$;
$(e, p_W) = G(t_{max}, fm, ai)$;
$crit = e - e \cdot t_{max}/p_W - \bar{e}$;
while $crit > 0$ **do**
    $t_{min} = t_{max}$; $t_{max} = t_{max} + 100$;
    $(fm, ai) = M(t_{max})$;
    $(e, p_W) = G(t_{max}, fm, ai)$;
    $crit = e - e \cdot t_{max}/p_W - \bar{e}$;
end
$tax = t_{min} + (t_{max} - t_{min})/2$;
while $|crit| > 0.01$ *and* $|\Delta tax| > 0.001$ **do**
    $(fm, ai) = M(tax)$;
    $(e, p_W) = G(tax, fm, ai)$;
    $crit = e - e \cdot tax/p_W - \bar{e}$;
    if $crit < 0$ **then**
        $t_{max} = tax$
    else
        $t_{min} = tax$
    end
    $tax = t_{min} + (t_{max} - t_{min})/2$;
end

Algorithm 2: GMC-1.8 - Coupling procedure with minimum domestic target $\bar{e_d}$

Input: Total target on Swiss emissions $\bar{e}$, Minimal target on Swiss domestic emissions $\bar{e_d}$
Output: Swiss tax tax
$target = 0$; $t_{min} = 0$; $t_{max} = 100$;
$(fm, ai) = M(t_{max})$;
$(e, p_W) = G(t_{max}, fm, ai)$;
$crit_d = e - \bar{e_d}$; $crit = e - e \cdot t_{max}/p_W - \bar{e}$;
while $crit_d > 0$ *or* $crit > 0$ **do**
  $t_{min} = t_{max}$; $t_{max} = t_{max} + 100$;
  $(fm, ai) = M(t_{max})$;
  $(e, p_W) = G(t_{max}, fm, ai)$;
  $crit_d = e - \bar{e_d}$;
  $crit = e - e \cdot t_{max}/p_W - \bar{e}$;
  if $crit_d \leq 0$ *and* $crit > 0$ **then**
    $target = t$; $criteria = e - rev/p_W - \bar{e}$;
  else if $crit_d > 0$ *and* $crit \leq 0$ **then**
    $target = d$; $criteria = e - \bar{e_d}$;
  end
end
$tax = t_{min} + (t_{max} - t_{min})/2$;
while $target = 0$ **do**
  $(fm, ai) = M(tax)$;
  $(e, p_W) = G(tax, fm, ai)$;
  $crit_d = e - \bar{e_d}$;
  $crit = e - e \cdot tax/p_W - \bar{e}$;
  if $crit < 0$ **then** $t_{max} = tax$ **else** $t_{min} = tax$;
  $tax = t_{min} + (t_{max} - t_{min})/2$;
  if $crit_d \leq 0$ *and* $crit > 0$ **then**
    $target = t$; $criteria = e - rev/p_W - \bar{e}$;
  else if $crit_d > 0$ *and* $crit \leq 0$ **then**
    $target = d$; $criteria = e - \bar{e_d}$;
  end
end
while $|criteria| > 0.01$ *and* $|\Delta tax| > 0.001$ **do**
  $(fm, ai) = M(tax)$;
  $(e, p_W) = G(tax, fm, ai)$;
  if $target = t$ **then**
    $criteria = e - e \cdot tax/p_W - \bar{e}$;
  else
    $criteria = e - \bar{e_d}$;
  end
  if $criteria < 0$ **then** $t_{max} = tax$ **else** $t_{min} = tax$;
  $tax = t_{min} + (t_{max} - t_{min})/2$;
end

Appendix B

Details on characteristics of the models

Table B.1: Dimensions of the complete GEMINI-E3 Model

Countries or Regions		**Sectors/Products**
Annex B		***Energy***
Germany	DEU	01 Coal
France	FRA	02 Crude Oil
United Kingdom	GBR	03 Natural Gas
Italy	ITA	04 Refined Petroleum
Spain	ESP	05 Electricity
Netherlands	NLD	***Non-Energy***
Belgium	BEL	06 Agriculture
Poland	POL	07 Forestry
Rest of EU-25	OEU	08 Mineral Products
Switzerland	CHE	09 Chemical Rubber Plastic
Other European Countries	XEU	10 Metal and metal products
United States of America	USA	11 Paper Products Publishing
Canada	CAN	12 Transport n.e.c.
Australia and New Zealand	AUZ	13 Sea Transport
Japan	JAP	14 Air Transport
Russia	RUS	15 Consuming goods
Rest of Former Soviet Union	XSU	16 Equipment goods
Non-Annex B		17 Services
China	CHI	18 Dwellings
Brazil	BRA	
India	IND	***Household Sector***
Mexico	MEX	
Venezuela	VEN	***Primary Factors***
Rest of Latin America	LAT	Labor
Turkey	TUR	Capital
Rest of Asia	ASI	Energy
Middle East	MID	Fixed factor (sector 01-03)
Tunisia	TUN	Other inputs
Rest of Africa	AFR	

Table B.2: MARKAL-CHRES Demand segments

RC1	Cooling
RCD	Cloth Drying
RCW	Cloth Washing
RDW	Dish Washing
REA	Other Electric
RH1	Room-Heating Single-Family Houses (SFH) existing building
RH2	Room-Heating SFH new building
RH3	Room-Heating Multi-Family Houses (MFH) existing buildings
RH4	Room-Heating MFH new buildings
RHW	Hot Water
RK1	Cooking
RL1	Lighting
RRF	Refrigeration

Part IV

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