EU emissions trading an 'open door' for crime, Europol says

by Leigh Phillips
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EUOBSERVER / BRUSSELS - The EU's flagship mechanism for combatting climate change, the Emissions Trading Scheme (ETS), has been revealed as a magnet for tax fraud on a grand scale, costing government coffers around â‚¬5 billion euros.

In announcing its investigations into the pan-European racket, Europol, Europe's criminal intelligence agency, said that as much as 90 percent of the entire market volume on emissions exchanges was caused by fraudulent activity, undermining the very viability of the ETS just as the EU is touting a similar scheme for the rest of the world.

Europol launched its inquiries in late 2008, when indications of suspicious trading activities first appeared. A number of emissions exchanges in different countries started seeing a sharp increase in trading volumes of carbon allowances.

Investigators say that the ETS is open to abuse by criminals engaging in what they call a "missing trader" scam.

Criminals establish themselves in one EU member state and open a trading account with the national carbon credit registry. They then buy carbon credits in a different country, which makes them exempt from VAT. These are then sold to buyers in the original country, but with VAT slapped on, although the VAT then just disappears along with the trader and the money never arrives in government coffers.

Some member states including France, the Netherlands, Spain and the UK, but not all, changed their taxation rules on such transactions to prevent further losses.

The Netherlands and Spain have reversed the way VAT is collected on carbon credits, with the buyer being responsible instead of the seller.

The way France and the UK solved the problem was by in effect giving up on attempting to collect tax on this type of product. France made carbon credits exempt from VAT while the UK reduced the VAT rate on carbon credits to zero.

Denmark is this week understood to be tackling the problem, but no other member states have made moves in this regard. According to a Europol official, the scam is very far from having been shut down in other member states. Germany in particular has a "huge problem."

As soon as this particular loophole was closed in the few member states that did deal with the problem, as much as 90 percent of the trading volume disappeared.

One Europol official, Rafael Rondelez, who was involved with the investigation said that the "missing trader" scam can happen to any good, particularly high-value items with high rates of taxation, such as carbon credits.

What makes the ETS such a beguiling enticement for criminals, he said, is that the item being traded - a carbon credit - is intangible.

"It makes it easier for fraudsters because it's an intangible good. Before, goods actually had to be transported from one member state to another. You had to prove that goods were really being transported. With this, it's just the click of a mouse."

"It's an incredibly lucrative target for criminals," he added, warning that there are other aspects of the ETS that are creaky.

"Beyond the missing trader scam, the ETS is attractive to fraudsters because in order to trade in EUAs [European Union Allowances] you have to register your company, but there are no strong regulations or checking principles as there is in banking to prevent such activities as money laundering."

"You don't need to show identification, other documents, any sort of credibility," he said.

Even if there were more stringent regulations, "How can you control this, how can you check up on someone selling an intangible credit from Belgium to Denmark to Paris even with more rules?" Mr Rondelez asked.

"It's an open door."

Environmental groups that have argued that the ETS is unlikely to reduce emissions jumped on the news.

"The Europol revelation shows that fraud is now systemic in the EU ETS. The EU should step in to limit speculation on the carbon market," said Oscar Reyes of Carbon Trade Watch.

"But any system with so many loopholes will always be a fraudsters' paradise, which could better be avoided by turning to more conventional regulation as a means to limit carbon emissions."

While the ETS has so far not resulted in reduced emissions, the European Commission has regularly pointed to the high volume of trading on emissions exchanges as a sign that the market was working.

"Europol has now revealed this to be a sham,' Mr Reyes said.

The European Commission for its part said that while the Europol report needed to be looked into, it was aware of existing faults in the transfer of greenhouse gas credits and that at a recent meeting of EU finance ministers, a general approach to tackle the matter was considered.

It is most likely in the near future that the system of national registries of emissions trades will be overhauled with a centralised one to eliminate such problems, it added.

"Any allegations of fraud of course are of concern and will be addressed in terms of the ETS as they will be with any market," said spokesman Ton Van-Lierop. "We take this very seriously indeed."