

Research Project

Price Behavior and Market Efficiency in Phase II of the EU ETS

Project funded by own resources

Project title Price Behavior and Market Efficiency in Phase II of the EU ETS

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Organisation / Research unit

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Project start 01.02.2013

Probable end 01.12.2014

Status Completed

The EU ETS is the world's largest carbon market and has been operating for more than eight years. We take stock of the empirical literature examining its overall efficiency. A significant strand of this literature focuses on observable fundamental drivers for allowance price fluctuations. Although the various models differ in content and methodology, a consensus has emerged that allowance prices are significantly related to fuel prices and to variables affecting the expected amount of necessary abatement, such as economic activity or changes in the cap. However, the relationship is not robust, probably because the relevant abatement technologies change with the economic conditions they operate in. Models explicitly accounting for uncertainty about future demand and supply of abatement seem better in explaining allowance price variation during certain periods. Yet, our understanding of the level of the allowance price remains poor. We cannot say with any degree of confidence whether the price is "right," in the sense that it reflects marginal abatement costs, or whether there is a price wedge caused by transaction costs, price manipulation, or other sources of inefficiency. It would also be difficult to predict the price effects of non-marginal changes such as adjustments to future emissions caps or of overlapping policies that affect CO₂ emissions. Nevertheless, the market has matured compared to Phase I, and the banking provision has induced it to incorporate future scarcity of allowances and to smooth the effect of transient shocks as intended.

Keywords EU emission trading, allowance prices, market efficiency

Financed by

University funds

Other funds

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ID	Kreditinhaber	Kooperationspartner	Institution	Laufzeit - von	Laufzeit - bis
2310464	Hintermann, Beat	Peterson, Sonja, Scientific Director	Kiel Institute for the World Economy	01.02.2013	01.12.2014

ID	Kreditinhaber	Kooperationspartner	Institution	Laufzeit - von	Laufzeit - bis
2310465	Hintermann, Beat	Rickels, Wilfried, Scientist	Kiel Institute for the World Economy	01.02.2013	01.12.2014