



POTSDAM INSTITUTE FOR
CLIMATE IMPACT RESEARCH

Preparing for the review of the EU ETS

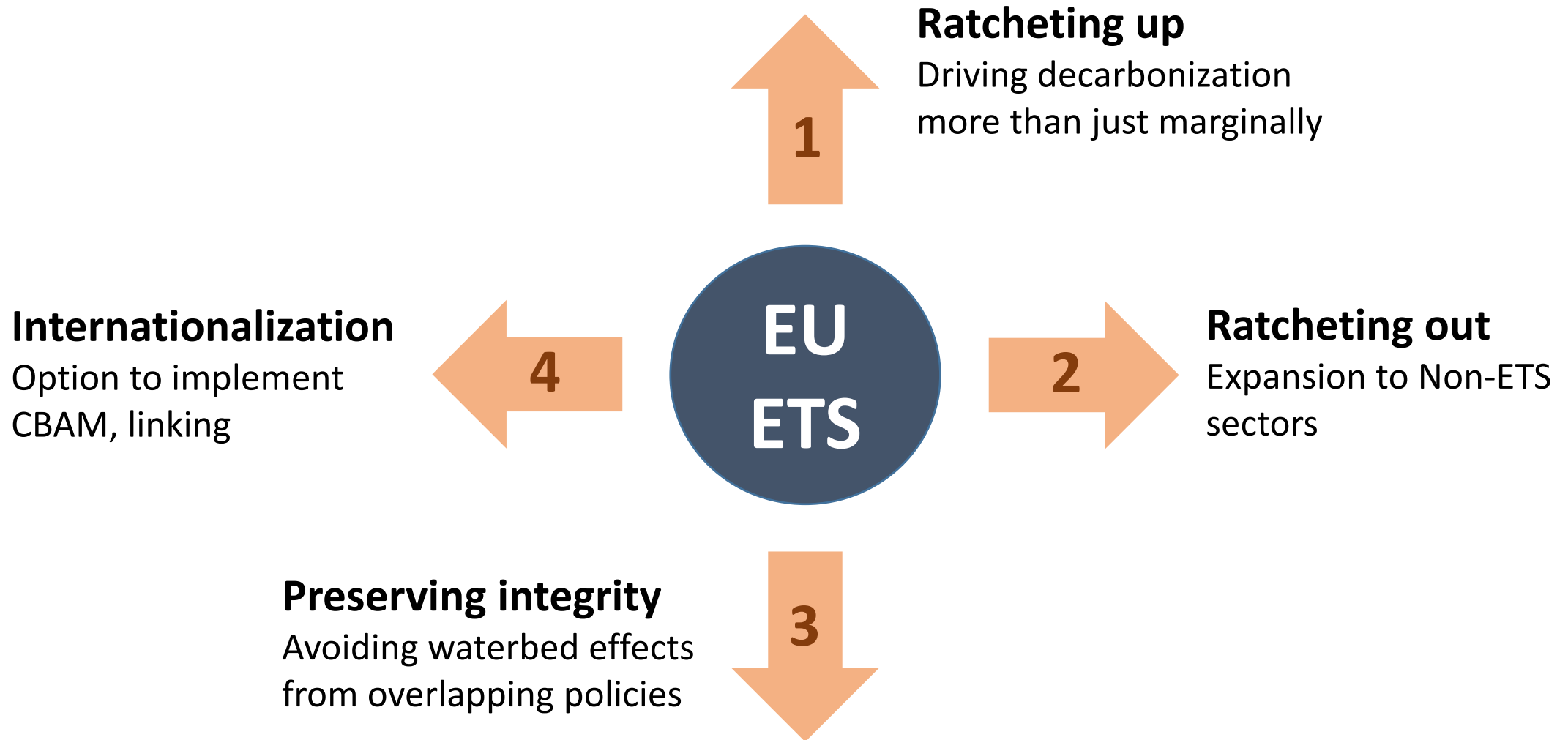
Michael Pahle

ERCST ETS brainstorming session, 4 September 2020

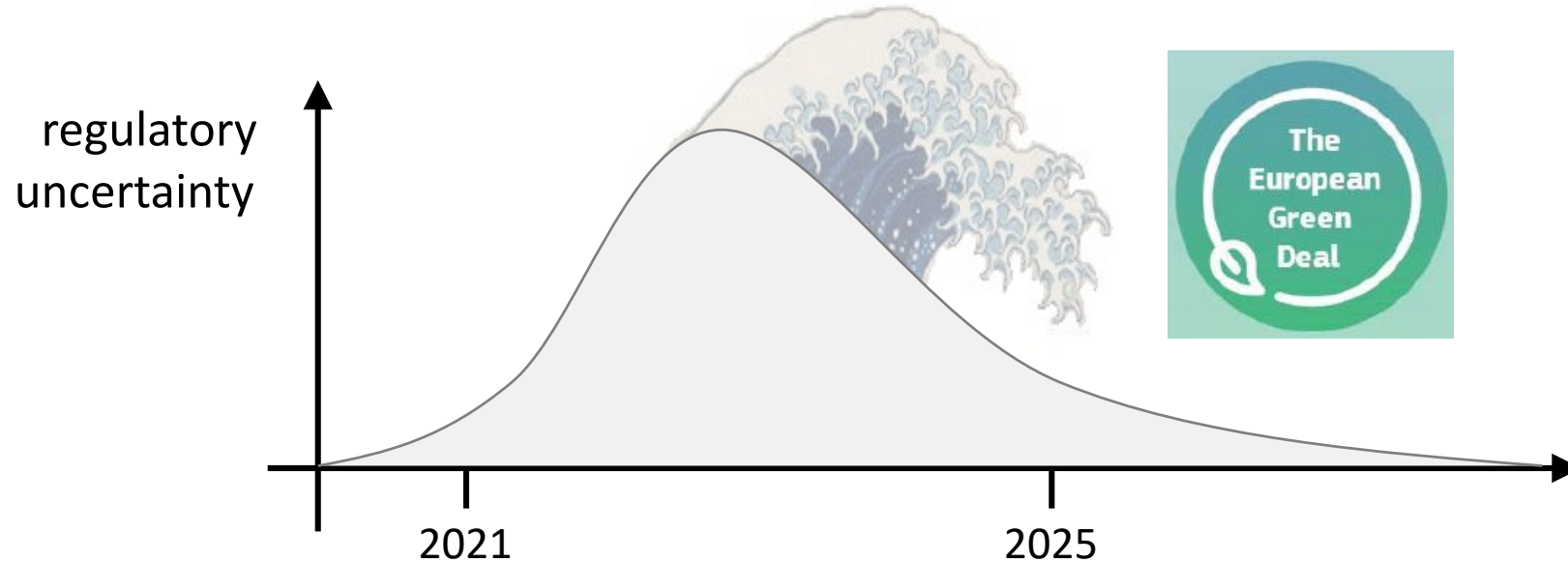
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ETS up for reform to deliver in four directions

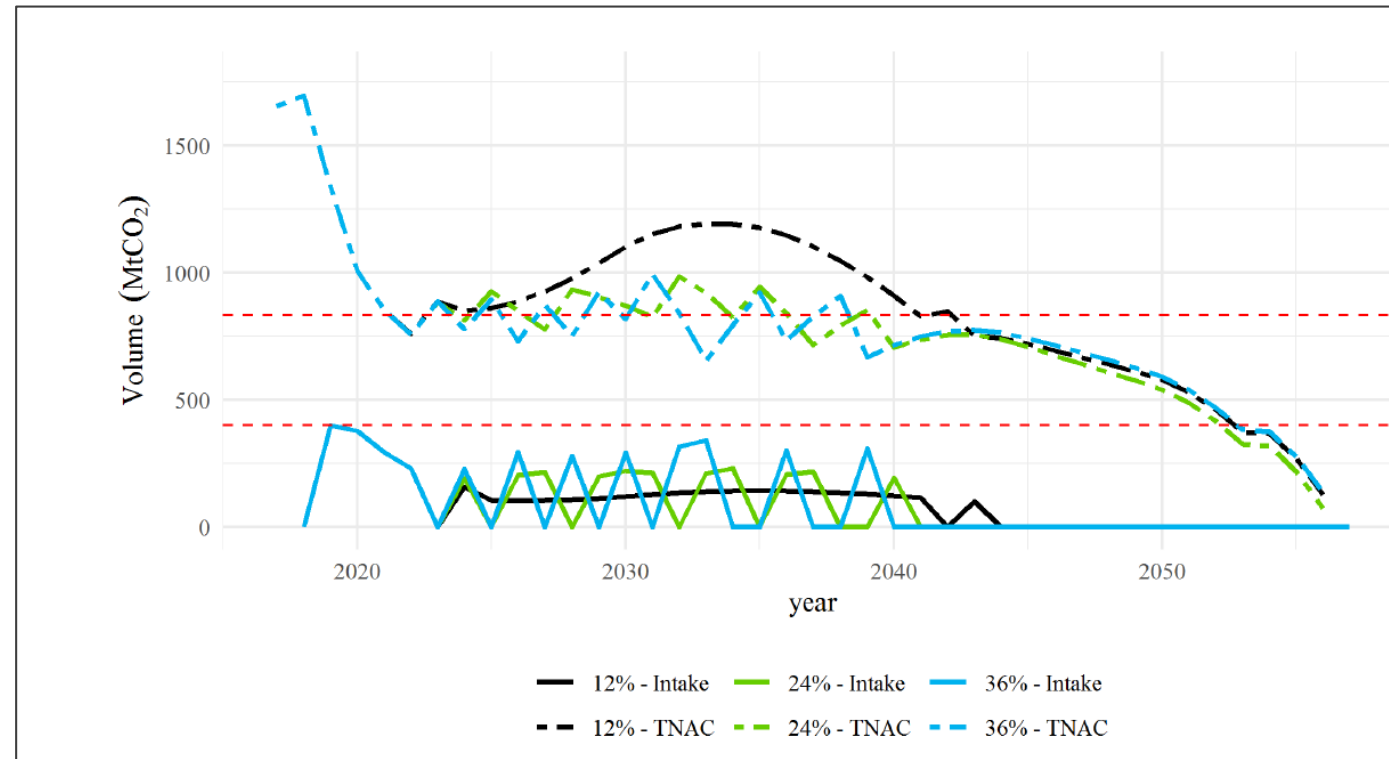


Containing speculation while riding the regulatory monster wave



- Regulatory uncertainty opens door to **speculation**, which...
 - amplifies price uncertainty/volatility, **destabilizing** the market
 - creates **negative feedback on politics** (whether “real” or not)
- **Future role the ETS can play** will hinge on containing speculation in next years

MSR (as is) unlikely to be of much help



*In anticipation of the TNAC falling below the intake threshold, **speculators may squeeze the market** by buying and holding enough allowances so that the threshold is not breached.*

Let there be a price collar

- Consider **price collar (PC)** as a potential remedy, optimally already in MSR Review



- **Main questions** to be answered:
 - Can PC effectively **contain speculation** to the “efficient” level?
 - Is PC itself “**speculation proof**”?
 - Can PC, as a positive side effect, **facilitate ETS expansion** and help **alleviating waterbed effects** from overlapping policies?
 - Can PC deliver on **more ambitious 2030 targets**?

More information

- Pahle, M. & Quemin, S. (16 June 2020): EU ETS: The Market Stability Reserve should focus on carbon prices, not allowance volumes. [Energypost](#).
- Quemin, S. & Pahle, M. (in preparation): Is Designing Environmental Markets as Financial Markets a Good Thing? Part II – Decomposing Banking Components with Open Interest in the EU ETS
- Osorio, S., Tietjen, O., Pahle, M., Pietzcker, R. C., & Edenhofer, O. (2020). Reviewing the Market Stability Reserve in light of more ambitious EU ETS emission targets. [Econstor](#)
- Friedrich, M., Mauer, E.-M., Pahle, M., & Tietjen, O. (2020). From fundamentals to financial assets: the evolution of understanding price formation in the EU ETS. [Econstor](#)
- Friedrich, M., Fries, S., Pahle, M., Edenhofer, O. (2020): Understanding the explosive trend in EU ETS prices - fundamentals or speculation? [arXiv Working Paper](#)
- Flachsland, C., Pahle, M., Burtraw, D., Edenhofer, O., Elkerbout, M., Fischer, C., Tietjen, O., & Zetterberg, L. (2020). How to avoid history repeating itself: the case for an EU Emissions Trading System (EU ETS) price floor revisited. *Climate Policy*, 20(1), 133–142.
- De Long, J. B., Shleifer, A., Summers, L. H., & Waldmann, R. J. (1990). Noise Trader Risk in Financial Markets. *Journal of Political Economy*, 98(4), 703–738.
- Barberis, N., Shleifer, A., & Vishny, R. (1997). A Model of Investor Sentiment. *Journal of financial economics* (Vol. 49)