The role of financial stakeholders in carbon markets: setting the scene

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My appetizers: some questions on the table

1) What are the pros and cons of financial trading in ETS?

2) What has been the role of financial stakeholders participating in the EU ETS?

3) How much of current price increase might depend on speculative activity?

4) What are the (research/regulatory) gaps we still need to fill?
Pros and cons of financial trading

- increases liquidity
- facilitates risk transfer
- reduces transaction costs
- reduces price volatility
- enhances price discovery

- tighter emissions limits increasingly attract speculators
- generates price bubbles
- increases price volatility
- risk of price manipulation
- risk of credibility loss
What’s the role of financials in the (EU) ETS?

- Dominant impact of the PHAs in early phases, significant presence of financial sector intermediaries (Betz and Schmidt, 2015)

- Borghesi and Flori (2018): PHA = 55% of D – 57% of S

- The system has become more homogeneous (less central nodes) and tended to diversify trading partners (declining assortativity)

EU ETS: an evolving structure

More recent trends

• “the number of counterparties holding EUA futures positions has tended to increase since 2018, this increase has been relatively homogeneous across types of counterparty” (ECB, 2022)

• A new financial actor: investment funds (from ~50 to 350; 2018-2021)
The elephant in the room: speculative activity

Evidence reassuring so far:

• ESMA (2022)
• Lucia et al (2015)
• Lovcha et al (2022)

but

• Early signals (Quemin and Pahle, 2022)
• Investment funds bound to grow
• Similarity w/ carbon leakage
Mind the (research) gap!

- need improvements to market oversight and monitoring based on a preliminary diagnosis → network analysis or other warning systems (e.g. Quemin and Pahle, 2022) to ring a bell

- need more data: policy debate ungrounded w/o robust empirical evidence

- need continuity in registries (e.g. EUTL)

- need international coordination

project @EUI
In a nutshell

• Diversity is good
• Carbon markets are good
• High energy prices not due to high carbon prices but to the lack of climate policy in the past

but

• Keep an eye on carbon markets
• Build up early diagnosis tools
• Coordinate regulatory measures internationally
Thank you for your attention!

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