

# Free market is best way to combat climate change, study suggests

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The best way to reduce carbon emissions and combat climate change is through the use of market forces, according to a new study.

Researchers who monitored the effectiveness of the European Climate Exchange (ECX) - the world's biggest [carbon trading](#) platform – found it to be as efficient as Europe's two biggest exchanges, the London Stock Exchange and the Euronext Paris.

Using free market platforms like the ECX to combat climate change could provide the basis for the introduction of a mandatory emissions cap and trade scheme worldwide.

The report found that the value of the trades on the ECX were higher after the market closed, a sign of growing sophistication within platforms. It means that trades were made with greater confidence based upon increasingly detailed information.

Researchers said there are also signs of maturity based on increased liquidity - the immediate availability of a party to trade with - and price efficiency, which means all available information is incorporated into prices so they are traded in a relatively transparent manner.

The ECX was created by the EU Emissions Trading Scheme (EU-ETS) in 2005 to help the European Union (EU) achieve its obligations under the Kyoto Protocol to reduce carbon emissions.

The EU set limits and issued permits for how much carbon firms could emit into the atmosphere. If companies exceed their limit, they incur regulatory penalties.

To avoid this, the EU-ETS allows firms with high emissions to buy the permits of other companies on platforms such as the ECX. By creating a market, it gave firms a financial incentive to reduce their [carbon emissions](#).

Researchers said that changes are needed to ensure the EU-ETS survives Europe's [economic downturn](#). Since the study appears to confirm the ECX's effectiveness, researchers say the EU-ETS should be allowed to self-adjust emission caps in reaction to changes in the Eurozone's fortunes and industrial production.

Gbenga Ibikunle, from the University of Edinburgh Business School, said: "While individual responsibility for combating climate change is important, much needs to be done to incentivise companies - especially those who emit most of the world's carbon - to cut back too. This study shows that free market mechanisms such as the EU-ETS can be effective in doing that. Several other schemes around the world are already learning from this and adopting it as a model."

The paper is published in the *International Journal of the Economics of Business*.

Provided by University of Edinburgh

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