



**University of Zurich**

**Department of Banking & Finance**

**Chair of Environmental Finance**

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**Bachelor Thesis**

**Regulation of the CO<sub>2</sub> emission trading market and the need for an  
independent regulator.**

**By**

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## **Abstract**

The EU ETS currently represents the largest system for marketable permits in the world and has been widely recognized. Nevertheless the EU ETS has been facing serious vulnerabilities. In April 2016 the price of a EUA stood at €5.96, which is too low to offer any incentives for low carbon investments. This phenomena can be seen worldwide as prices for emission certificates lie well below social costs. The reasons for the low price level can be summarized to a permit demand exceeding supply. The factors influencing the demand are still strongly uncertain and complex. Market participants are exposed to fluctuations in the prices. The current EU ETS does neither hold the credibility nor the instrumental flexibility to address uncertainties in the price development and to keep prices at an appropriate level. Therefore in the literature it has been widely suggested to introduce an independent regulator to solve the current market failure. To forge such an institution the European Central Bank and other monetary central banks are taken as model. In addition to the current European long-term goals of emission reduction the presented institution offers an instrumental framework to also address short-term price stability and the capability to raise prices to an optimum of social and emission abatement costs. Central banks adjust money supply to indirectly control the inflation rate. This paper makes use of exactly this concept. A soft price corridor is suggested where the price is kept in a barrier by supply intervention of the regulator. This intervention is either in the form of buy-back programs or the additional injection of permits into the markets. Furthermore other mechanisms are suggested to contain wrong incentives from the market, but also the institution itself. This paper finds that a price instrument is indeed needed to address current market failures. Furthermore political and economic independency is addressed as an important factor for credibility. An independent regulator with additional short-term instrumental tools offers strong benefits to the current system and in conclusion this paper favors such a regulator over the current EU ETS. Nevertheless the complexity and the political feasibility of the framework are concerns which need to be taken into account.