Carbon Price Stability in the EU ETS: Reflections on the Australian Approach

Thomas SPENCER, IDDRI
thomas.spencer@iddri.org

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The flexibility/commitment trade off

- For investment, price is important not as such, but as a signal for the (long-term) future of the covered, and non-covered, sectors.

- Price uncertainty comes from:
  1. Regulatory uncertainty
  2. Exogenous evolutions (economic, scientific, technological).

- Hence the paradox: the endogenous solution (government commitment) reduces flexibility in the face of exogenous uncertainties. This is the problem the ETS faces in Phase III.

  ➢ Therefore public policy commitment mechanisms need to respond to both sides of the paradox.
Australian approaches to the paradox

- **Numbers**: (2020/2050 objectives; five year rolling caps)

- **Institutions**: (climate change authority; productivity commission)

- **Political economy**: (compensation and investment packages).

- **International political economy**: (eventual linkage with EU/NZ)
Impacts of Short-Termism

Bossetti and Victor, “Politics and Economics of Second Best GHG Regulation”, 2011
Reflections

• The market price is important for what it signals to actors about the future.

• Credible institutions + a range of commitment devices.

• Second best effects and multiple externalities necessitate complementary policies, no matter how stable the price.