



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

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## The flexibility/commitment trade off

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- 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.

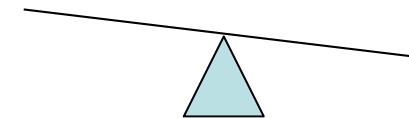
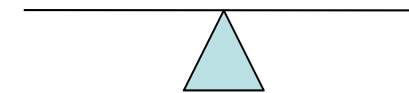
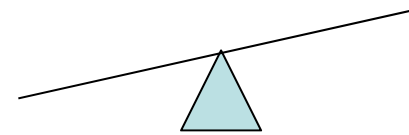
# Australian approaches to the paradox

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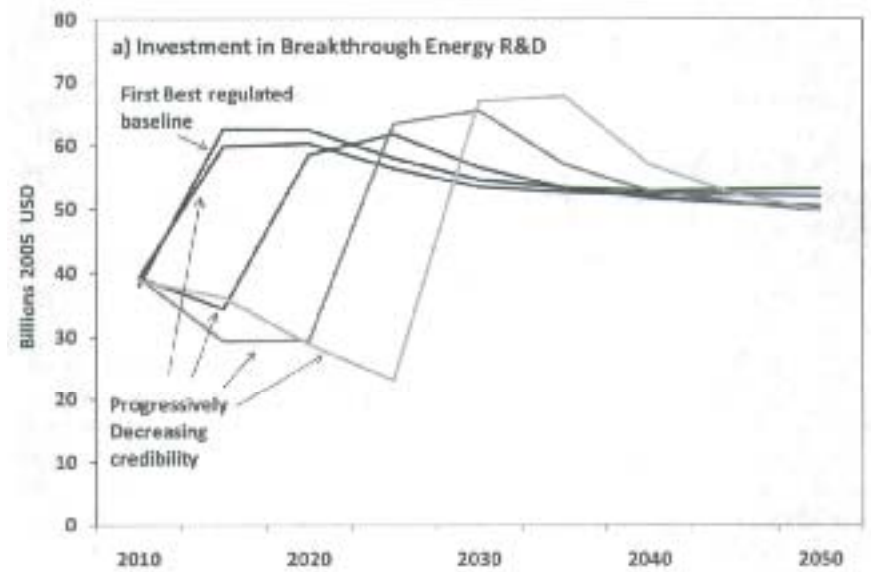
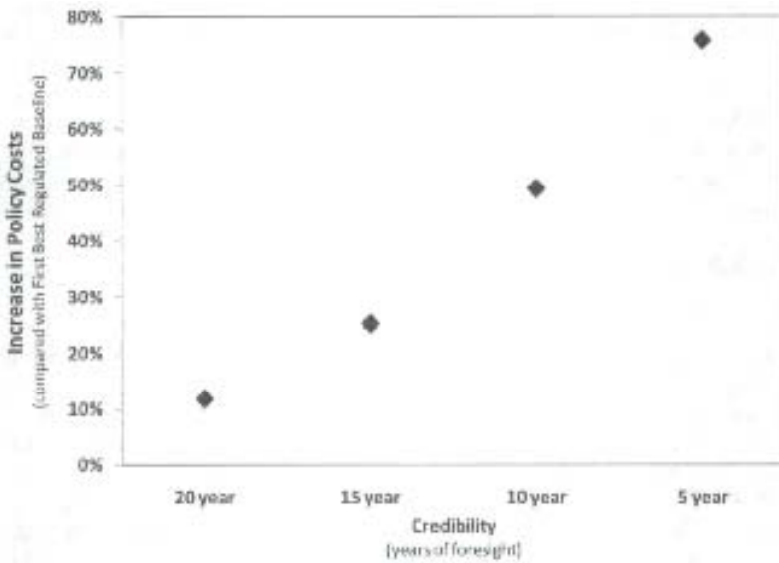
- Numbers: (2020/2050 objectives; five year rolling caps)
- Institutions: (climate change authority; productivity commission)
- Political economy: (compensation and investment packages).
- International political economy (eventual linkage with EU/NZ)

Flexibility

Certainty



# Impacts of Short-Termism



Bossetti and Victor, "Politics and Economics of Second Best GHG Regulation", 2011

# Reflections

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- 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.