POSITION PAPER

CAN Europe position on the EU Emissions Trading System (ETS)

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Executive summary

For Climate Action Network (CAN) Europe, the EU Emissions Trading System (ETS) must remain the cornerstone of EU climate and industrial policy. This is not only a climate imperative, but a matter of economic resilience and energy security. Europe still spends nearly €400 billion each year on fossil fuel imports, exposing its economy to geopolitical risks, price volatility and supply disruptions. Recent events have once again shown how quickly these vulnerabilities translate into real economic costs. Reducing this dependence requires accelerating the transition to clean, domestic energy and industrial transformation.

A strong and credible carbon pricing mechanism is central to this effort. From 2026 to 2030, it is expected to generate between €120 and €150 billion in revenues, offering a unique opportunity to finance Europe's industrial transformation, invest in clean technologies and infrastructure, and support households and workers through the transition. At a time of intensifying global competition for the clean industry, weakening the ETS would undermine investment certainty and risk pushing clean industrial projects outside the EU.

The upcoming ETS review is therefore a critical moment to strengthen and not dilute the system, ensuring it delivers rapid decarbonisation while supporting prosperity and resilience. CAN Europe's priorities for the next review:

- *The current **cap trajectory and linear reduction factor should be preserved** at least **until 2036,** providing the predictability needed for immediate long-term investments. Discussions about additional flexibility should concern only the period thereafter, when limited liquidity risks might need to be addressed.*
- *Second, the **phase-out of free allocations** must continue. In 2024 alone, free allocation still represented more than €30 billion in forgone auction revenues, while also weakening the carbon price signal for industry. Maintaining generous free allowances would only delay investment in cleaner production and undermine the effectiveness of the ETS. Conditionalities attached to any remaining free allocations should be strengthened in order to force additional investments in industrial transformation and deep emission cuts.*
- *Third, **ETS revenues must be used strategically**. Auction revenues should support in the first place a just transition for citizens, while also speeding up the transformation of European industry. This means investing in clean industrial technologies, infrastructure and deployment of renewables, while also helping households and workers cope with the costs of the transition, both within Europe and internationally. Within Europe, there is also a need to continue allocating revenues specifically to those regions where transition costs are higher.*
- *Finally, the **integrity of the ETS must be protected**. International credits and carbon removals should remain outside the system. Introducing them into the ETS would weaken the carbon price, reduce incentives for real emission cuts in European industry and risk undermining confidence in the system.*

ETS2 for road transport and buildings must remain outside the scope of this review and off the negotiating table until its scheduled 2028 revision.

Introduction

The EU Emissions Trading System (ETS) has long been central to EU climate policy, yet in the first half of 2026, it has been cast as a scapegoat in an increasingly heated debate over Europe's industrial future. The coordinated attack from fossil fuel incumbents and vested interests is unprecedented in scale. At the same time, however, the case for a strong and effective ETS has never been more compelling. This is reflected in the broad and growing support it continues to receive - not only from civil society, but also from a wide range of businesses and industrial actors calling to stay the course on climate action.

Bury the €400 billion bill

Europe still spends nearly €400 billion every year on fossil fuel imports. This leaves the EU exposed in two ways: first, by deepening dependence on countries increasingly willing to weaponise energy dependency for geopolitical ends; and second, by locking Europe into a global fossil fuel system that is structurally vulnerable to shocks, price spikes and conflict. Since the US and Israeli attacks on Iran in 2026 began, the EU's fossil fuel import bill has jumped €22 billion in just 44 days, complained EC President Ursula von der Leyen in mid-April 2026. The recent destruction of oil and gas infrastructure in the Middle East is only the latest reminder that Europe's prosperity remains tied to unstable supply chains and geopolitical chokepoints as a consequence of a lack of determination in moving away from fossil fuels.

A credible carbon pricing mechanism is therefore not only a climate tool; it is an industrial, economic and security strategy. The ETS already is an independence instrument, as it has allowed the EU to save 100 bcm of fossil gas consumption[1]. Over the next five years alone, ETS auction revenues are expected to generate between €120 and €150 billion.[2] This represents a unique opportunity to finance the transition directly at Member State level and at EU level: to invest in clean industry and innovative solutions, modern infrastructure and affordable net-zero technologies, while also ensuring that households and workers are supported through the transition, provided that free ETS allowances handed out to industry are phased out as soon as possible.

The ETS has already proven its value. Since 2005, emissions in the sectors covered by the EU ETS have fallen by around 50%. The strongest progress has been achieved in the power sector, where the combination of carbon pricing, renewable deployment and fuel switching has driven rapid reductions. Business representatives have recently called it a "competitiveness engine for Europe", which has "driven billions of euros of investments by early movers, has provided a market signal for innovation and can be the demand signal for European cleantech solutions to scale." Together with the Carbon Border Adjustment Mechanism (CBAM), the ETS has also become a global reference point, encouraging both developed and emerging economies to develop or strengthen their own carbon pricing frameworks, with now 80 carbon pricing instruments in 95 jurisdictions covering around 28% of global greenhouse gases emissions.

Invest in industry and avoid decarbonisation leakage

The next challenge is industry. Progress in heavy industry has been painstakingly slow, largely because a muted and unpredictable carbon price has failed to provide a sufficient incentive for investment in Europe's ageing industrial base. This is precisely where the ETS must now deliver, as many industrial installations require major investments before 2030. Energy-intensive industries still account for more than a quarter of the EU's final energy use and more than 20% of total greenhouse gas emissions.

[1] Communication from the European Commission, Accelerate EU, 22 April 2026 -COM(2026)370 final
[2] Assuming an EUA price range of €75 to €95 see CMW report

The upshot is that the EU hosts around a quarter of the global pipeline of clean industrial projects, with an even higher fraction in sectors such as steel and cement, waiting for a final investment decision. But this potential must now be turned into reality. Weakening the EU carbon price would push investment in clean industrial production to regions that are moving faster and providing greater certainty, while penalising first movers who already launched investments in Europe. Without a strong and predictable ETS, the business case for clean steel, green chemicals, circular materials and electrified production weakens significantly, undermining the objectives of both the Clean Industrial Deal and future instruments such as the Industrial Accelerator Act.

Calls to dilute the ETS would therefore freeze investment decisions, penalise first movers and lock Europe into yesterday's industrial model at precisely the moment when the global race for clean industry is accelerating. **The key risk Europe now faces is no longer carbon leakage, but decarbonisation leakage**. If Europe fails to create the right conditions for investment, clean industrial projects will move elsewhere. Residual carbon leakage concerns should be addressed through the Carbon Border Adjustment Mechanism and continued close collaboration with trade partners to foster the uptake of carbon pricing systems worldwide.

For CAN Europe, the conclusion is clear: the ETS must remain the cornerstone of EU climate and industrial policy. The priority is not to weaken the carbon price signal, but to strengthen and improve the system so that it accelerates decarbonisation, protects citizens and helps deliver Europe's economic and energy security.

CAN Europe's principal demands for the next review

1. Maintain the cap trajectory minimally until 2036

There is no need to change the cap or Linear Reduction Factor (LRF) in the coming decade. Under a pathway consistent with reducing EU emissions by 90% by 2040, the EU ETS will remain oversupplied until 2036. In other words, there will still be enough allowances in the system to cover industrial emissions, given moderate to realistic decarbonisation assumptions.

Calls for lowering the LRF amount to both bad industrial and climate policy:

- **A stable, predictable carbon price signal is essential for mobilising capital for clean industry:** reducing the LRF would weaken long-term carbon price expectations and slow down investments in industrial transformation at a moment when 90% of announced clean industrial projects are awaiting Final Investment Decision. Moreover, it would also penalise first movers who have already invested under the current framework, rewarding laggards and undermining the credibility of EU climate policy.
- **Lowering the LRF would significantly increase emissions:** even small reductions in the LRF have large long-term effects. Lowering it to 3.4%, as has been suggested, would delay near-zero emissions from around 2040 to 2043, allowing roughly one billion additional tonnes of CO_2 into the atmosphere - equivalent to the combined annual emissions of Germany and Poland today. ETS emissions in 2040 would be roughly twice as high as under the 90% reduction pathway.

Any additional emissions within the ETS would require deeper cuts elsewhere, shifting more burden onto sectors outside the ETS, where steeper reduction efforts are politically challenging.

For these reasons, the LRF should remain unchanged until at least 2036. After 2036, the LRF and cap may be adjusted to allow only **a limited, steadily declining level of residual emissions**, excluding fossil fuel and capture-ready process emissions. Such residual emissions should be strictly reserved for sectors essential to the EU's economic security and resilience, ensuring that emissions allowances support only critical, non-substitutable activities.

2. Preserve the Market Stability Reserve

The Market Stability Reserve (MSR) is central to stabilising the EU carbon market and securing the business case for climate-friendly investments. By automatically adjusting the supply of allowances, it protects the carbon price from extreme fluctuations and ensures predictable conditions for companies investing in electrification, energy efficiency, green hydrogen, and other decarbonisation technologies.

In this context, we are very concerned with the proposal announced in March 2026 to scrap the invalidation mechanism. This Commission's proposal, issued without any consultation or impact assessment, could flood the market with surplus allowances once the MSR buffer starts releasing in the 2030s. The consequences include a weaker and less credible long-term carbon price, significantly higher emissions, and **a prolonged "wait-and-see" approach by industries**, delaying investments in deep decarbonisation when they are urgently needed.

Notably, this change would have little to no effect on carbon prices in the near term. Any tweaks to the Market Stability Reserve to address concerns around price stability should be dealt with as part of the ETS review in a balanced, coherent and consistent package.

3. Price carbon for real to drive investments

Free allocation of EU allowances has long been presented as a temporary instrument to shield industry from carbon costs and mitigate carbon leakage risks. Empirical evidence suggests that economy-wide leakage has not materialised at a large or systematic scale, even if some sector-specific and trade-related effects have been identified in energy-intensive industries. In practice, it has nevertheless become a structural feature of the EU ETS, dampening the carbon price signal and reducing abatement incentives, thereby weakening the system's overall efficiency and environmental integrity

Between 2008 and 2021, heavy industry received approximately €200 billion worth of EUAs at no cost. In 2024 alone, nearly 500 million allowances - valued at over €32 billion were still handed out for free. These are forgone revenues that could otherwise fund climate action, social support, and the transformation of the European economy. Sectors like metals, minerals, chemicals, and paper firms often received more allowances than their verified emissions, generating windfall profits concentrated in iron and steel, cement, petrochemicals, and refineries, estimated between €26 billion to €46 billion. Despite these handouts, the industry has favoured short-term financial gains over long-term investment in the green transition. Many companies have prioritised share buybacks and dividend payouts while dropping capital expenditure, which on average has fallen from 18.4% in 2010 to 14.9% in 2023.

Free allocations were always intended as temporary. To restore integrity to the EU ETS, free allocations must be fully phased out. For CBAM-covered products, the planned phase-out trajectory must be respected. For non-CBAM ETS sectors deemed at risk of carbon leakage, including refineries and chemical producers, free allocation must end no later than 2034 by including sectors such as plastics into CBAM.

Any remaining free allocations must be made strictly conditional on additional, verifiable decarbonisation investments. The conditionality introduced under the CISAF for electricity price compensation - requiring companies to undertake additional decarbonisation investments in return for state aid - could serve as a model. In the ETS, however, this principle should be applied more rigorously: free allowances should only be granted where companies can demonstrate additional decarbonisation investments outlined in solid decarbonisation pathways of at least equivalent value. In addition, circularity and energy efficiency objectives should be

integrated into these conditionalities. Albeit absent from most subsidy schemes[3], social and just transition objectives should also be an element of the reinvestment in decarbonisation, for example, to accompany workers in the adaptation to the transition towards climate-neutral production processes.

Finally, benchmarks determine the allocation of free allowances and must continue to be updated as planned to reflect technological progress and the real decarbonisation potential of each sector. Freezing or delaying benchmark updates would reward laggards, penalise first movers, and undermine the credibility of the ETS. It would also weaken investment certainty by signalling that companies investing early in cleaner technologies will no longer be rewarded.

4. ETS revenues: use every Euro to accelerate the transition

Between 2026 and 2030, the EU ETS is expected to generate €120 –150 billion in Member State auction revenues, with the Innovation and Modernisation Funds mobilising up to an additional €93 billion for climate action.

As ETS revenues are likely to peak in this period before declining as emissions fall, weakening the ETS would not only erode the carbon price signal **but also significantly reduce the public resources available for the transition**. Preserving ETS integrity is therefore essential both to drive decarbonisation and to secure this temporary window of strategic investment. These revenues must be used transparently and effectively to support citizens, accelerate industrial transformation, and finance infrastructure, innovation, and targeted transition instruments at both the national and EU levels.

At present, this is not happening. Although the revised ETS Directive requires that 100% of auctioning revenues be spent on climate-related purposes, there is still very limited transparency on how revenues are used and only a small share is directed explicitly towards financing the transition. The current list of eligible spending priorities is outdated and needs a fundamental overhaul. Member States should also be required to **publish clear, detailed and comparable information on how ETS revenues** are spent.

Therefore, we call for:

- **Amending the EU ETS Directive to embed additionality and Do No Significant Harm (DNSH) as core principles for ETS revenue spending.** Article 10(3) should prioritise policies and investments that deliver the highest CO_2 reductions and require all supported measures to meet robust criteria on additionality and climate impact. This must explicitly exclude fossil fuel subsidies and prevent investments that create carbon lock-in.
- **Redirecting ETS revenues towards industrial transformation by strengthening climate investment over carbon leakage protection.** In the next ETS review, phase out all free allocation to expand the Innovation Fund, phase out indirect cost compensation, and ensure revenues are channelled toward significant climate investments that accelerate industrial transformation, innovation, and long-term emissions reductions.
- **Strengthening monitoring, transparency, and enforcement of Member State ETS revenue use.** The Commission should rigorously monitor compliance with ETS earmarking provisions, clearly assess additionality in Member States' climate spending, and require Member States to use integrated national energy and climate progress reports (NECPRs) to track how ETS revenues support vulnerable households, including contributions to reducing energy poverty and delivering energy savings, and international climate finance.

[3] CAN Europe: Lessons learned from Member States concerning social and environmental conditionalities in public finance for companies: A promising way forward?, 2026

Furthermore, ETS 1 revenues should be used for **three overarching priorities:**

- **Accelerating industrial transformation and renewable energy deployment**

A growing share of ETS revenues should be channelled towards industrial transformation and the rapid deployment of renewable energy through competitive and transparent processes. Broader access to ETS revenues should be strictly conditional on the planned phase-out of free allocations, ensuring progressive exposure to the carbon price. We support a reform of the ETS Innovation Fund and the establishment of an EU Industrial Decarbonisation Bank that prioritises investment in renewables-based electrification, resource and energy efficiency, renewable energy deployment and circularity measures across clean industrial projects, so as to build on the experience of the ETS Innovation Fund and avoid repeating its limitations.

Support should be allocated through competitive auctions and contracts that reward the greatest emissions reductions at the lowest cost. Public support must be linked to clear conditions: measurable decarbonisation outcomes, binding investment commitments, transparency, social goals and respect for labour standards. Recipients should be required to demonstrate credible transition plans and to reinvest support into industrial transformation rather than distributing windfall profits.

In the meantime, the EU ETS Innovation Fund should also be reformed to ensure that its overall budget is directed towards genuinely transformative green solutions, such as the uptake of clean energy and energy efficiency, rather than being heavily concentrated on Carbon Capture and Storage (CCS) and Carbon Capture and Utilisation (CCU) projects, as is currently the case.

At the same time, ETS revenues must not be used to prolong fossil fuel dependence. In particular, support for fossil fuel-based electrification and compensation for fossil-based electricity use should be phased out. The current system of Indirect Cost Compensation (ICC) is fundamentally flawed. By compensating electricity consumption regardless of whether it is based on fossil fuels, the mechanism weakens incentives for electrification based on renewable energy, lacks transparency and is implemented inconsistently across Member States. ICC should therefore be fundamentally reformed and progressively phased out.

- **Supporting citizens and ensuring a just transition**

ETS revenues cannot become a mere “cashback” mechanism for the industry. The costs of climate change and industrial pollution are borne by society as a whole, and the benefits of ETS1 revenues must therefore also be shared more broadly. A significant share of revenues must be directed toward supporting people in the transition, in particular lower-income households and vulnerable groups. This includes investments in building renovation, clean mobility, public transport, affordable renewable heating and cooling, energy efficiency, and targeted social support, ensuring that those most exposed to energy and transport poverty are not left behind. There are already good examples of Member States investing a significant share of their ETS 1 auctioning revenues in social support, e.g. for highly targeted renovation of (social) housing, delivering both emissions reductions and improvements in housing quality for low-income households in Belgium and France.

In this context, ETS1 revenues can also play a role in **reinforcing Social Climate Plan investments**, complementing the use of ETS2 revenues and providing Member States with additional means to address remaining gaps and ensure that the needs of vulnerable households are effectively met.

The use of ETS revenues should also support a **place-based industrial strategy** that strengthens cohesion across Europe. The transition must not become a two-track process in which only already-wealthy regions benefit, while others are left behind. ETS revenues should therefore help stimulate the development of industrial value chains

across the continent, maximise regional competitive advantages and support regions facing the greatest transformation challenges.

    - **The Modernisation Fund** should be maintained as a crucial instrument for supporting the energy transition in lower-income EU Member States, but recent disbursement patterns have raised serious concerns about its effectiveness, with a significant share of funding directed toward investments that are misaligned with EU climate, energy and environmental objectives; to ensure it fulfils its core purpose, the Fund must be significantly strengthened through stricter governance and a clear phase-out of support for fossil fuel projects.
    - The announced European "**Investment Booster**" could provide an important additional instrument to support regions with lower fiscal capacity and higher transition costs.

- **Meeting Europe's international climate finance obligations**

A meaningful share of ETS revenues should be earmarked for international climate finance. The EU has repeatedly committed to supporting developing countries in implementing the Paris Agreement and in adapting to the growing impacts of climate change. These commitments now need to be matched with concrete funding.

Using ETS revenues for international climate finance is not only a matter of fairness and solidarity; it is also essential for Europe's climate diplomacy, geopolitical credibility and the success of global climate action. The scope extension of ETS to all departing flights and all international voyages (see below) could be particularly well-suited to support decarbonisation in partner countries outside the EU.

5. Safeguard the ETS from offsets

Offsetting must have no place in the EU ETS. **International credits** under Article 6 of the Paris Agreement should not be allowed into the ETS under any circumstances. The EU has already experienced the damage caused by offsets: during Phase 3 (2013-2020) of the ETS, more than 1.6 billion Kyoto credits flooded the market, weakened the carbon price and delayed emission reductions for years. These credits undermined both the environmental integrity and the credibility of the system, while many failed to deliver real climate benefits. Recent analysis gives no reason to believe that credits from Article 6 would perform differently. Reopening the ETS to international offsets would once again weaken the incentive for European industry to decarbonise, deprive Member States of ETS revenues and risk subsidising competitors outside the EU.

Permanent removals should likewise not be integrated directly into the ETS. Allowing removals to compensate for emissions would turn the ETS back into an offsetting scheme and weaken its primary purpose: driving actual emission reductions. This is especially problematic given that major emissions in industry, power and transport remain highly abatable. Current certification rules in the CRCF do not yet guarantee environmental integrity or permanence, nor ensure the delivery of actual atmospheric removals. Moreover, the CRCF Regulation establishes liability and monitoring for permanent removals to be compliant with the CCS Directive. However, this is not the case for biochar, despite being categorised as a permanent removal activity. The appropriate role for the ETS is therefore not to use removals as offsets, but to support high-quality removals indirectly through ETS revenues for research, innovation and targeted funding.

6. Improve the accounting of biomass emissions

Zero-rating biomass emissions creates a misleading picture of emissions. The assumption of carbon neutrality in the ETS does not reflect real-world impacts, including forest carbon stock losses, forgone sequestration, and indirect land-use change, as these are either ignored completely or not adequately regulated in the Renewable

Energy Directive (RED) and the Land Use, Land Use Change and Forestry (LULUCF) Regulation. This accounting approach in the ETS therefore masks emissions, which can be higher over climate-relevant timescales than for fossil fuels, and creates incentives that further weaken the already declining LULUCF sink. Where LULUCF targets are not at least as demanding (e.g. in terms of implicit or explicit carbon price as in the ETS), or are not binding or effectively enforced, or where criteria in the RED do not exclude everything except fast-decaying wastes and residues with no other uses, zero-rating of biomass emissions in the ETS needs to be discontinued.

7. Scope extension to include all international flights, international voyages and smaller vessels, and waste incineration

Expanding the scope of the EU ETS is essential to close **major coverage gaps**, strengthen the polluter pays principle, and ensure all significant emissions sources contribute fairly to the EU's climate objectives. Extending carbon pricing to underregulated sectors such as aviation, shipping, and waste would improve environmental integrity, reinforce decarbonisation incentives, and generate additional revenues to support Europe's industrial transformation, energy security, and circular economy objectives.

- The ETS covers **only 15% of the aviation sector**'s total climate impact, as it applies solely to flights between EEA airports and only to CO_2 emissions, excluding all non-CO_2 effects. Extending ETS to at least all CO_2 emissions from flights departing EEA airports could raise an additional €9 billion annually by 2030 and cover an additional 80 Mt of CO_2 emissions into the scheme, compared to the current 64 Mt . Next to this, we call for including private jets into a full scope ETS (departing and incoming flights), removing the de minimis emissions threshold.

  The aviation sector must take responsibility for its full climate impact. The EU must consider addressing **contrail impacts** within the ETS by gradually incorporating verified non-CO_2 effects into carbon pricing.

- In 2024, shipping ETS generated €2 billion, while **only 50% of emissions from extra-EEA shipping voyages** were covered. Extending coverage to 100% and including smaller vessels (400–5000 gross tonnage), which emit 17.8 Mt CO_2 annually, would strengthen incentives to shift toward cleaner technologies.
- The continued exclusion of **waste incinerators** from the EU ETS undermines its climate effectiveness and sends a distorted price signal that contradicts the EU waste hierarchy. Given that waste incineration generates substantial greenhouse gas emissions while often destroying recyclable and reusable materials, its inclusion in the ETS is essential to strengthen climate ambition, support circular economy objectives and incentivise waste prevention, reuse and recycling over polluting disposal practices. Adding incineration to the EU ETS **would slash CO_2 emissions by 4 to 7 million tonnes in 2030**, rising to 18 to 32 million tonnes in 2040.

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