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Review of the EU Emissions Trading System (EU ETS)

Business & Science Poland Position Paper

The EU ETS review will be one of the key regulatory processes shaping the operating conditions for European industry after 2030. While the system remains the EU's core climate policy instrument, its future design should be assessed not only from the perspective of achieving emission reduction targets, but also in terms of its impact on industrial competitiveness, economic security, energy costs, carbon leakage risk, and companies' ability to finance decarbonisation investments.

The fact that such important elements of the system are being analysed as part of the review, including the MSR parameters, the rules on the automatic cancellation of allowances held in the reserve, the future trajectory of free allocation, carbon leakage protection, indirect cost compensation, a more sector-specific approach to fallback benchmarks, financing for industrial decarbonisation, the integration of permanent CO_2 removals, and the potential role of CCU, shows that the future design of the EU ETS requires a broader assessment than merely adapting the system to new emission reduction targets. It is essential that these solutions be assessed in terms of their actual impact on market stability, cost predictability, investment conditions, and the competitiveness of energy-intensive sectors.

After more than 20 years of operation of the EU ETS, it is necessary to reassess whether the system continues to deliver emission reductions in a cost-effective manner, while remaining predictable for market participants and consistent with the need to maintain the competitiveness of European industry. The current functioning of the EU ETS is increasingly revealing serious structural limitations, the effects of which are felt in particular by industrial sectors most exposed to the risk of losing competitiveness.

The current Green Deal framework, built around steadily increasing carbon prices, places significant cost burdens on European industry. While the EU ETS contributes to reducing CO_2 emissions, in some energy-intensive sectors the risk of losing competitiveness is growing, and questions arise as to whether the costs imposed remain proportionate to the environmental benefits achieved. This phenomenon is therefore not only economic, but also environmental in nature: emissions are increasingly being shifted outside the European Union rather than being genuinely eliminated.

On this basis, Business & Science Poland identifies four areas that should be of key importance in the EU ETS review.

1. **From the cost of emissions to investment in decarbonisation** - the EU ETS should provide stronger support for decarbonisation investments in the sectors bearing the costs of the system, including through more effective use of ETS revenues and access to CAPEX and OPEX financing.

2. **Stability and predictability of the EUA market** - the future design of the system should limit excessive allowance price volatility and enable companies to plan investments, in particular through appropriate adjustments to the MSR and to the trajectory for reducing the number of allowances after 2030.

3. **Effective protection against carbon leakage** - free allocation, benchmarks, indirect cost compensation and CBAM should operate as mutually reinforcing instruments, rather than leading to a weakening of protection for the sectors most exposed to the loss of competitiveness.

4. **Recognition of sector-specific circumstances** – uniform EU ETS parameters should be assessed taking into account the real technological capabilities, strategic importance of individual sectors, and the risk of production and emissions being shifted outside the EU.

The following sections present BSP's detailed comments and recommendations with respect to each of the above areas, identifying both the necessary systemic changes and the effects of the current functioning of the EU ETS on sectors particularly exposed to emission-related costs.

1. The need to shift from a "cost of emissions" approach to an "investment in decarbonisation" approach

In its current form, the EU ETS is increasingly less aligned with the current needs of industry and EU regions. The rapid pace of increasing climate ambition is not matched by companies' real capacity to adapt to new requirements. Persistently high emission and energy costs, limited access to financing, and insufficient flexibility in implementation policies are increasing the risk of deindustrialisation.

The EU ETS generates significant revenues for Member States through the auctioning of CO_2 emission allowances. In line with the objectives of EU climate policy, these revenues should primarily be used to finance the transition towards climate neutrality and to support the sectors most exposed to the risk of losing competitiveness. In practice,

however, it is necessary to ensure that the system provides stronger support for the real transformation of industry, rather than merely generating high emission costs.

In this context, BSP draws attention to the following issues:

- **Mandatory use of ETS revenues for decarbonisation investments**

BSP underlines that ETS revenues should be directed **in particular to energy-intensive sectors covered by the EU ETS**, including agri-food processing sectors which, despite their important role in the food value chain, often remain outside the mainstream of investment support. At present, the ETS does not provide for a mechanism ensuring that part of the funds originating from the purchase of emission allowances is returned to energy-intensive sectors and used to finance their decarbonisation. It is therefore necessary to **establish a dedicated mechanism for recycling such funds, with a view to supporting decarbonisation investments or covering increased operating costs** resulting from the deployment of technologies with lower emission levels.

The allocation of national ETS revenues to decarbonisation measures undertaken by installations covered by the EU ETS **should be mandatory for Member States**, rather than merely recommended. These funds should support a broad range of technologies, not limited to those listed in the NZIA, and should be targeted at modernisation, energy efficiency and investments that reduce emissions at source. Only then will it be possible to maintain technological neutrality and make full use of the innovative potential of European industry.

In view of the EU's ambitious climate objectives, including the objective of achieving climate neutrality, it is essential to ensure that financial support is also directed towards **investments with the highest potential to reduce greenhouse gas emissions**. This applies in particular to large-scale energy projects enabling the replacement of coal-based installations, as well as to the modernisation of sectors of significant social and regional importance, such as district heating and the food industry. In Poland, support for the district heating sector is particularly important, as it remains largely based on coal infrastructure and requires urgent modernisation. The primary beneficiaries of such support would be end consumers, who would gain access to clean and affordable heat.

Such a solution would make it possible to partially offset the costs of the ETS and turn the system itself into a mechanism driving the implementation of new low-emission investments in the industrial sector.

- **Support mechanisms should cover both CAPEX and OPEX**

The decarbonisation of industry requires the launch of new, effective financial support mechanisms covering both investment and operating costs. In many sectors, the barrier to transformation is not only the cost of building new installations or modernising existing infrastructure, but also the subsequent operating costs of low-emission technologies. Companies undertaking emission reduction measures should receive support in the form of compensation for part of the investment costs incurred for decarbonisation. Only real financial support can ensure that European industry remains competitive in global markets and increase the actual climate impact of the EU ETS.

- **Faster, more predictable and geographically fair access to financing**

The energy transition requires stable and swift support mechanisms. However, current aid instruments are not sufficiently aligned the real needs of companies: they are too complex, and the time needed to obtain decisions and disbursement of funds remains disproportionate to the pace of transformation and market volatility. The Modernisation Fund, the Innovation Fund and the Just Transition Fund are too limited, while access to them is time-consuming and unpredictable. Faster and more predictable forms of support are therefore needed, including for large industrial companies.

At the same time, the design of certain instruments, such as the Innovation Fund or the CISAF State aid framework, raises concerns as regards the effectiveness and fairness of the redistribution of funds. In the case of CISAF, it should be recalled that **the framework creates a possibility for Member States to grant State aid, but does not guarantee that such support will actually be made available**. In practice, companies' access to support may therefore depend on the decisions, budgetary capacities and priorities of individual Member States, which risks deepening disparities between EU economies and weakening the cohesion of the Single Market.

The lack of a geographical criterion in some EU instruments also limits the possibility of obtaining support for projects located in Central and Eastern Europe. An additional risk is that support may be made conditional on prior purchases of EUAs, which could favour companies from Member States with greater fiscal capacity and better access to capital.

In light of the above, it is essential to avoid similar disparities when designing new financial instruments. A complete replacement of the Innovation Fund is not justified. Instead, geographical balance in the allocation of funds should be taken into account and should take precedence over competition at EU-wide level.

- **Support mechanisms should strengthen local value chains and the EU's economic resilience**

An important element of support mechanisms should also be the promotion of investments involving domestic suppliers and the development of local value chains. Support for projects with a high share of "local content" can strengthen the EU's economic resilience while reducing dependence on imports of technologies and raw materials from third countries. At the same time, new aid instruments should preserve technological neutrality, so as to support genuine emission reductions and industrial modernisation regardless of the technological pathway chosen. Such an approach would make better use of the investment potential of European companies, while also strengthening national and regional supply chains.

2. EUA price stability and the role of the MSR - beyond parameter changes: assessing real effectiveness

Increasing allowance prices and regulatory uncertainty generate significant burdens for companies, which are not always proportionate to the environmental benefits achieved. High emission and energy costs, the complexity of the system and unequal access to support instruments limit its economic efficiency. This applies in particular to energy-intensive sectors, including industrial and food processing, which are characterised by seasonal production patterns and limited investment flexibility.

In the context of dynamic increases in allowance prices, installation operators are unable to effectively plan the modernisation of existing installations. Financing such projects also remains a challenge, given the need to allocate significant resources to the purchase of emission allowances. Therefore, an MSR mechanism that operates in a one-directional manner, by limiting the number of allowances available on the market, is not able to respond adequately to price shocks and cannot be considered an effective tool for ensuring stability and predictability for market participants.

The European Commission is currently analysing the parameters of the Market Stability Reserve, including the rules on the automatic cancellation of allowances held in the MSR. It is essential, however, that any potential changes should not only be technical or formal in nature, but should genuinely increase market stability and predictability for participants in the EU ETS.

In this context, the planned 2026 EU ETS review should also cover the adjustment of key system parameters, including the linear reduction factor (LRF) and the rules governing the functioning of the Market Stability Reserve (MSR).

1) **Adjusting the LRF after 2030** - The current design of the LRF would lead to the cap on allowances reaching zero already in 2039, creating an inconsistency with the 2050 climate neutrality objective. The LRF should therefore be revised to ensure an adequate supply of allowances for industry, in particular for energy-intensive sectors and hard-to-abate industries. For these sectors in particular, transition periods must be sufficiently taken into account for companies seeking to achieve full emission reductions and, consequently, facing major organisational and technological challenges requiring very significant investment expenditure. Adjusting the LRF after 2030 would help maintain the EU ETS as a tool for transformation rather than deindustrialisation, while limiting the risk of sudden increases in EUA prices. This change should be accompanied by measures supporting market stability, including moving away from the cancellation of allowances held in the MSR and allowing for the use of additional units, such as removals or international offsets.

2) **MSR - the need to restore balance in the allowance market-** the MSR was originally introduced as an exceptional instrument aimed at addressing the oversupply of allowances. However, its current functioning raises significant concerns from the perspective of its impact on the availability of allowances and EUA price levels. If the mechanism is maintained, it should be adjusted to ensure greater market predictability and stability. In particular, the MSR should be transformed from a passive mechanism that tightens the emissions cap into an active market-stabilising tool, taking into account the competitiveness of EU industry and the costs of the transition.

For this purpose, BSP calls for:

- **ending the mechanism for cancelling allowances -** the volumes accumulated in the MSR should serve as a safety buffer, increasing market liquidity and limiting excessive price volatility;
- **introducing a transparent algorithm for releasing allowances from the MSR** – for example, a defined percentage of the MSR per quarter, subject to an annual cap, in order to limit the risk of price shocks without undermining the long-term decarbonisation signal. This buffer could be strengthened by partially restoring historically cancelled allowances to the MSR;
- **adjusting the MSR parameters, including the intake rate and TNAC thresholds, towards a more flexible "liquidity corridor"** - one that better reflects market and investment cycles and limits EUA price volatility. The intake rate should return to

12% in order to reduce excessive restrictions on the availability of allowances. In addition, it would be justified to move away from a static approach to TNAC towards a more flexible mechanism for withdrawing and releasing allowances, allowing the system to better respond to market developments and stabilise investment expectations. At the same time, consideration should be given to adjusting the MSR activation thresholds, including raising them, in order to limit excessive intervention by the mechanism in the supply of allowances during periods of regulatory change and industrial transformation.

An additional factor affecting the stability of the EUA market is the active participation of financial entities, including those from outside the EU, such as banks and investment funds, which treat EUAs as a financial instrument. This may have a negative impact on allowance price stability and amplify risks resulting from the current imperfections of the market. **The EU ETS should remain a market-based mechanism, however, its stability requires additional instruments to limit excessive price fluctuations and address risks stemming from the activity of entities not directly involved in emission reductions.**

Some Member States, including Poland, are particularly sensitive to EUA prices, as their energy and industrial sectors remain more reliant on fossil fuels for historical reasons. High and unstable allowance prices may therefore place a greater burden on economies facing a more challenging starting point in the transition, limiting the resources available for modernisation and increasing the risk of losing competitiveness.

3. Free allocation and benchmarks – carbon leakage protection must remain effective

Free allocation of allowances and benchmarks remain among the key instruments for protecting energy-intensive sectors against the risk of carbon leakage. Their future design should be assessed not only as part of the technical allocation methodology, but above all as a tool to ensure that industrial production can be maintained in the EU in a context of rising emission, energy and decarbonisation investment costs.

In this context, BSP draws attention to the following issues:

- **The update of benchmarks should take into account the real technological capabilities of sectors covered by the EU ETS**

The way in which benchmarks are updated for subsequent allocation periods is of particular importance, as benchmark values directly affect the level of free allocation of allowances and the scale of protection against carbon leakage. Reducing benchmark

levels without taking sufficient account of technological realities may lead to a disproportionate reduction in free allocation in sectors that have limited possibilities to reduce emissions rapidly for technological, feedstock-related or process-related reasons.

This applies both to product benchmarks and to fallback benchmarks based on heat and fuel. In the case of product benchmarks, it is particularly important that their update reflects the real emission reduction potential of a given production process, the availability of low-emission technologies, transformation costs and the risk of losing competitiveness vis-à-vis producers from outside the EU. Too deep a reduction in a product benchmark may lead to a significant reduction in free allocation even in sectors that are of strategic importance for EU value chains and do not currently have access to widely available, cost-competitive technological alternatives.

In the case of fallback benchmarks, a more sector-specific approach is necessary, taking into account differences between industrial processes covered by the same benchmarks. The current approach covers very diverse installations, even though their technological profile, temperature requirements, fuel-switching possibilities and emission reduction potential may differ significantly. A uniform methodology may therefore lead to reduced protection in sectors that do not have the same reduction possibilities as the reference installations.

The update of benchmarks should be based on a robust assessment of the actual emission reduction potential in individual sectors, rather than solely on averaged parameters or the performance of installations whose technological conditions are not representative of the entire group covered by a given benchmark. The objective of updating benchmarks should not be to mechanically reduce the level of free allocation, but to maintain effective protection against carbon leakage while preserving incentives for real emission reductions in installations covered by the EU ETS.

- **Free allocation of allowances should continue to provide effective protection for the sectors most exposed to the loss of competitiveness**

Free allocation of allowances should continue to serve as an effective instrument for protecting sectors exposed to carbon leakage. As long as EU producers bear regulatory costs that their competitors from outside the EU do not bear to a comparable extent, the system should limit the risk of production and emissions being shifted outside the European Union.

This protection should include both an adequate level of free allocation and the maintenance of complementary instruments, including indirect cost compensation.

Limiting these mechanisms without a robust assessment of their impact on industrial competitiveness could lead to higher production costs, a weakening of the European industrial base, and an increased risk of carbon leakage.

- **CBAM should remain complementary to free allocation, rather than automatically replacing it**

The CBAM mechanism can play a complementary role to the existing protective tools under the EU ETS, such as free allocation of allowances and indirect cost compensation. However, its effectiveness and its implications for global trade and the EU's internal value chains remain uncertain. Therefore, the phase-out of free allowances for sectors covered by CBAM should take place only after an evaluation of the effectiveness of CBAM during the transitional phase, taking into account its impact on exports, value chains and the level of global emissions.

4. Sector-specific circumstances – the need to protect strategic sectors and sectors particularly sensitive to EU ETS costs

The EU ETS affects different sectors of the economy in different ways. Therefore, the assessment of its future design after 2030 should not be limited solely to system-wide parameters, such as the level of emission reduction ambition, the availability of allowances or the functioning of the MSR. It is also necessary to take into account the specific circumstances of sectors that are of strategic importance for the European Union's economic, food, energy and raw material security, while at the same time being particularly sensitive to EU ETS costs, energy prices and competitive pressure from producers outside the EU.

- **Fertiliser sector**

The fertiliser sector is of key importance for food security, the resilience of supply chains and the maintenance of competitive agricultural production in the EU. At the same time, nitrogen fertiliser production is particularly exposed to high costs of natural gas, energy, CO_2 emissions and environmental regulation. An increase in these burdens, combined with competition from producers outside the EU, may weaken the EU production base in one of the most sensitive links of the agri-food value chain.

From the perspective of the fertiliser sector, maintaining effective protective mechanisms under the EU ETS is of key importance, in particular an adequate level of free emission allowances. Free allocation should continue to effectively limit the risk of carbon leakage, especially at a time when the sector is facing high energy, gas and CO_2 costs, as well as the costs of investing in low-emission technologies. Effective protection against carbon

leakage also requires a robust mechanism for compensating indirect CO_2 costs reflected in electricity prices. Such protection is necessary not only to maintain industrial competitiveness, but also to preserve production capacities in the EU and ensure the security of fertiliser supplies for European agriculture.

CBAM may play a complementary role to the EU ETS, but the current design of the mechanism does not provide full protection for the competitiveness of the fertiliser sector. It does not sufficiently take into account all costs borne by EU producers, including indirect energy costs, regulatory costs and differences in the level of public support. In addition, the absence of effective solutions for EU exports may further weaken the competitive position of European producers on global markets. Therefore, the gradual phase-out of free allowances should depend on a robust assessment of the effectiveness of CBAM in preventing carbon leakage and ensuring a level playing field, including with regard to exports outside the EU.

Trade measures, including the suspension of Common Customs Tariff duties on certain fertilisers and the proposed Article 27a of the CBAM Regulation, are also relevant. These instruments should be assessed as part of the broader regulatory environment of the fertiliser sector, as they may affect the level of import pressure, the predictability of operating conditions and the effectiveness of protection against carbon leakage. This is particularly important in a situation where the fertiliser sector already faces significant burdens related to the functioning of the EU ETS and the process of adapting to decarbonisation requirements. **It would be worth considering the introduction, under the EU ETS, of a mechanism similar to Article 27a, i.e. a temporary exemption from the obligation to surrender emission allowances for activities experiencing sudden and difficult-to-predict market situations.**

The cost pressure resulting from the EU ETS should therefore be assessed not only as a matter of industrial competitiveness, but also as an element of fertiliser supply security, the stability of European agriculture and the resilience of the entire agri-food value chain. Maintaining an adequate level of free allocation for the fertiliser sector is essential to limit the risk of production and emissions being shifted outside the European Union and to preserve strategic production capacities in the EU.

- **Agri-food processing**

Agri-food processing, including energy-intensive sectors such as sugar production, also requires particular attention. Some plants in this sector operate as installations covered by the EU ETS, bearing costs related to the purchase of emission allowances and the modernisation of energy infrastructure. At the same time, these are sectors of significant

social, regional and economic importance, directly linked to food security and the maintenance of local value chains.

Agri-food processing is characterised by seasonal production patterns and limited investment flexibility. In the case of the sugar campaign, the accumulation of costs related to energy, fuels, CO_2 emission allowances and obligations arising from the EU ETS may significantly undermine the cost competitiveness of production. Under the current regulatory and market conditions, these costs cannot always be flexibly spread over time or passed on to customers.

The transformation of these installations requires investments in the modernisation of technological heat sources, improvements in energy efficiency, cogeneration, heat recovery and a gradual shift towards lower-emission fuels. Future support instruments and rules for the use of EU ETS revenues should therefore take into account the specific characteristics of agri-food processing as a sector that not only bears the costs of the system, but also requires real access to funding for decarbonisation investments.

- **Non-ferrous metals and copper**

The non-ferrous metals sector, including copper production, is of strategic importance for the energy transition, infrastructure development, electrification and the EU's open strategic autonomy. Copper is an essential raw material for many value chains related to energy, transmission grids, electromobility and modern industry. At the same time, copper producers operate on a global market as "price takers", which means that they have limited ability to pass on rising regulatory costs to customers.

For this sector, maintaining effective instruments of protection against carbon leakage is of particular importance, including an adequate level of free allocation and appropriate benchmarks. This applies especially to fallback benchmarks based on heat and fuel, which cover highly diverse industrial processes with different technological conditions, temperature requirements and emission reduction possibilities.

Copper production requires high-temperature technological processes and the maintenance of very high quality and purity of the final product. In practice, this means that solutions that may be applied in some installations covered by fallback benchmarks, such as the wider use of biomass, cannot always be transferred to non-ferrous metals production. In the case of copper, the use of biomass may be limited both by the temperature requirements of the processes and by the risk of affecting the quality of the product, which is used in strategic energy, infrastructure and industrial applications.

Therefore, when assessing benchmarks for sectors using fallback benchmarks, it is necessary to take into account the technological realities of non-ferrous metals production. A uniform approach to fallback benchmarks may lead to a disproportionate reduction in free allocation in sectors that do not have the same emission reduction possibilities as the reference installations. With regard to copper production, it is therefore particularly important to apply a more appropriate sector-specific methodology or, at least, a more gradual reduction for activities related to the production of critical raw materials that are strategic for the EU's energy transition.

- **Aviation**

The civil aviation sector remains one of the most sensitive segments of the economy to the effects of the implementation of EU climate policy. Due to the global nature of its activities, the high costs of decarbonisation, the limited availability of low-emission technologies and competition from carriers outside the EU, changes to the EU ETS concerning aviation should be designed with particular caution.

The relationship between the EU ETS and the global CORSIA system developed within ICAO for international civil aviation is of particular importance. In BSP's view, extending EU ETS Aviation to flights outside the EU and the EEA would not be the right direction of change. International air connections are already covered by the CORSIA mechanism, therefore, the priority should be to strengthen its effectiveness and ensure its full and even implementation by third countries, rather than creating parallel administrative burdens that could lead to international tensions and competitive asymmetries.

Extending the EU ETS to such operations could lead to overlapping regulatory burdens and increased costs for EU carriers. As a consequence, this could weaken the competitiveness of European carriers vis-à-vis airlines from outside the EU and encourage the shifting of passenger traffic outside the EEA, in particular through non-EU hubs. This would not only weaken European aviation, but could also lead to carbon leakage through the choice of longer routes. Therefore, any change in the scope of the EU ETS in aviation should be preceded by an assessment of its impact on the competitiveness of EU carriers, transfer hubs, connecting traffic, global emissions and coherence with the CORSIA system.

In this context, it is particularly important that EU ETS revenues be used to a greater extent for the real decarbonisation of the aviation sector, in particular for the development and production of sustainable aviation fuels. Obligations arising from the EU ETS and the ReFuelEU Aviation Regulation should be assessed jointly, as both instruments increase cost pressure on EU carriers and require appropriate support mechanisms for genuine emission reductions.

▪ **Energy-intensive sectors of significant social and regional importance**

Energy-intensive sectors of significant industrial, social and regional importance also require particular attention, including the chemical, refining and petrochemical sectors, district heating, combined heat and power generation, and selected branches of industrial and food processing. In many cases, these are installations covered by the EU ETS, whose modernisation involves high infrastructure costs, limited investment flexibility and high sensitivity to energy and allowance prices.

These sectors encompass highly diverse technological processes, with different temperature requirements, installation operating profiles and emission reduction possibilities. Therefore, the future design of the EU ETS should take into account not only the overall emission reduction objective, but also the real conditions for the transformation of individual sectors. This applies both to the rules on free allocation and benchmarks, as well as to access to instruments financing modernisation.

The system should support investments that reduce emissions at source, in particular by directing ETS revenues to the sectors and installations that bear the costs of the system and have real emission reduction potential. Otherwise, growing cost pressure may lead not to an acceleration of decarbonisation, but to a reduction of production in the EU, a deterioration in the competitiveness of strategic sectors and the shifting of emissions outside the European Union.

About BSP

Business & Science Poland (BSP) combines the experience of leading Polish enterprises with the European Union's agenda. We represent the knowledge and interests of Polish companies employing over 280,000 people in Poland, the EU, and worldwide. Our goal is to support the EU Single Market, taking into account the need for its responsible and effective transformation.