

BRIEFING

The EU ETS review: strengthen and enlarge for clean and competitive shipping and aviation

Briefing published: September 2026

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Key recommendations

- **Stay aligned to the 2040 EU climate target.** Lowering the Linear Reduction Factor (LRF) to 3.7% for 2031-2035 and 1.7% for 2036-2040 would delay EU climate targets, create an oversupply of allowances that would undermine the long-term price signal, and jeopardise the business case for clean-tech frontrunners that have already invested in decarbonisation.
- **Cutting the Market Stability Reserve (MSR) intake rate from 24% to 12% of the Total Number of Allowances in Circulation (TNAC) would sharply reduce its capacity to absorb surplus allowances and weaken support for the carbon price.** Diluting the MSR now would break investor expectations of steadily increasing scarcity, erode the long-term price signal, and heighten regulatory risk – pushing up financing costs for precisely the industries that need to invest most in the green transition.
- **EU ETS revenues must be actively recycled to support the structural technological shift needed to lower industrial carbon costs over time.** Out of the 50% of their national ETS revenues allocated to decarbonise priority sectors, Member States should ring-fence an increasing portion for direct industrial transition and electrification. For example, dedicating 25% of aviation and shipping ETS revenues to e-fuels could provide [crucial support](#) for their development and uptake in these transport sectors. The remaining 50% should still be spent in actions supporting climate transition. The transparency clause regarding the use of these revenues (Article 10(3)(l)) and Article 19(2) of Regulation (EU) 2018/1999) should be strengthened to ensure Member-States comply with the climate requirements. On top of that, the European Investment Bank should establish a dedicated facility allowing Member States to frontload at least €100 billion by borrowing against guaranteed future EU ETS revenues.
- **Prioritise internal emissions reductions over international carbon credits.** The EU could consider including within its 2040 target the acquisition of a limited amount of high-quality, high-integrity international carbon credits. However, these must be characterised by stringent eligibility criteria. If these stringent criteria cannot be guaranteed, international carbon credits should not form part of the EU's target.
- **Carbon Dioxide Removal (CDR) integration must not become a net increase in emission space.** The proposal guarantees the 250 million extra allowances but not the removals meant to match them. Unauctioned allowances should be cancelled, not returned to the cap, and any delivery shortfall recovered from future auction volumes. Eligibility and biomass sustainability criteria belong in the Directive, not

delegated acts; the 2034 review must not admit non-permanent removals; and the revision should deliver the residual emissions definition the Climate Law still lacks.

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Introduction

The European Commission's proposal to review the EU Emissions Trading System (EU ETS) comes at a pivotal moment for Europe's climate, industrial and economic policy. Since its launch in 2005, the EU ETS has become the EU's flagship climate instrument, helping to reduce emissions from the power sector, industry, aviation and maritime transport while **generating more than €230 billion in auction revenues**.

Emissions from sectors covered by the EU ETS have fallen by around 50% compared with 2005 levels, demonstrating the effectiveness of a robust, declining emissions cap combined with carbon pricing.

Europe faces **heightened geopolitical uncertainty, growing international competition in industry and clean technologies, persistently high energy prices in parts of the economy, and significant investment needs in electricity grids, electrification and industrial decarbonisation**.

The recent devastating wildfires across Europe reiterate loud and clear the need for a strong EU ETS capable of assisting in preventing climate-related natural disasters. At the same time, **the EU continues to pay nearly €400 billion annually on imported fossil fuels**, leaving the European economy exposed to international supply chokepoints and price shocks. A strong ETS acts as an energy independence instrument; keeping a robust price signal accelerates the shift to domestic clean energy.

A **predictable and credible carbon market** remains one of Europe's greatest competitive advantages. Weakening the integrity of the EU ETS would not address the structural challenges facing European industry. On the contrary, greater regulatory uncertainty undermines long-term investment decisions, increases financing costs for capital-intensive low-carbon projects and slows the deployment of clean technologies essential for Europe's competitiveness and energy security.

The post-2030 EU ETS should preserve the core principles that have made the system successful while adapting it to support Europe's next phase of industrial and energy transformation. **This means maintaining a strong and predictable emissions cap aligned with 2040 climate objectives while providing stability and flexibility for investment**. It also demands **ensuring that**

EU ETS revenues are used more strategically to accelerate investment in decarbonisation, electrification and clean technologies.

Within the post-2030 framework, **ETS2 and the SCF are essential to strengthen energy security, economic resilience, enable European industry to scale decarbonised solutions on their home market, ensure a fair energy transition for consumers and reinforce the global competitiveness of European industries.**

For this reason, **we call upon EU lawmakers to [launch ETS2 in 2028](#), without further delays or reopening, and use the time to actively prepare implementation.** Private consumers, SMEs, and large businesses across the clean heat and road transport sectors have invested significantly based on the stability and predictability of ETS2. Undermining this certainty now would erode confidence, disrupt investment decisions, and jeopardise Europe's competitiveness and energy security at a critical moment. The EU and its Member States must use the one-year delay to accelerate infrastructure deployment and streamline administration. **Taking advantage of the pre-launch window for ETS2, Member States must urgently transpose the Directive into national law, finalise and start implementing their Social Climate Plans.** Moreover, Member States must [make use of the EIB's Frontloading Facility](#) to begin investment-related spending as soon as possible before ETS2 commences in 2028.

In this paper, T&E sets out recommendations to strengthen the EU ETS as a driver of emissions reductions, competitiveness and strategic resilience.

For our specific positions on [aviation and shipping ETS](#), please consult our papers [HERE](#) and [HERE](#). See below, a short summary outlining T&E's key recommendations.

Aviation

- The proposal to cover all departing flights to airports within 5,000 km from Frankfurt is a pragmatic first step, but it's not enough. In line with the Commission's CORSIA assessment, the ETS aviation scope should cover all departing flights.
- Member States and the Parliament should support the extension of the SAF allowances, the shift towards more scalable fuels via the UCO and animal fat phase-out, and the made-in-Europe clause. The allowances should only be claimable in proportion to emissions covered by the ETS - if you don't pay into the ETS because you are not in the 5,000km radius, you should not be allowed to claim free European money. More than 10 million allowances should be bookable in advance, over more than 5 years, to prevent the allowances from running out too quickly. In addition, lower price coverage rates would improve the cost-efficiency of the scheme, while earmarking would improve its predictability.
 - SAF allowances should not come at the expense of double-sided auctions which are critical for the long-term revenue certainty of eSAF producers. The lack of inclusion of aviation and maritime synthetic fuels in the scope of the IDB is problematic in that regard.

- For the first time ever, a policy has been put in place to address the climate impact of contrails. Member States and the Parliament should support the innovative contrails allowances proposal, but ensure they truly support operational avoidance costs. Contrail allowances should be separated from the SAF allowance pot.
- Electric aircraft development is also supported, which is a great measure that will reward first movers.
- Private jets inclusion is extended to all arriving and departing flights. This is a first step to ensure the largest polluters pay a fair price for their emissions.

Shipping

- The proposal to include some categories of small ships (between 400 and 5000 GT) within the ETS scope is a welcome step. However, there is no reason not to include all categories of small ships, current exclusions leave around a third of these emissions uncovered, and will cost the EU €2.9bn between 2031 and 2035. Small passenger ferries in particular are often ideal candidates for electrification.
- The Commission decided to extend protections against carbon leakage, by including more ports in the list of non-EU ports counted as relevant ETS port calls. However, the ETS discount for 10,000+ TEU vessels involved in transshipment is a worrying addition which lets off some of the most polluting vessels and will distort the level playing field. The extension of other derogations until 2035 will also unnecessarily delay the transition and distort competition.
- The introduction of free allowances for sustainable marine fuel and propulsion technologies (SMAP) with significant price-gap coverage for e-fuels and clean propulsion technologies is an opportunity to incentivise e-fuels and electrification. However, fundamental changes are needed to make it work: without earmarked allowances for EU-made e-fuels and a mechanism to reserve allowances in advance, there's a risk that allowances will end up subsidising imported biofuels rather than the e-fuels and electrification the EU needs to scale. SMAP allowances should not come at the expense of establishing double-sided auctions (DSAs) or other support mechanisms for RFNBOs.
- The inclusion of a clear deduction mechanism to avoid "double payment" if the IMO adopts a global measure is important to reinforce the Maritime ETS, which will still be essential even if the IMO passes a global measure. In addition, the introduction of an ETS-as-a-service mechanism and allowances earmarked to support developing countries are helpful steps to move forward on shipping decarbonisation beyond Europe.

Stay aligned to the 2040 EU climate target and invest in electrification

The European Commission's proposal sets out structural adjustments to the EU ETS trajectory that align with the EU's 2040 climate objectives. **While making no changes to the Linear Reduction Factor (LRF) until 2031 is a welcome decision, lowering it to 3.7% for 2031-2035 and 1.7% for 2036-2040 would delay EU climate targets, create an oversupply of allowances that would undermine the long-term price signal, and jeopardise the business case for clean-tech frontrunners that have already invested in decarbonisation.**

Cutting the MSR intake rate from 24% to 12% of the Total Number of Allowances in Circulation (TNAC) would sharply reduce its capacity to absorb surplus allowances and weaken support for the carbon price. Diluting the MSR now would break investor expectations of steadily increasing scarcity, erode the long-term price signal, and heighten regulatory risk – pushing up financing costs for precisely the industries that need to invest most in the green transition.

Looking at the EU ETS financial architecture, **targeted funding tools** must be deployed to accelerate the industrial transformation, reduce fossil fuel reliance, and drive large-scale electrification across the continent.

Early action is driven by the **ETS Investment Booster**, which would deploy 400 million allowances before 2030 to provide fast-track, fixed carbon premia for pre-selected projects, with a strong focus on frontloading capital and reserving up to 160 million allowances specifically for lower-income Member States.

From 2031 onward, the newly established **Industrial Decarbonisation Bank** (IDB) should become the principal vehicle for scaling mature technologies via 10-year Carbon Contracts for Difference (CCfDs) and carbon premia.

Complementing this, an updated **Modernisation Fund** aims to expand its mandate to fund industrial electrification, and grid modernization in lower-income Member States, while the extended **Innovation Fund** intends to broaden its focus beyond first-of-a-kind projects to commercial deployment, clean-tech manufacturing, and low-carbon fuels.

By combining these structural grant and debt instruments with rigorous, investment-linked conditionality, the EU ETS framework should effectively **ring-fence capital to establish a predictable, long-term business case for made-in-Europe clean technologies and rapid industrial electrification.** For instance, reinvesting a share (25%) of aviation and maritime revenues back into these sectors would provide long-term certainty needed to scale up

made-in-Europe e-fuels and decarbonise our heaviest emitters. The EU Sustainable Transport Investment Plan (STIP) already commits the EU to establish a market intermediary to run double-sided auctions and dedicated financing support for e-fuels to de-risk industrial-scale projects. The proposed Industrial Decarbonisation Bank (IDB) and the initial ETS Investment Booster should be used to support such financing mechanisms.

Moreover, **EU ETS revenues must be actively recycled to support the structural technological shift needed to lower industrial carbon costs over time**. Currently, too little of the revenue generated by industrial emissions flows back to the sectors paying into the carbon market. A fairer contribution rate is key.

Out of the 50% of their national ETS revenues allocated to decarbonise priority sectors, **Member States should ring-fence an increasing portion for direct industrial transition and electrification. In addition, the remaining 50% should still be spent in actions supporting climate transition. The transparency clause regarding the use of these revenues (Article 10(3)(l)) and Article 19(2) of Regulation (EU) 2018/1999) should be strengthened to ensure Member-States comply with the climate requirements.**

Frontloading capital to close the EU investment gap: tackling Europe's climate investment gap requires immediate liquidity alongside gradual disbursements. To overcome national budget constraints, the EU must leverage future ETS revenues upfront - turbocharging investments before 2030. Therefore, the European Investment Bank (EIB) should establish a dedicated facility allowing Member States to **frontload at least €100 billion by borrowing against guaranteed future EU ETS revenues** - a structure that does not count as national debt. Additionally, selected incumbent industries should be permitted to leverage a portion of their 2026–2030 transitional free allowances as financial collateral to secure low-interest loans via National Promotional Banks (NPBs).

Frontloaded funds would unlock upfront capital for **strategic, zero-emission industrial assets, such as battery gigafactories and direct electrification infrastructure**, that would otherwise be delayed by tight annual national budgets. Frontloaded carbon revenues should complement existing initiatives, such as the ETS Investment Booster, to maximise economic impact. Furthermore, part of these frontloaded funds could capitalise the IDB, while remaining resources would be distributed to Member States via established allocation keys to **scale up European clean-tech manufacturing, including battery supply chains**.

Crucially, all funding channels must enforce **strict fossil-free governance** by completely phasing out any lingering support for fossil fuel-linked infrastructure or unmitigated gas projects, ensuring every euro of carbon revenue is channeled toward genuine additionality, clean industry, and European energy independence.

Prioritise internal emissions reductions over international carbon credits

The Commission proposes establishing a dedicated facility to purchase up to **260 Mt of high-quality Article 6 international carbon credits between 2036 and 2040**, funded by auctioning EUAs from within the EU ETS cap. The European Climate Law allows the EU to use international carbon credits equivalent to up to 5% of 1990 net emissions.

To increase the fairness and equity of its contribution to global mitigation, **the EU could consider including within its [2040 target](#) the acquisition of a limited amount of high-quality, high-integrity international carbon credits characterised by stringent eligibility criteria**. These should be considered only after a detailed impact assessment carried out by the Commission outlining the risks and benefits of a possible limited contribution of credits towards the 2040 target. They should **support partner third countries in pursuing transformative greenhouse gas reduction trajectories compatible with the Paris Agreement's** objective of holding the increase in the global average temperature to well below 2°C and pursuing efforts to limit it to 1.5°C above pre-industrial levels, for example renewables-based industrial development, including e-fuel production, provided mitigation outcomes are robustly attributed and claimed only once, and not also counted toward EU compliance obligations. **Where credits derive from removal activities, only permanent removals should qualify; credits based on non-permanent or land-based storage should be excluded in all cases.**

The Commission should adopt a legislative proposal outlining stringent **eligibility criteria** for international carbon credits, as well as guidelines for their purchase by Member States. Key eligibility criteria should include a guarantee that the EU and third countries purchase and use credits that contribute to GHG emission reduction targets compatible with the Paris Agreement's objective to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels. Moreover, the projects underpinning those credits should put in place transformative activities, while the net removal benefits generated by these credits should be measurable, verifiable, transparent, and [respect human rights](#). **If these stringent criteria cannot be guaranteed, international carbon credits should not form part of the EU's target.**

Having said that, while Article 6 of the Paris Agreement introduces new rules intended to create credible systems for both offsetting and international carbon markets, experience to date highlights [serious challenges](#). A key concern is double counting, where the same carbon credits are claimed by more than one actor. Additionally, empirical evidence has shown that carbon credits [have not brought the expected results in the past](#). Between 2008 and 2020, companies covered by the EU Emissions Trading System (ETS1) were permitted to purchase international credits, and more than 1.6 billion were used and problems arose. Many of the underlying projects

failed to deliver genuine emissions reductions, and some were linked to [fraud](#), too. The abundance of cheap credits also lowered the EU carbon price, making it easier for companies to continue polluting and slowing down domestic emissions cuts. In light of these shortcomings, the EU decided to stop accepting international credits after 2020.

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CDR integration must not lead to a net increase in emission space

The Commission proposes (new Article 9c) to raise the EU ETS cap by **250 million allowances between 2031 and 2040, auctioning them to fund its own purchase of an equivalent amount of biogenic emissions capture with carbon storage (BioCCS), and direct air capture with carbon storage (DACCS) removal units certified under the Carbon Removal Certification Framework (CRCF)**, with a further 10 million allowances (from within the existing cap) available to bridge the gap between removal costs and the allowance price. The Commission would be the sole purchaser, cancelling units on purchase; operators never hold or surrender removals. **The design intends a one-for-one match, but only the allowances are guaranteed: the removals delivered depend on what auction revenue can buy, and the Commission's own impact assessment prices DACCS above the allowance price for the whole period and BioCCS until 2036–38.**

T&E's central recommendation is that **this must not become a net increase in emission space** - a risk the Commission's own proposal concedes, admitting the measures "introduce uncertainty about reaching the net climate contribution of the EU ETS (carbon removals integration with a pre-increase of the cap)". Two safeguards follow. First, **allowances not auctioned by 2041 should be cancelled** - the proposal currently provides the opposite: Article 9c(3) returns them to the general cap as ordinary supply, preserving the emission space even if the removals programme fails entirely. Second, **where allowances are auctioned but the revenue buys fewer removal tonnes than allowances sold, the shortfall should be recovered by cancelling equivalent volumes from future auctions**, so the cap increase can never exceed removals actually delivered. Without those safeguards the mechanism prices in removals that current deployment gives no basis to expect: **EU BioCCS and DACCS remain negligible at commercial scale, and the CRCF has yet to recognise a single certification scheme, let alone certify a unit.**

Integration also needs a boundary: a legal definition of the residual emissions that removals are meant to compensate for. The proposal contains none, while granting what its own explanatory memorandum calls "guaranteed additional emission space for the hardest-to-abate sectors", its impact assessment declares the definition of hard-to-abate "highly disputed" and any operator-level link to it "politically unfeasible at this stage". T&E recommends that the EU ETS review deliver the legal definition of residual emissions that the European Climate Law still lacks - the only durable boundary on how far removals can extend. This matters directly for transport:

alongside central purchasing, the proposal would allow shipping companies and aircraft operators to compensate their own fossil emissions with CRCF-certified BioCCS generated from their own biogenic emissions. The design is cap-neutral (compensation is capped at zero, with matching allowances cancelled from the 250 million), but the provision should be tightly bound and closely monitored, as it is the one route by which removals become a compliance option for the sectors T&E covers, and it normalises exactly the operator-level use of removals that the proposal's 2034 review is mandated to consider extending "beyond own use".

Finally, **integration must not be built on the carbon that Europe's e-fuel projects depend on**. Biogenic point-source CO₂ - from bioethanol, pulp and paper, waste-to-energy - is simultaneously the feedstock for e-SAF and e-marine fuels and the input to BioCCS. A publicly funded purchaser bidding for that CO₂ at allowance-linked prices raises the cost of sustainable carbon for e-fuel plants already struggling to reach financial close.. **Procurement must not displace biogenic CO₂ from e-fuels for aviation and shipping. Separately, the 2034 review must not become the widening mechanism: its mandate to examine nature-based removals and carbon farming should be constrained by the proposal's own principle (recital 32) that only permanent removals can be integrated.**

Further information

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