POSITION PAPER

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The Future of the ETS, priorities for the chemical industry

Europe's chemical industry supports the transition towards climate neutrality. Nevertheless, further transformation requires the enabling conditions including: affordable and abundant low-carbon energy, market pull measures for low-carbon products, energy and carbon storage capacity and transport infrastructures, strong carbon leakage protection, and effective protection against unfair competition. In their absence, the sector's ability to deliver the transition will remain increasingly undermined by intense global competition from regions subject to less stringent climate rules and, lower energy costs, resulting in site closures in Europe.

In this context, the EU ETS must be urgently adapted well before 2030 into a more flexible, and industry-supportive framework reflecting industrial realities and enabling companies to remain competitive while progressing towards the EU's climate objectives. The role of carbon cost should be mitigated for companies, as long as the climate transition is not yet technically and economically feasible. Without such adjustments, Europe risks losing industrial capacity without delivering any climate benefit, while increasing dependencies, and for reasons going beyond industry's control.

A resilient and future-proof ETS should be anchored in a clear set of principles guiding any future revision. These include:

- A realistic cap trajectory,
- Strong carbon leakage safeguard,
- Appropriate benchmark values fully reflecting the situation of the chemical sector,
- Removal of the MSR invalidation rule,
- Avoid conditionality for carbon leakage mitigation,
- Integration of carbon removals and carbon circularity,
- Elimination of conflicting regulations through a coherent legal framework,
- Implementation of Article 6 of the Paris Agreement, and linking the ETS to similar schemes,

- Improved investment conditions driven by market demand for low-carbon goods, and ETS revenues fully redirected to industry.

During the ETS revision these elements should be negotiated and assessed separately, as well as in combination, particularly evaluating their impact on the competitiveness of industry.

Beyond the Commission's intention to align the ETS framework with the 2040 climate target, including by extending the availability of free allocation beyond 2039, it is crucial to stress the need for urgent action to support the chemical industry during this challenging period and in the transition further.

Hence, industry requires a more realistic approach to what is technically and economically achievable in the short, medium, and long term reflecting on the key conditions that should lead to an improved ETS beyond 2030.

A realistic cap timeline

Currently, the ETS cap is set to reach zero by 2039, but this trajectory is impracticable. Technology, low carbon energy and infrastructure development across Europe have not reached the required level for a successful transition based on industrial transformation. Within the accelerated timeline it is also unclear how residual emissions will be addressed. This is resulting in an increasing gap between the regulatory framework and the feasibility and affordability of technical implementation through robust business cases. Industry, especially hard-to-abate sectors like chemicals, is more exposed to the risk of carbon leakage. Structural changes to the ETS, such as integrating carbon removals, allowing greater flexibility, and recognising sector-specific abatement needs as well, are needed.

When transposing the 2040 ambition into the ETS, also the review mechanism should be fully reflected, by introducing an automatic adjustment mechanism to the cap whenever essential enabling conditions mentioned above are not met.

Cefic urgently asks for a more pragmatic approach to setting the ETS cap decline. The current trajectory should be slowed down as soon as possible, before 2030, and recalibrated to remain consistent with the EU climate neutrality objective.

The cap decline should reflect the actual pace of enabling conditions such as effective market pull measures for low-carbon products, energy and CO2 infrastructures, access to economically viable low-carbon energy, robust protection against carbon leakage and unfair competition.

Strong carbon leakage protection

The persistent asymmetry in carbon pricing between Europe and the rest of the world, the uncertainty surrounding the effectiveness of CBAM, and the reduction of free ETS allowances raise significant concerns for the chemical industry regarding safeguards against carbon leakage. It is a priority that the debate on carbon pricing addresses the need for an immediate robust carbon leakage protection. Tightened benchmark values and limitation in free allowances allocation, expose industry to increased carbon costs at a time where EU industry is facing high energy and regulatory costs and increasing competition, further limiting its capacity to invest, and risking to accelerate shutdowns. Therefore, maintaining an adequate level of free allocation and ensuring in parallel compensation for indirect carbon costs remain essential pillars of effective carbon leakage protection.

The chemical sector regards effective carbon leakage protection as fundamentally rooted in a sufficient allocation of free allowances and indirect carbon cost compensation.

Appropriate benchmark values

Benchmark values should be based on realistic performance levels, reflecting the EU-wide availability of energy, feedstock, process technologies and infrastructure. Parameters based on unrealistic extrapolation, anticipated future performance, and inappropriate mathematical baselines must be removed. Benchmarks should also reflect the technology available to a representative part of the production activity of the installations concerned. Where installations use resources, infrastructures or technologies that cannot be implemented in economies of scale in Europe, those installations should not determine the benchmark. This approach would also reduce the applicability of the cross-sectoral correction factor.

Cefic calls for a more realistic and transparent approach when designing benchmark values with a more appropriate exercise of calculation of the performance level and reflecting the current technology progress.

The recent 50% reduction in fallback benchmarks for heat and fuel under the EU ETS is excessive, unrealistic, and not supported by the actual transition potential of the chemical sector. It indicates these benchmarks are being based on a few cases (e.g. highly subsidized pilot projects, biomass, electrification

of heat generation, heat recovery from exothermal chemical processes) rather than technologies and resources that are widely available across regions and installations. Cefic warns that such a sharp cut to the benchmarks would significantly raise carbon costs for heat-intensive chemical plants, increase the risk of carbon leakage and relocation outside Europe, and reduce the sector's ability to invest in the climate transition.

Cefic therefore calls for the fallback benchmark update to be based on a consistent methodology, including a possible reconsideration of literature-based values, in order to mitigate the reduction currently adopted. Any methodology should duly reflect the specific characteristics of the chemical sector and ensure that disproportionate reductions are avoided.

Removing the MSR invalidation rule

Currently, the effectiveness of the MSR (Market Stability Reserve) to tackle future scarcity is questioned. The MSR needs more versatility to address the consequences of rapid economic changes leading to limited liquidity in the ETS market, by strengthening supply rather than invalidating allowances.

Cefic calls for an immediate reform of the MSR to halt any further invalidation of allowances, reassess intake and release rules in light of any potential change to the Linear Reduction Factor, and make the mechanism more agile. The MSR should also better reflect carbon price developments and safeguard adequate liquidity in the EU ETS.

Conditionality

Already in the last ETS revision, new conditionalities for obtaining free allowances were introduced on the basis of recommendations from energy audits under the Energy Efficiency Directive. This resulted in extra obligations for industry, which continues being exposed to the carbon price signal, without delivering tangible added value. Current discussions suggest that similar approaches may be further expanded in the upcoming legislation, adding conditionality criteria as a precondition to provide support to prevent the risk of carbon leakage.

With such an approach, conditionality will weaken the ETS's core function of preventing carbon leakage, forcing companies to explore investment in technologies that are not economically viable while adding administrative burden and regulatory overlaps.

Considering the current economic situation and the lack enabling conditions to further speed-up industry transition, introducing extra limitations to receive free allowances would only increase ETS compliance costs exposure as well as reduce CAPEX and OPEX capacity, further hindering investments towards climate neutrality.

The free allocation is an approach to reduce the risk of carbon leakage and not to incentivize investments. Cefic therefore calls for avoiding conditionality for access to free allowances in the revised ETS, given the already difficult operating context for industry and the continued absence of key enablers for the climate transition.

Recognition of carbon removals and carbon circularity

A robust CO2 accounting should be the basis to an effective ETS. The current rules differentiate between fossil CO2 (fully counted), CO2 from sustainable biomass (zero-rated), and the exemption of surrendering allowances for ETS installations that perform permanent Carbon Capture Use and Storage (CCUS). However, effective accounting for non-permanent carbon capture and utilisation (CCU) and permanent carbon removals is essential to prevent that these are disincentivised. Cefic reflects on some technology routes, which require proper rules for avoidance and removal of CO_2 under ETS review.

- **CCU to chemicals from fossil CO2**, transforming captured CO2 into chemicals (and materials). This requires revising the concept of "permanently chemically bound" including at the end-of-life as in the ETS directive, therefore encompassing the waste sector into the ETS. Hence, the utilisation of captured fossil CO_2 for the production of chemicals requires a downstream accounting (waste incineration), unless practically not possible such as in the case of urea.
- **CCU to fuels from fossil CO2** where captured CO2 produces synthetic fuels. Recent MRR review zero-rate CO2 emitted when combusting RFNBO, but the CO2 captured and used to produce fuels is rightfully accounted. The CO2 cost should remain upstream.
- **CCU to chemicals from biogenic CO2 or DAC** binding carbon from atmospheric CO_2 or CO_2 from sustainable biomass in chemicals should be recognized as removals at the production stage, while potential end-of-life emissions should be accounted downstream (waste incineration).
- **CCS with biogenic CO2 or with CO2 from Direct Air Capture (DAC)**, which are currently not recognised into the ETS. These could be included either modifying the Monitoring and Reporting Regulation (MRR)

art 49 or referencing to the Carbon Removal Certification Framework (CRCF) as this recognises as a permanent carbon removal any activity capturing and storing atmospheric or biogenic carbon.

- Use of bio-based feedstock assigning credits that chemically bind biogenic carbon in chemicals from sustainable bio-based feedstock.

For the chemical industry, a consistent CO2 accounting allows the use of both permanent carbon removals and non-permanent CCU, with a clear distinction between non-permanent CCU products (with a downstream accounting) and CCU fuels (with an upstream accounting).

Avoid conflicting legislation

The increasing overlap between EU climate and energy legislation has made it harder for companies to invest in low-carbon solutions. Allowing all eligible CO2 sources to account for RFNBO or RCF production could remove the challenges presented by RED III and support the development of CCU. Moreover, the RFNBOs target for industry does not align with the principle of technology neutrality and GHG reduction in a cost-effective way as established by the ETS and has no associated carbon leakage cost mitigation.

Cefic recommends regulatory coherence across EU legislation to ensure simple, implementable rules that support low-carbon solutions.

Implementation of Art. 6 Paris Agreement and bilateral linkage

The introduction of international credits would enhance the liquidity of the ETS after 2030 and beyond. The implementation of Article 6 of the Paris Agreement, which establishes an international carbon crediting mechanism will be incorporated within the Union since the EU is a signatory to the agreement.

In addition, bilateral linking the ETS with similar systems of other countries would help to increase liquidity, fostering climate change mitigation. A recent positive example is the proposal of the EU and UK authorities to link their respective ETS systems.

The Chemical Industry recognises the steady implementation of Article 6 as a valid policy option to improve mid-and long-term liquidity in the EU ETS, ensuring consistency with existing criteria applicable within EU. Considering that this operationalisation may lead to invest EU industry funds in non-EU economies, an international common understanding of these credits is critical to avoid double counting and ensuring the same quality as the EU processes.

Adequate investments framework

Currently, Europe lacks the conditions needed for industry investments. Due to the current complexity of regulatory environment in the EU, combined with a challenging international business climate, and the absence of demand-side market value for lower-carbon products, it is essential to re-think how to enable EU industry to be competitive at a global scale and progress towards climate transition.

ETS revenues should fund not only project-tech development like in the case of the Innovation Fund but, at the same time, broader market-forming policies should also be established. Recognising sector specific technological, infrastructural and operational constraints will help hard-to-abate sectors to be part of support systems as well.

Furthermore, ETS revenues should be fully channeled back to the industries in scope to support reinvestment in their climate transition, whereas currently only 5%[1] is redirected for this purpose.

Trade-exposed companies lack the business-case for their low-carbon products. The EU needs to create markets focusing on the consumer demand side, which needs to systematically value lower carbon goods and services. Absent that, there can never be a realistic business case for trade exposed Industry to make the massive investments required for the transition at scale.

Cefic requests that in the future ETS, the dimension of market pull measures targeting consumer products, should also be further developed simultaneously. This approach will be critical for businesses to remain competitive and advance towards climate transition, while being protected against carbon leakage.

[1] Data confirmed by the Commission during the High-Level Stakeholders ETS Roundtable 12.05.26 based on the report on the Functioning of the European Carbon Market in 2024 available here

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About Cefic

Cefic, the European Chemical Industry Council, is the forum of large, medium and small chemical companies across Europe, accounting for 1.2 million jobs and 13% of world chemicals production.

On behalf of its members, Cefic's experts share industry insights and trends, and offer views and input to the EU agenda. Cefic also provides members with services, like guidance and trainings on regulatory and technical matters, while also contributing to the advancement of scientific knowledge.