

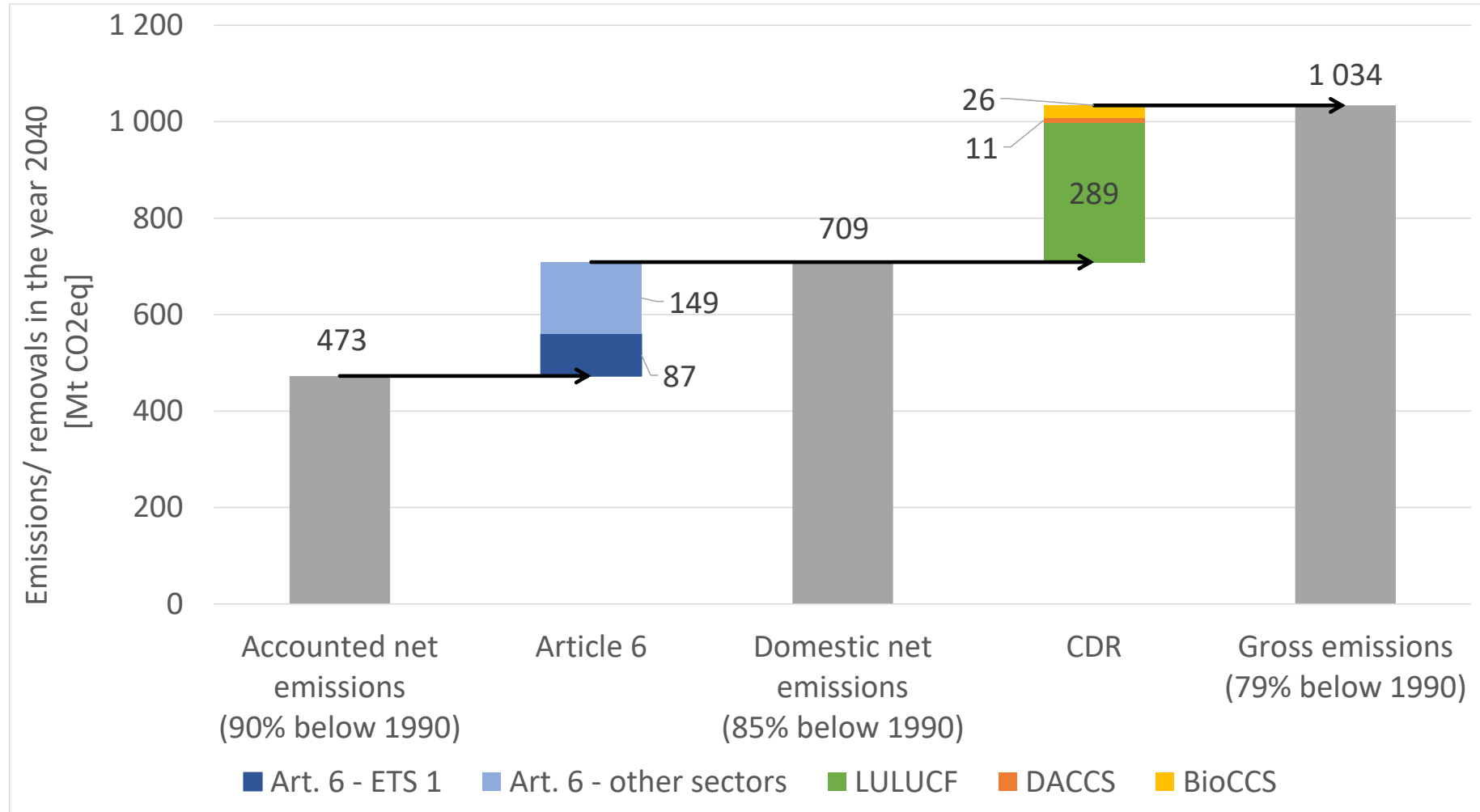


Out of Balance

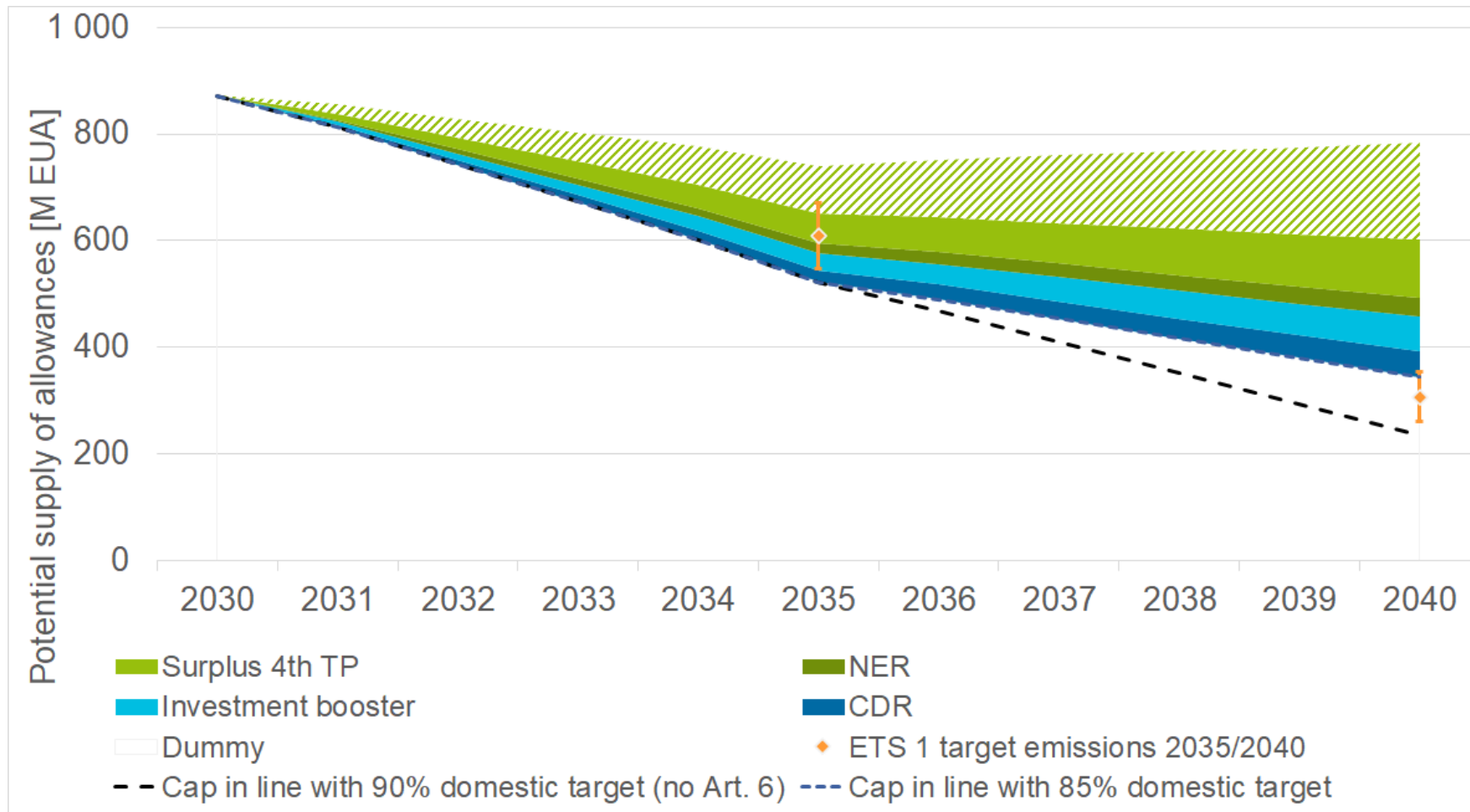
Assessing the 2026 Commission proposal for the EU ETS 1

Jakob Graichen | Vordenkwerk ETS Review & Conditionality| Berlin, 05.10. 2026

Emissions and removals in 2040



Potential emissions in the ETS 1 under the reform proposal



ETS 1 emissions could be double of cap in 2040:

- LRF
 - Is at the ambitious NDC-range in 2035
 - in line with 2040 target with/without Article 6
- Oversupply through (potential) quantities on top of cap
 - CDR
 - Investment booster
 - NER
 - Market surplus 2030
 - MSR holdings

Are CDR treated in a safe way?

CDR financing mechanism through the ETS: 250 M EUA are added **on top of the cap** to generate revenues for the purchase of an equivalent amount of domestic permanent carbon removal units generated by BioCCS and DACCS activities under the CRCF Regulation

One-to-one even after additional 10 Mio EUA relation between CDR and EUA is very optimistic:

Technology costs (EUR)	2030			2035			2040		
	BECCS	DACCS	Biochar	BECCS	DACCS	Biochar	BECCS	DACCS	Biochar
Lower bound	167	288	66	163	201	50	160	185	37
Average	214	428	141	196	302	113	176	278	88
Upper bound	261	567	215	228	402	175	192	370	138

[CO₂ Price indices from Primes/ Impact Assessment 2028=100, 2030: 88; 2035: 145; 2040: 228]



Too many international credits are designated for the EU ETS

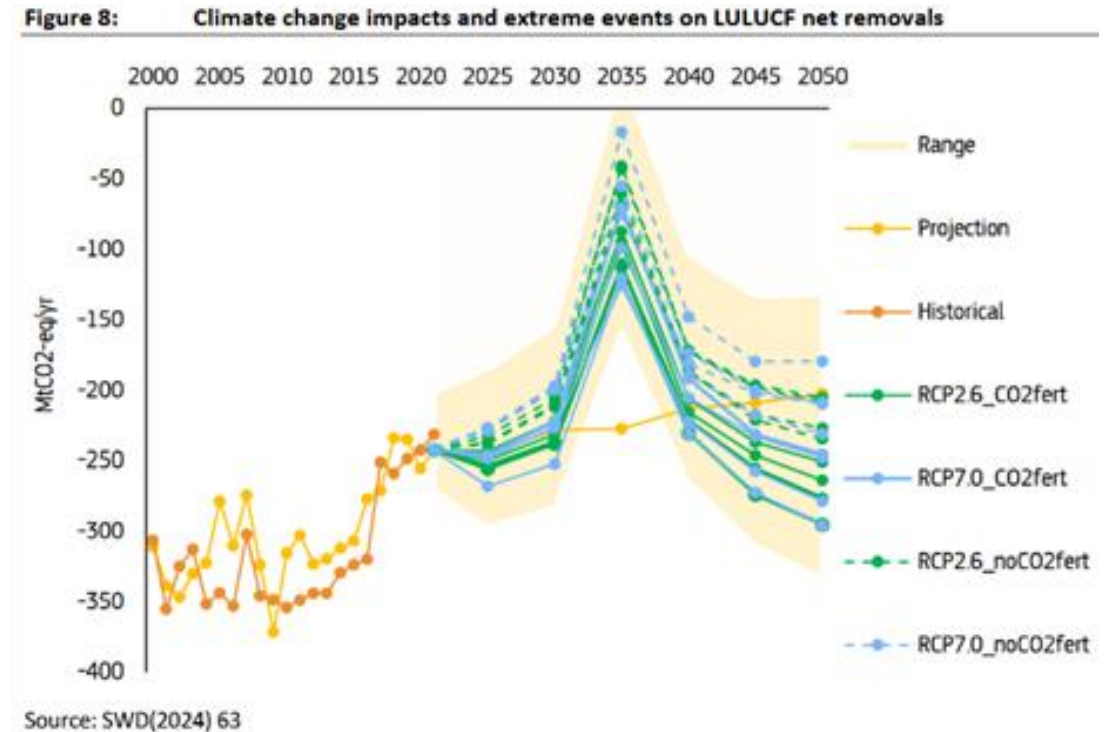
COM proposal:

- 260 Mt CO₂ in total, 87 M EUA in 2040
- 37% of total quantity (1.8% of 1990 net emissions)

But: LULUCF needs safety reserve

- “shortfall not at the expense of other economic sectors”
- Uncertainties in the LULUCF-sector
 - 100 Mt/year even without extreme events
 - 200 Mt/year with extreme events
 - 40% uncertainty in LULUCF inventories

Additionally: Share of ETS1 in total emissions 20-25%



MSR becomes more dynamic but weaker

- MSR becomes more dynamic with faster reaction
 - TNAC-definition used to trigger MSR-activity is updated to include formerly ignored demand from aviation
 - Thresholds are gradually lowered to reflect smaller ETS
 - Outflow rate becomes dynamic to avoid threshold effects
- MSR becomes less able to deal with new surplus
 - Intake rate will return to 12% from 2028 already
 - Separate proposal on invalidation
 - COM: end invalidation in MSR asap
 - EP: set limit to 650 M EUA (from 400 today)
 - Council: end invalidation asap, declining limit from 2031 onwards, starting at 800 M EUA

Aviation ETS

- In theory: full scope should be back on the table (all in- and outgoing flight)
- Proposal:
 - include all aerodromes within 5000 km from Frankfurt
 - Best likely scope given the political realities
- Proposed scope minimises distortion of competition on routes to the east (less of a potential issues towards west/south)



Key Messages

- Risk of significant oversupply until 2040: LRF, additional supply through CDR and Investment booster, market holdings at the end of 2030 and MSR exceed demand by 35%
- Risk of missing climate objectives: Integrity of Article 6 credits unclear, additional ETS emissions linked to future but uncertain permanent CDR
- MSR becomes more dynamic but will be less able to remove future surplus from the system: Updated TNAC-definition and thresholds but lower intake rate and end of invalidation
- More free allocation and more auctioning quantities: Lower LRF increases supply, and investment conditionality might push industry transformation, but carbon price will be much lower undermining need to act
- Scope extension for aviation is good compromise between climate protection and political realities



Out of balance

Assessing the 2026 Commission proposal for the EU ETS 1

// Jakob Graichen, Sabine Gores, Johanna Cludius, Nora Wissner, Felix Matthes

This policy brief provides a quantitative assessment of the proposal by the EU Commission for the reform of the EU ETS 1.

Key messages

- **Significant oversupply in 2031–2040:** The lower LRF, additional allowances for the Investment Booster and CDR, and the carry-over of market surplus and MSR holdings from previous periods would result in allowance supply substantially exceeding projected demand. This would weaken the carbon-price signal and risk undermining the EU's 2040 target. The LRF should remain at 4.4% until 2035 at the least.
- The indirect inclusion of **international credits and CDR** increases emissions inside the ETS but commensurate emission reductions outside the ETS are not guaranteed. Especially for CDR it seems unlikely that the funding will be sufficient.
- **MSR reforms have mixed implications:** Dynamic thresholds, the lower buffer and the updated TNAC definition—including historic net aviation demand—would improve the MSR's responsiveness and smooth allowance releases. However, the lower intake rate and the removal of invalidation would weaken its ability to absorb and permanently remove surplus allowances.
- **Free allocation increases substantially:** The proposal would significantly increase the volume and value of free allocation to industry, while introducing broader decarbonisation investment conditionalities from 2031.
- **Higher auction volumes and revenues entail a trade-off:** Additional auctioning due to a higher cap would raise revenues, but also increase supply and risk weakening the carbon-price signal reinforcing carbon lock-in.
- **Scope extension for aviation** is a balanced compromise between responsibility and political realities. The extension of carbon price to more shipping activities and waste incineration further strengthens the ETS.

Out of balance

Many more details can be found in our assessment:

<https://www.oeko.de/en/publications/assessing-the-2026-commission-proposal-for-the-eu-ets-1/>



Two new ETS reports are expected to be published mid/late October.



Any questions or comments?