EU Carbon Market Revision: Three Implications of the European Commission's 2026 Reform for Industry

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Context

The Emissions Trading System (ETS) is the cornerstone of EU climate policy. Operating for more than 20 years, it has successfully halved emissions from the sectors it covers.[1] While a significant part of the emissions cuts has come from the decarbonisation of the power sector, Europe's emissions have also been influenced by broader industrial trends, including deindustrialisation and the permanent closure of numerous factories.

On 17 July, the European Commission proposed a revision of the EU ETS to establish the post-2030 rules for the world's largest carbon market. The new proposal would place the EU on a more gradual decarbonisation pathway and comes with a promise of increased support for innovation, emissions reduction investments and sustainable aviation and maritime fuels. The Commission foresees that at least €30 billion in support measures could be available before 2030.[2]

The revision, which will now be scrutinised by the European Parliament and Council, comes at a particularly politically charged moment. Energy prices are high, the geopolitical environment remains unstable and European industry faces growing challenges in an increasingly competitive global market. As a result, the proposal aims to rebalance climate ambition with competitiveness concerns and offer support to both emerging technologies and longstanding industries in need of decarbonisation.

Key Takeaways for Industry

1. A Broader and More Flexible Carbon Market

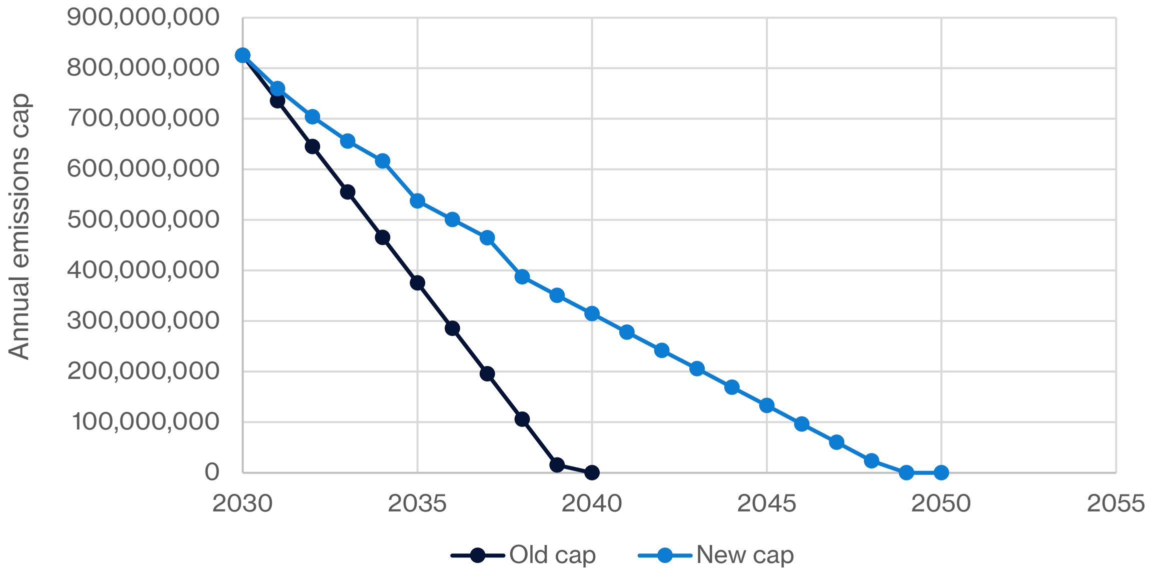
For two decades, the logic of the EU ETS has been to reduce the number of carbon allowances over time and allow the carbon price to drive decarbonisation. The Commission's proposal would broaden that approach by expanding the scope of the carbon market, introducing greater flexibility, seeking to mitigate price volatility and strengthening funding mechanisms for industrial decarbonisation.

That shift is visible throughout the proposal. The pace at which allowances are removed from the market would slow after 2030, while new flexibility mechanisms would broaden the ways in which emissions reductions can be achieved. Under the revised proposal, the ETS would expand further into aviation and maritime transport, while new sectors such as municipal waste incineration would gradually be brought into scope. Perhaps most strikingly, the Commission proposes an "ETS as a Service" model that would allow interested third countries to adopt EU ETS-style carbon pricing for aviation and maritime, effectively extending the reach of the system beyond the EU's borders.

[1] European Commission, EU Emissions Trading System, July 2026

[2] European Commission, Questions and answers on the EU Emissions Trading System (EU ETS) review, July 2026

Figure 1. The tightening of the ETS emissions cap under the current (old) trajectory versus what is proposed in the revision.[3]



The introduction of international carbon credits is equally significant. From 2036, up to 260 million credits could enter the system, but only if the Commission concludes by 2033 that a sufficiently robust international carbon credit market exists. If it does not, the EU would tighten the cap instead. For business, this means that a future political assessment by the Commission will determine one of the key drivers of the post-2035 carbon market years after the legislative framework has been finalised. The carbon market would therefore become not only larger but also more actively managed.

Taken together, the slower reduction in the emissions cap, the proposed use of international carbon credits, the integration of permanent carbon removals and the remaining allowance surplus suggest that the Commission is seeking to avoid structural allowance scarcity over the next decade.

2. More Flexibility, but Not a Free Pass

The Commission's proposal reflects a growing recognition that price alone will not deliver Europe's industrial transformation. Instead, the ETS is evolving into a broader industrial policy framework, offering companies greater flexibility in how they decarbonise while placing more conditions on access to its benefits.

The clearest example is the introduction of permanent carbon removals into the system. Rather than relying solely on a progressively tightening allowances cap, the revision proposes creating additional room for emissions through the purchase of certified carbon removals. It is a fundamental shift in how the ETS works and reflects an acceptance that hard-to-abate sectors,

[3] Teneo analysis based on the European Commission's proposed revision of the EU ETS and the current ETS linear reduction factor (LRF) trajectory.

especially those with process emissions, will require more than emissions reductions alone to reach climate neutrality.

That flexibility, however, comes with a quid pro quo. The Commission is proposing to slow the phase-out of free allocation, but only for companies willing to reinvest an equivalent value into industrial decarbonisation in Europe. Businesses would be required to publish "Invest in EU decarbonisation plans," demonstrate that projects have been delivered and risk repaying the costs of previously received free allocation if production is relocated outside the EU. The message here is straightforward: public support will increasingly be tied to domestic investment.

Whether this bargain proves attractive remains an open question. Industry is likely to welcome the slower withdrawal of free allocation and the expansion of funding mechanisms. At the same time, businesses may question whether the additional reporting requirements, investment conditions and reliance on future secondary legislation create more administrative burden and uncertainty than additional flexibility.

3. Will the Money Follow the Ambition?

As part of the revision, Brussels is unveiling a reformed funding architecture built around the €100 billion Industrial Decarbonisation Bank, the €30 billion ETS Investment Booster, an expanded Innovation Fund and a strengthened Modernisation Fund.[4] The Commission is also seeking to steer national spending by requiring Member States to dedicate at least 50% of their ETS auction revenues to industrial decarbonisation and related climate investments, potentially shifting funding towards energy-intensive industries, clean technologies and hard-to-abate sectors at the expense of competing national priorities.[5]

For companies, the question is no longer only how much compliance with the ETS will cost, but also whether they can successfully compete for public support to finance their transition. The Commission clearly hopes that carbon pricing and industrial subsidies will increasingly work hand in hand, particularly for sectors facing international competition and high investment costs.

Yet the headline figures are more aspirational funding targets than fixed budgetary commitments. Much of the proposed financing depends on future ETS revenues, which in turn depend on carbon prices. The Industrial Decarbonisation Bank also assumes significant national and private co-financing. Even where funding already exists, delivery has been slower than expected: according to the Commission itself, less than 5% of the €7.1 billion awarded through the Innovation Fund has actually reached projects.[6] For businesses making investment decisions today, actual access to funding and time-to-money are likely to matter more than the headline figures announced in Brussels.

[4] European Commission, Questions and answers on the EU Emissions Trading System (EU ETS) review, July 2026
[5] European Commission, Directive of The European Parliament and of The Council, July 2026
[6] Financial Times, Companies Swamped by 3,000 Hours of Paperwork to Tap EU Climate Funds

Next Steps

The proposal will now be negotiated by the European Parliament and the Council. More than the EU's climate ambition itself, the central political debate is likely to focus on whether the Commission's proposal has struck the right balance between industrial competitiveness and climate action.

Frontrunners have raised concerns that lower climate ambition would weaken the price signal and make their investments less worthwhile. Other parts of industry can be expected to push for greater flexibility and financial support, while climate-focused Member States, MEPs and NGOs are likely to argue that the proposal delays emissions reductions and extends Europe's dependence on fossil fuel imports.

Although the Commission hopes to conclude negotiations by the end of the first quarter of 2027, the political sensitivity of these trade-offs makes a longer legislative process likely.

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