Let’s Be Radically Honest about the EU ETS

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Few European policies are under greater pressure than the EU Emissions Trading System (ETS). Business leaders, trade unions, and large parts of the political spectrum increasingly see a far-reaching ETS reform as a lifeline for Europe's struggling industrial base.

Their concerns are real. High energy prices, sluggish infrastructure deployment, global overcapacity, and intensifying geoeconomic competition are putting Europe's energy-intensive industries under growing pressure to adapt. Germany, once Europe's export powerhouse, is feeling the pressure particularly acutely.

Earlier this year, Germany's chemical industry called for an "emergency brake" on the ETS. Shortly afterwards, the German Chancellor publicly took up these concerns at the Antwerp Industry Summit, while Germany's conservative CDU has since become openly divided over the future of climate policy.

When pioneering companies, emerging clean industries, and leading scientific advisory bodies subsequently pushed back against weakening the ETS, one thing became clear: **the upcoming ETS reform has long since become a proxy battle over Europe's industrial future**.

As a result, expectations surrounding the reform have continued to grow – and now risk spiralling out of control. **Increasingly, the ETS is expected to solve problems that it neither created nor can resolve on its own**.

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The ETS Is an Effective Industrial and Geoeconomic Policy Tool

The increasingly blurred boundaries between climate, industrial, and geopolitical policy are no coincidence. Today, the ETS shapes policy outcomes that extend well beyond cutting emissions.

First, **the ETS has demonstrably increased innovation among regulated firms**. By creating incentives to develop and deploy low-carbon technologies, it directly shapes Europe's industrial transformation.

Moreover, the planned integration of carbon dioxide removals into the carbon market is an important shift in industrial policy. For the first time, an emerging economic sector – with its own value creation and employment potential – will become part of the system.

Second, together with the gradual introduction of the Carbon Border Adjustment Mechanism (CBAM), **the ETS extends the reach of European climate policy beyond EU borders**. Companies outside Europe gain incentives to decarbonise their production in order to maintain access to the European market. This is particularly relevant for countries with abundant renewable energy resources.

At the same time, an increasing number of countries – including China, India, and Brazil – are introducing or expanding carbon pricing systems of their own, allowing them to retain carbon pricing revenues domestically rather than effectively transferring them to the EU. Economic theory has long predicted this response, and empirical evidence is increasingly pointing in the same direction.

Third, **the ETS strengthens Europe's geopolitical security**. By reducing demand for fossil fuels, the carbon price lowers Europe's exposure to energy price shocks.

Recent estimates suggest that an ETS surcharge of only €12/t – if accompanied by appropriate revenue recycling – would have provided protection comparable to the European gas price cap while delivering twice the emissions reductions. At the same time, lower fossil fuel imports reduce Europe's dependence on countries that use fossil fuel revenues to finance military power projection.

The ETS Has Become a Proxy for Europe's Structural Problems

These successes should not obscure the fact that many of today's industrial challenges lie outside the ETS's direct sphere of influence.

This is particularly evident in the ongoing structural transformation of European industry. Not every existing business model will remain viable. Put bluntly, if Europe wants to preserve its steel industry despite comparatively high electricity and hydrogen costs, it will likely have to import a larger share of primary iron.

The same applies to basic chemicals. Where structural disadvantages can only be offset through permanent subsidies, Europe should not seek to preserve every step of the value chain. **Sound industrial policy also requires the discipline to let uncompetitive production stages relocate**.

Yet even where Europe has genuine industrial opportunities, the conditions for a successful transformation are often missing. Energy-intensive firms face rising carbon prices while high electricity costs, insufficient hydrogen supply and inadequate CO_2 transport infrastructure continue to impede the main pathways to decarbonisation.

Electrification, hydrogen, and carbon capture and storage (CCS) have long been recognised as central technologies for industrial decarbonisation, but the enabling conditions for their large-scale deployment remain incomplete.

Ensuring that these technologies become available in time is therefore one of the defining challenges of the next phase of decarbonisation. Carbon prices currently fluctuate around €80/t and are likely to reach several hundred euros over the long term. **This makes reliable investment conditions, targeted public support, and strategic use of ETS revenues increasingly important so that firms are not left facing steadily rising carbon prices without viable alternatives**.

If Member States fail to provide the necessary political and financial conditions, pressure on industry will continue to mount. At the same time, the ETS itself will come under increasing political pressure, as rising carbon prices expose

unresolved structural shortcomings and thereby fuel demands for short-term interventions in the carbon market.

As a result, expectations placed on the ETS continue to expand beyond what it can realistically deliver. **Neither high electricity prices, missing infrastructure, nor unresolved structural competitiveness challenges can be solved through ETS reform alone**.

The ETS has Clear Capacity Limits

The central challenge of the upcoming reform is therefore not to burden the ETS with ever more expectations. Rather, policymakers must distinguish clearly between the problems that carbon pricing can solve and those that require different policy instruments.

Within the ETS, this means avoiding a reform debate centred on industries whose structural competitiveness challenges cannot be solved through carbon pricing. Auction revenues should also be used more strategically to accelerate investment in Europe's industrial transformation. Finally, carbon pricing should be recognised as a tool that can help economies adjust to fossil energy supply shocks, rather than being weakened whenever energy markets come under stress.

Beyond the ETS, Europe needs an honest debate about which industrial activities have a sustainable long-term future. Germany and the European Union should focus industrial policy on innovative value creation and strategic lead markets. That requires addressing the key enablers of industrial transformation: lower and more flexible electricity prices, large-scale deployment of hydrogen and CO_2 transport infrastructure, deeper capital markets, a stronger single market and effective protection against unfair international competition.

Treating the ETS as a repair mechanism for problems that lie beyond its capabilities ultimately risks undermining precisely what makes it so valuable: its credibility as a long-term investment framework. **The ETS should not be stretched beyond its purpose – not because it is a weak policy instrument, but because it is too important to Europe's industrial future to be compromised**.

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