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Commonalities and Differences Between the EU ETS 1 and the UK ETS:

Considerations for Linking

1 Introduction

The European Union Emissions Trading System (EU ETS 1) and the United Kingdom Emissions Trading System (UK ETS) are cornerstones of the respective jurisdiction's climate mitigation policy. The EU ETS 1, launched in 2005, is the world's largest cap-and trade program, covering emissions from electricity and heat generation, energy-intensive industries, intra-European Economic Area (EEA) aviation, and (since 2024) maritime transport. After the UK's exit from the EU in 2020 (Brexit), the UK ETS was established in January 2021 as a standalone system, largely mirroring the EU ETS 1 design and scope but featuring some specific national adjustments. Both systems will be revised in certain areas soon and, because of political processes in each of the jurisdictions, they may increasingly diverge.

Yet, 19 May 2025 marked a turning point in the history of both ETSs. When UK and EU leaders met for their first joint summit since Brexit, they agreed a Common Understanding[1] that includes the intention to link both ETSs. The UK ETS and EU ETS 1 seem thus on track to grow closer together again, if the negotiation of a legally binding linking agreement is successful.

The linking intention is part of a larger effort to reduce unnecessary barriers to trade and investment across the two jurisdictions.[2] From a climate-policy perspective, linking the two systems can increase efficiency. In fact, already the 2021 EU–UK Trade and Cooperation Agreement explicitly encouraged both parties to consider linking their ETSs.[3] A linked EU–UK ETS could reduce compliance costs for regulated entities, create a larger, more liquid market, and enhance the overall cost-effectiveness of abatement. Another major motivation for both sides are the Carbon Border Adjustment Mechanisms (CBAMs) that both the EU and the UK have implemented or announced: The EU CBAM is already in force since October 2023. The definitive phase started in 2026. The UK has announced a national CBAM with a similar scope to the EU CBAM from 2027.[4]

Building on these developments and ETS similarities, Chapter IV of the UK-EU Common Understanding expresses the intention to link the EU ETS 1[5] and the UK ETS[6] through a formal agreement, which will lay the foundation for an official link between the two systems.[7] Once

[1] A renewed agenda for European Union–United Kingdom cooperation Common Understanding. https://ec.europa.eu/commission/presscorner/detail/en/statement_25_1267 (last accessed on 15 December 2025).

[2] A renewed agenda for European Union–United Kingdom cooperation Common Understanding. https://ec.europa.eu/commission/presscorner/detail/en/statement_25_1267 (last accessed on 15 December 2025).

[3] The EU-UK Trade and Cooperation Agreement. https://commission.europa.eu/strategy-and-policy/relations-united-kingdom/eu-uk-trade-and-cooperation-agreement_en (last accessed on 15 December 2025).

[4] UK Government. Factsheet: Carbon border adjustment mechanism. https://commission.europa.eu/strategy-and-policy/relations-united-kingdom/eu-uk-trade-and-cooperation-agreement_en (last accessed on 15 December 2025).

[5] International Carbon Action Partnership (ICAP). EU ETS 1 factsheet. https://icapcarbonaction.com/en/ets/eu-emissions-trading-system-eu-ets (last accessed on 15 December 2025).

[6] International Carbon Action Partnership (ICAP). UK ETS factsheet. https://icapcarbonaction.com/en/ets/uk-emissions-trading-scheme (last accessed on 15 December 2025).

[7] A renewed agenda for European Union–United Kingdom cooperation Common Understanding. https://ec.europa.eu/commission/presscorner/detail/en/statement_25_1267 (last accessed on 15 December 2025).

implemented, allowances issued under either system would be mutually recognised for compliance in both. Additionally, the linking agreement is planned to create the conditions for mutual exemptions from the respective CBAM, contingent on compliance with relevant legislation.

On 12 November 2025, as a follow up to the UK-EU Common Understanding, EU Member States unanimously agreed on a negotiating mandate for the European Commission to open negotiations with the UK on linking the EU and UK ETSs.[8] Negotiations started in early 2026. While the associated benefits are substantial, linking the two systems also poses challenges, as it requires close alignment of core design features, legal frameworks, and climate ambition in order to function effectively and equitably. In general, there is a risk of market distortion when there are differences in central design elements. These opportunities and risks make linking a complicated yet potentially transformative approach to ETS development.

This paper compares the EU ETS 1 and UK ETS to identify their commonalities and differences. It highlights areas where regulatory and legal alignment is necessary for linking. The detailed comparison of the two systems across key design features is followed by a discussion of the implications for market functioning and regulatory coordination. The paper also considers the broader context that would influence linking.

As we will show in this paper, the EU and UK ETSs have more commonalities than differences and the current review processes for both systems provide alignment opportunities. A linking negotiation process would need to systematically resolve all remaining issues. The experience of linking the Swiss ETS to the EU ETS 1 over the last decade has demonstrated that technical alignment is feasible. Yet, it also demonstrated that the politics of linking negotiations are more complicated than pure technical design questions, which can lead to a lengthy but ultimately fruitful process.

[8] Council of the European Union, EU-UK relations: Council greenlights negotiations on agri-food deal and linking emissions trading systems. https://www.consilium.europa.eu/en/press/press-releases/2025/11/13/eu-uk-relations-council-greenlights-negotiations-on-agri-food-deal-and-linking-emissions-trading-systems/ (last accessed 15 December 2025).

2 Linking ETSs: Concept and Design Considerations

Linking can be understood in different ways, ranging from non-binding unilateral links to binding bilateral or multilateral links. ETSs can be directly linked with each other but there can also be indirect links, which occur when two ETSs are linked to the same third ETS but not to each other. If the UK ETS were to directly link to the EU ETS 1, it would indirectly become linked to the Swiss ETS as this system equally has a direct link to the EU ETS 1. A unilateral link means that allowances from one ETS can be used for compliance in another but not vice versa.[9] Also, the linking agreement can have different legal forms. For example, the North American subnational ETS links are based on Memoranda of Understanding that are not formally binding, while the EU ETS 1 links to the EEA countries and Switzerland are based on binding international treaties.[10] In the case of the planned UK-EU link, a binding, direct and full linking is the expressed goal of both jurisdictions. This requires the negotiation of an international treaty, the linking agreement.

Fully linking ETSs means mutual recognition of allowances between two (or more) systems. In such a case, an allowance from one system can be surrendered for compliance in the other, effectively merging the ETSs. In theory, linking offers several benefits:[11]

- Cost efficiency: A larger market can equalise the carbon price between jurisdictions, ensuring emissions are reduced wherever it is cheapest to do so. Firms with lower abatement costs sell allowances to those facing higher costs, minimising overall compliance expenses.
- Market liquidity and stability: A larger, linked market has more participants and trade volume, which can reduce price volatility and increase liquidity.
- Carbon leakage and competitiveness: Linking can level the carbon costs faced by industries in different jurisdictions. This avoids competitive imbalances and carbon leakage (shifting of emissions-intensive production) between the jurisdictions.

Article 25 of the EU ETS Directive specifies conditions for linking the EU ETS 1 with other ETSs. It postulates that the EU ETS 1 can be linked to "compatible mandatory greenhouse gas emissions trading systems with absolute emissions caps established in any other country or in sub-federal or regional entities." It refers to the compatibility of system designs, which is a crucial condition for a successful full linking in terms of system integrity and climate ambition. This refers to compatibility not only at the moment of linking but also in the future since adjustments after concluding the linking agreement may cause specific risks for the functioning of the market. Compatibility of ETSs refers to the following elements:

- Comparability of ambition: If one system has a significantly weaker cap, linear reduction factor or a much larger share of free allocation (and thus lower carbon price), linking could undermine the other's climate ambition. While total emissions remain bound by the sum of

[9] Ahlberg, M., Arnold, H,. Gagelmann, F., Gibis, C., Kruse, M., Kühleis, C., Obkircher, C., Takramah, G., Wohlert, T., Wolke, F., and Zirkel, A. (2013). Linking verschiedener Emissionshandelssysteme. Stand und Perspektiven. Berlin: German Emissions Trading Authority (DEHSt). https://www.dehst.de/SharedDocs/downloads/DE/europaeischer-emissionshandel/Linking.pdf?__blob=publicationFile&v=2 (last accessed on 15 December 2025).

[10] Görlach, B., Mehling, M. and Roberts, E. (2015). Designing Institutions, Structures and Mechanisms to Facilitate the Linking of Emissions Trading Schemes. Berlin: German Emissions Trading Authority (DEHSt). https://www.dehst.de/SharedDocs/downloads/EN/emissions-trading/Linking_report.pdf?__blob=publicationFile&v=1 (last accessed on 15 December 2025).

[11] Haites, E. (2016). Experience with linking greenhouse gas emissions trading systems. WIREs Energy Environment 2016 (5):246–260.

all caps, a large allowance surplus in one market could flood the other, reducing its carbon price and diluting incentives to abate.

- Harmonised rules and MRV: Linking requires mutual trust that a tonne of CO_2e measured and reported in one system equals a tonne in the other. Monitoring, reporting, and verification (MRV) procedures as well as enforcement provisions need to be consistent. If one system had looser monitoring or weaker enforcement, it could undermine the environmental integrity of both.
- Allowances and legal nature: Linked systems must treat allowances as fully fungible and secure instruments. Aligning the legal status of allowances facilitates cross-border transactions and helps integrate registry systems.
- Coverage and scope: Ideally, linked systems cover the same sectors and greenhouse gases (GHGs) or at least have overlapping scope since major discrepancies can complicate linking. For instance, if one system includes sectors not covered by the other, companies in the uniquely covered sector could buy allowances from the partner market, indirectly subjecting these market participants to the extra sector's demand. It could also lead to carbon leakage from the jurisdiction in which the sector is covered to the other jurisdiction where it is not covered by a carbon price.
- Offset credits and removals: If one system allows international offset credits or domestic removal units and the other does not, the influx of cheaper credits could distort the linked market. Not only whether offsets and removals are permitted but also their quality criteria are of relevance in this regard, potentially affecting the environmental integrity of one system if the other has laxer quality rules.
- Market stability measures: Differences in quantity and price management mechanisms can affect linking. If one market has price management mechanisms such as a hard price ceiling or floor, and the other does not, it could distort prices in a linked system unless aligned. The same applies to quantity management mechanisms: if one system has a rules-based mechanism to manage allowance surplus and scarcity and the other does not, the linked market could be distorted.
- Jurisdiction: Legal competence and the respective legal frameworks are important because each ETS is based on its jurisdiction's laws and regulations. If these are not compatible, uncertainties may arise, for example, in the recognition of allowances, the enforcement of penalties or the control of emissions. Differences can lead to loopholes and jeopardise the effectiveness of the system. A joint governance and dispute resolution mechanism can help address these risks.

Past experiences like the EU–Switzerland ETS link suggest that strong similarity concerning design, scope and stringency facilitates linking. The more harmonised the systems, the easier the link and the less risky that linking will compromise the individual jurisdictions' policy objectives. It is however equally important that similarity is guaranteed not only at the time of linking but also for the future. ETSs evolve and are regularly reviewed. Changes implemented in one system that is linked to another can have significant implications for the entire linked market. For this

reason, ensuring dynamic alignment and safeguarding future compatibility is an important consideration.

In the Common Understanding, a procedure of ‚dynamic alignment' of the UK legal framework with EU rules that underpin the functioning of the ETS link is proposed to ensure that both systems evolve coherently and to preclude the emergence of market distortions, with "due regard to the UK's legal and legislative procedures".[12] The exact rules and legal framework for the proposed dynamic alignment are to be agreed during the formal linking negotiations. The next section zooms into the EU and UK ETSs to identify implications for linking in their current state, including plans for the future where they are known.

12 A renewed agenda for European Union–United Kingdom cooperation Common Understanding. https://ec.europa.eu/commission/presscorner/detail/en/statement_25_1267 (last accessed on 15 December 2025).

3 Structured Comparison of the UK ETS and EU ETS 1

Given their shared origin, geographic proximity, and ambitious climate goals, the EU ETS 1 and UK ETS represent a compelling case for exploring the feasibility and implications of linking. The EU already linked with the Swiss national ETS in January 2020, providing a precedent for the necessary alignment process.

This section compares the EU and UK ETSs across key design elements that are critical for the linking discussion to assess their commonalities and differences. A thorough comparison of the UK ETS and EU ETS 1 is essential to assess the feasibility of their linking. Both systems share common roots, as the UK ETS was modelled on the EU ETS 1 following the UK's departure from the EU. However, the two systems have evolved independently since, resulting in distinct design features and policy priorities in certain areas. The comparison highlights the areas of alignment that could facilitate linking and the differences that would require additional alignment or coordination. It also reflects on the broader implications of these commonalities and differences for market functioning, competitiveness, and environmental integrity.

The comparative table below includes an assessment of the degree of current alignment between the EU and UK ETSs on the respective design element, using a scale ranging from a high to a low degree of alignment. We only compare the current regulatory alignment of individual design features, not taking into account the changes in the legal framework of the respective systems that would be needed for a potential linking. The criteria for assessing the degree of alignment are:

- High degree of alignment: The rules are identical or very similar. There are no significant differences that would require further alignment for a potential linking between the two systems.
- Moderate degree of alignment: The rules are similar and/or related, but there are some differences. Depending on the relevance of the respective design feature for a potential linking, further alignment could be required.
- Low degree of alignment: There are significant differences that would require further alignment for a potential linking between the two systems. These differences would currently hamper a link between the EU and UK ETS.
- (Not) relevant for linking: There are some design elements where differences between the two systems might exist but are not relevant for a potential linking and therefore would not require alignment. We indicate for each design element whether or not it is relevant for linking.

Table 1: Comparison of the EU ETS 1 and UK ETS on key design elements

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
Scope (GHGs and Sectors)	Gases: CO_2, N_2O, PFCs, HFCs For the maritime sector: CH_4 and N_2O (from 2026). Sectors: • Power: >20 MW thermal rated input • Industry: >20 MW thermal rated input and other capacity threshold expressed as production capacity, • Aviation: intra-EEA and flights departing to Switzerland and the UK • Maritime (from 2026): 50% emission coverage for international voyages, 100% emission coverage for voyages within EEA Reporting requirements for municipal waste incineration apply from 2024. Reporting requirements for non-CO_2 emissions from the aviation sector apply from 2025. The scope might be expanded following the review in 2026.	Gases: CO_2, N_2O, PFCs Sectors: • Power: >20 MW thermal rated input • Industry: >20 MW thermal rated input • Domestic aviation and flights from the UK to the EEA and Switzerland Scope expansion announced to cover the domestic maritime (from 2026) and waste (from 2028) sectors, with MRV starting in 2026.	**Moderate degree of alignment** There are some differences in the sectoral scope and covered gases (HFCs) that could be aligned over the coming years with the planned scope expansions that have been announced and the upcoming reviews. *Relevant for linking*
Cap setting / Ambition	Single EU-wide absolute cap that declines annually via a linear reduction factor (LRF). Previously, the LRF was 2.2% per year (2021–2023). Following the 2023 reforms, the LRF increases to 4.3% annually for 2024–2027 and 4.4% from 2028 onwards. The cap trajectory is aligned with the European Climate Law and the EU's 2050 net-zero target, including two one-off cap reductions: one in 2024 (by	Single absolute cap that declines annually via a linear reduction factor (LRF). The initial cap, introduced in 2021, was set at 5% below the UK's national share of the EU 1 cap for its 4th phase and declined by ~2.7% per year (155.7 Mt in 2021, down 4.2 Mt per year), resulting in the UK LRF being more stringent that the EU's 2.2% at the time.	**High degree of alignment** The methods for setting the cap are comparable and have similar levels of ambition (reduction factor and targets). *Relevant for linking*

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
	90 million allowances) and one in 2026 (by 27 million allowances). Through the revised cap, the EU ETS 1 is set to deliver a 62% reduction from ETS-covered sectors by 2030 compared to 2005 levels. To ensure that this target is reached, the European Commission announced in December 2025 that it will reduce the cap in 2026 by an additional 27 Mt, contributing to a cap reduction of 8.7% in total. Thereby, it contributes to the EU's economy-wide target of reducing net emissions by at least 55% below 1990 levels by 2030 (and net-zero by 2050).[13]	In 2024 the cap trajectory was rebased to cut the overall 2021–2030 cap by about 30%. The annual cap now reduces from 156 $MtCO_2e$ in 2021 to about 50 Mt in 2030. The revised cap is intended to align with the UK's climate targets of reducing net emissions economy-wide by 68% below 1990 levels by 2030; and net-zero by 2050.[14]	
Cap size	Cap for 2024 (post-reform Phase 4): ~1,298 $MtCO_2e$ allowances, including the maritime sector with ~78 million allowances as it entered the system.[15] The cap however excludes the aviation cap (28.86 Mio allowances in 2024), which is calculated separately and then added to the total supply of allowances.[16]	Cap for 2025: 86.7 $MtCO_2e$ allowances (down from ~107 Mt in 2024, following the net-zero-aligned cap reduction). The cap will continue to decline annually toward ~50 Mt in 2030.[17]	*Not relevant for linking (but the EU ETS 1 cap being significantly larger than the UK ETS cap has implications for the dynamics between the two markets in terms of price equilibrium etc.)*
MRV	Harmonised EU-wide MRV rules. All regulated installations and airlines have approved monitoring	MRV framework mirrors EU ETS 1 Phase 4 regulation. Operators submit an annual emissions report (by the	**High degree of alignment**

[13] On 10 December 2025, the European Parliament and the Council of the EU have concluded a provisional agreement on the European Commission's proposal to set the EU's 2040 emission reduction target at 90% by 2040, relative to 1990. If adopted, this would also have implications for the EU ETS 1 cap and LRF. As of 15 December 2025, the agreement is pending formal adoption by the co-legislators before the corresponding amendment to the European Climate Law can enter into force.

[14] All UK reduction targets include emissions from LULUCF.

[15] See UBA Factsheet on EU ETS 1 cap in the light of the Fit-for-55 reforms: https://www.umweltbundesamt.de/system/files/medien/11850/publikationen/factsheet_cap_msr_2023_en_v2.pdf (last accessed on 15 December 2025).

[16] European Commission. Commission Decision (EU) 2023/2440. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32023D2440&qid=1760524427667 (last accessed on 15 December 2025).

[17] International Carbon Action Partnership (ICAP). ETS Factsheet: UK Emissions Trading Scheme. https://icapcarbonaction.com/en/ets/uk-emissions-trading-scheme (last accessed on 15 December 2025).

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
	plans. They must monitor emissions and report annually (reports due by 31 March). Emissions reports are verified by independent accredited verifiers. Monitoring: Emissions monitoring based on a monitoring plan. Use of measurement-based and calculation-based methodologies are allowed. Reporting: annual self-reporting. Verification: Annual emissions reports must be verified by an accredited verifier and submitted by 31 March of the following year.	end of March) with self-reported emissions data that is verified by an independent accredited verifier. The UK ETS adopted the EU's MRV regulations almost entirely, with only minor simplifications (e.g. reduced frequency of required improvement reports, streamlined monitoring plan requirements through reduced approval requirements for monitoring plan changes).[18] Monitoring: Emissions monitoring based on a monitoring plan. Use of measurement-based and calculation-based methodologies are allowed based on the same rules as in the EU ETS 1. Reporting: annual self-reporting. Verification: Annual emissions reports must be verified by an accredited verifier and submitted by 31 March of the following year.	UK ETS framework is based on the EU ETS 1 MRV framework *Relevant for linking*
Penalties and Enforcement	Penalty of €100 per tCO_2e for non-compliance, adjusted for inflation. Obligation to surrender allowances remains. The ETS Directive requires publishing the names of non-compliant operators (shaming). Compliance is enforced by Member State competent authorities. Member States can also impose additional administrative or criminal fines under national law.	Penalty of £100 (ca. € 115.89) per tCO_2e for non-compliance, adjusted for inflation. Obligation to surrender allowances remains. Continued failure triggers an additional penalty equal to 1.5 times the prevailing carbon price for each unpaid allowance, plus daily fines (£1,000 per day) until compliance is achieved. Regulators publish the names of operators in breach to ensure transparency. Compliance is enforced by the UK Environment Agency and the respective sub-national environment agencies (Scotland, Wales, Northern Ireland).	**High degree of alignment** Approaches to penalties and enforcement are largely consistent across both systems. *Relevant for linking*

[18] UK Government (2025). UK ETS MRR – General guidance for installations. https://assets.publishing.service.gov.uk/media/6889f51c76f68cc8414d5b67/ukets01-mrr-general-guidance-for-installations.pdf (last accessed on 15 December 2025).

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
Jurisdiction / dispute settlement authority	The EU ETS 1 regulation and implementing regulations are codified in European law, with the Court of Justice of the EU acting as the ultimate authority for dispute settlement. The European Commission oversees the overall system and the registry, while Member State competent authorities implement allocation, verification, and enforcement-related measures.[19]	The UK ETS is created by UK legislation (the Greenhouse Gas Emissions Trading Scheme Order 2020 and amendments) and is administered domestically. A joint UK ETS Authority (UK government together with devolved governments of Scotland, Wales, Northern Ireland) is responsible for policy and oversight. Day-to-day regulation and enforcement are carried out by UK agencies (e.g. Environment Agency, SEPA). Legal disputes or appeals are handled within the UK's legal system and courts.	**Low degree of alignment** A common legal framework and dispute settlement mechanism are vital to ensuring legal certainty. The EU-UK joint statement from May 2025[20] proposes the establishment of an independent and arbitration-based resolution mechanism, with the Court of Justice of the European Union (CJEU) serving as the ultimate authority on matters of EU law. *Relevant for linking*
Compliance period	Annual compliance cycle. Free allocation deadline: 30 June Reporting by 31 March Surrendering allowances by 30 September in year +1.	Annual compliance cycle. Free allocation deadline: 28 February Reporting by 31 March Surrendering allowances by 30 April in year +1.	**Low degree of alignment** Annual compliance cycles diverge, except for the reporting deadline. *Not relevant for linking*
Quantity-based market stability provisions	Market Stability Reserve (MSR): quantity-based mechanism that adjusts supply of allowances to	The UK ETS currently does not have a quantity management mechanism in place. The government launched a consultation on a Supply Adjustment	**Low degree of alignment** No quantity-based instrument in the UK ETS,

[19] Iceland, Norway, Liechtenstein participate in the EU ETS via the EEA, and Switzerland via a linking agreement. Electricity generators in Northern Ireland remain in the EU ETS due to the all-Ireland electricity market.

[20] A renewed agenda for European Union–United Kingdom cooperation Common Understanding. https://ec.europa.eu/commission/presscorner/detail/en/statement_25_1267 (last accessed on 15 December 2025).

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
	prevent shortages and surpluses, based on the yearly total number of allowances in circulation (TNAC). The MSR mechanism annually adjusts supply to manage surplus and reduce scarcity, based on the TNAC. Established in 2018 to reduce the historical surplus of EUAs and rebalance supply and demand in the short term. Constrained by an upper and lower threshold, adjustments to the number of auctioned allowances are made annually based on the TNAC. Allowances held in MSR above a certain threshold are invalidated annually.	Mechanism (SAM) in late 2023. Following this consultation, it concluded in December 2025 that the UK ETS's existing price-based mechanisms are sufficient to mitigate risks in the UK ETS as a stand-alone system.[21]	whereas the EU ETS main mechanism for market adjustment is based on the quantities of certificates in the system. *Relevant for linking*
Price-based market stability provisions (primary market)	No price floor or ceiling. The ETS Directive includes a cost containment clause (Article 29a). In contrast to quantity-based market stability provisions such as the MSR, the cost containment clause acts based on the carbon price rather than the allowance supply. It can be invoked if prices rise too sharply. If for more than 6 consecutive months the carbon price is more than three times the average price of the previous two years, the European Commission may intervene, for example, by auctioning extra allowances from the MSR. This provision has never been triggered to date. In practice, the EU relies on the MSR to indirectly	Cost Containment Mechanism (CCM): The CCM is triggered if the current allowance price is higher than the historic average for a prolonged period. It allows for the regulator to auction additional allowances. The CCM was triggered in both December 2021 and January 2022. The UK ETS Authority chose not to intervene on either occasion. Since February 2023, the CCM is triggered if the UKA December futures contract is three times the average price for the reference period for six consecutive months.[22] Auction Reserve Price (ARP): minimum auction price of £22 (price floor), planned to be increased to £28 in 2026 and subsequently inflation-adjusted from 2027.	**Moderate degree of alignment** Both systems, through the UK CCM and the EU cost containment clause, allow for additional allowance injections if a certain relative price increase is reached. The main difference is the UK's price floor, which does not exist in the EU ETS 1. *Relevant for linking*

[21] UK Government. Consultation Outcome: UK Emissions Trading Scheme: future markets policy. https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-future-markets-policy (last accessed on 15 December 2025). The consultation specifically did not consider possible linking with the EU, but rather the functionality of the UK ETS as a stand-alone system.

[22] UK Government. Guidance: Taking part in the UK Emissions Trading Scheme Markets. https://www.gov.uk/government/publications/taking-part-in-the-uk-emissions-trading-scheme-markets/taking-part-in-the-uk-emissions-trading-scheme-markets#cost-containment-mechanism (last accessed on 15 December 2025).

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
	support prices by preventing shortages and oversupply of allowances.		
Legal nature of allowances	Allowances are financial instruments under EU law.	Allowances are financial instruments under UK law.	**High degree of alignment** The legal nature of allowances is aligned between the two systems. *Relevant for linking*
Offsets	Use of international offset credits has not been allowed since Phase 4 (from 2021 onwards).[23]	Use of international offset credits is not allowed, maintaining parity with EU ETS rules.	**High degree of alignment** Both systems prohibit the use of international offset credits for compliance under the current legal provisions. For the future, this key question depends on the outcome of the trilogue negotiations on the EU Climate Law, and potentially on future rules on their implementation. *Relevant for linking*
Carbon dioxide removals (CDR)	There is presently no mechanism to credit negative emissions from carbon dioxide removal (CDR) projects under the EU ETS 1. The EU is studying how to	The UK government has announced the integration of engineered CDR units in the UK ETS, targeting 2029 as the starting year with relevant legislation to be developed by the end of 2028. No limits on the	**Moderate degree of alignment** Exact conditions and scope of permitted CDRs for

[23] In July 2025, the European Commission proposed a 90% GHG reduction target by 2040 (relative to 1990 levels) that would allow the use of international carbon credits sourced through Art. 6.4 of the Paris Agreement from 2036, for a share equivalent to 3% of 1990 emissions. Those offsets will not be eligible for compliance under the EU ETS 1. In the trilogue negotiations, the European Parliament and the EU Council agreed on a share of up to 5% of 1990 EU net emissions that can be met with high-quality international credits. As of 15 December 2025, the agreement is pending formal adoption.

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
	integrate permanent CDR in the upcoming EU ETS 1 review (legislative proposal expected by July 2026). Carbon capture utilisation and storage (CCUS) of emissions released by regulated entities is already permitted in the EU ETS 1 (see CCUS regulation row).	share of removals used for compliance are currently planned. The cap of the UK ETS will be maintained. To do so, the UK ETS authority introduces a "one-in-one-out" principle which will replace emission allowances with CDR allowances. As a result, the overall allowance supply will be maintained. In the long term, and after CDR units are integrated into the UK ETS, the UK ETS authority considers moving to a new net cap that includes only emission allowances. The UK ETS Authority will consult further on the technical and implementation options. [24] The UK Government also considers integrating domestic woodland removals.	compliance is still to be determined for both the EU and the UK ETS. *Relevant for linking*
Carbon capture utilisation and storage (CCU/S)	The EU ETS 1 includes provisions for CCU/S as a method to reduce emissions. If CO_2 is captured and permanently stored in geological formations that meet EU regulatory requirements or permanently bound in a product, it is not considered emitted and does not require allowance surrender. The relevant rules are laid out in the ETS Directive and the CCS Directive (2009/31/EC). CCU: emissions are generally considered avoided only if CO_2 is permanently embedded in products and not eventually released. All products that qualify are listed in Commission Delegated Regulation (EU) 2024/2620.	The UK ETS excludes CO_2 that is captured and permanently stored from the surrender obligation, mirroring EU rules. The UK Greenhouse Gas Emissions Trading Scheme Order 2020 and accompanying guidance provide for CCS accounting in line with international best practices. CO_2 captured from industrial installations or power plants and stored in licensed geological formations does not require allowance surrender. The UK ETS Authority is actively consulting on expanding support for CCUS, including recognition of non-pipeline transport (e.g., shipping or trucking) of CO_2 to mirror EU flexibility and support more diverse CCUS infrastructure.	**High degree of alignment** The EU and UK ETS are aligned on their approaches to CCU/S. In both systems, permanently stored CO_2 does not require allowance surrender and CCU emissions are only considered avoided if permanently embedded. *Relevant for linking*

[24] UK Government. Integrating Greenhouse Gas Removals in the UK Emissions Trading Scheme: Main Response. https://assets.publishing.service.gov.uk/media/689cda8487bf475940723f5b/uk-ets-ggrs-main-response.pdf (last accessed on 15 December 2025).

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
		CCU: Emissions are only considered avoided if the CO_2 is permanently sequestered or embedded, which most CCU processes do not achieve. The UK is reviewing documentation and verification rules for CCU and synthetic fuel use, aiming to align with sustainability criteria and lifecycle analysis to ensure proper accounting. These consultations are expected to inform updated rules to be implemented before the next trading phase (beginning in January 2031).	
Documentation requirements for sustainable fuel use (biomass, synthetic fuels)	Under the EU ETS 1, emissions from biomass and biofuels can be considered zero-rated if they meet specific sustainability and GHG savings criteria as outlined in Article 29(2)–(7) and (10) of the Renewable Energy Directive (EU) 2018/2001 (RED II). To demonstrate compliance, operators must provide proof through voluntary schemes recognised by the European Commission. This proof typically includes certificates verifying that the biomass meets the required sustainability standards and GHG savings thresholds. For synthetic fuels, including Renewable Fuels of Non-Biological Origin (RFNBOs) and Recycled Carbon Fuels (RCFs), zero-rating is possible if they comply with the GHG savings criteria specified in Article 29a of RED II. Operators must provide evidence of compliance through recognized certification schemes and ensure that the carbon content of these fuels has been accounted for appropriately, including the prior surrendering of allowances under the EU ETS 1 for the captured carbon used in their production.	In the UK ETS, biomass fuels can be considered zero-rated if they meet sustainability criteria similar to those in RED II. Operators must provide evidence such as certificates from recognized voluntary schemes or documentation proving that the biomass is derived from waste or residues. This includes environmental permits or waste transfer notes. For synthetic fuels, including Sustainable Aviation Fuels (SAFs), the UK ETS requires compliance with the Renewable Transport Fuel Obligation's (RTFO) sustainability criteria. Operators must demonstrate that the fuels meet these criteria through appropriate certification and documentation. This includes providing evidence of the fuel's sustainability characteristics and ensuring that the fuel's use aligns with the requirements set out in the UK ETS monitoring and reporting regulations.	**High degree of alignment** Both systems base their sustainability assessments on the principles in RED II and require third-party certification to demonstrate compliance. *Relevant for linking*

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
Registry	A single Union Registry is used by all EU ETS 1 participants across the EU and EEA. The Union Registry tracks ownership of allowances, issuances, surrenders, transfers, etc. All compliance entities and eligible traders hold accounts in this central registry. The data on free allocation, verified emission and compliance status of operators and transactions taking place in the Union Registry is publicly available. The Union Registry holds accounts for stationary installations, aircraft operators and maritime operators. It is not a trading platform. The EU's registry is electronically linked with Switzerland's national registry under the EU–Swiss ETS link, allowing for transfer of allowances between the two systems.	A dedicated UK ETS Registry (the UK Emissions Trading Registry) is used for all UK ETS accounts. The UK Emissions Trading Registry serves both as the UK ETS Registry and UK Kyoto Protocol Registry. UK ETS compliance entities must have an Operator Holding Account (OHA) for installations, and an Aircraft Operator Holding Account (AOHA) for aircraft operators. It is not a trading platform. The Registry holds records of the ownership of allowances, the movement of allowances between accounts, verified emissions, allowances surrendered by operators and free allocation. Trading accounts allow entities to hold and trade UKAs even if they do not have compliance obligations under the UK ETS.	**Moderate degree of alignment** The registries are functionally similar. Further alignment to ensure technical interoperability, common rules, and mutual recognition of compliance units will be required. Specifically, a secure linking interface / registry bridge will need to be established to allow for the electronic transfer of allowances between the two registries (similar to the EU-Swiss link). *Relevant for linking*
Auction shares	Auctioning is the primary allocation method in the EU ETS 1. Up to 57% of allowances are auctioned in Phase 4 (2021-2030): • Power generation: 100% of allowances are auctioned, eligible Member State can award up to 40% of free allocation to power producers. • Industry: The exact split between auctioning and free allocation for each industry is determined by benchmarks, carbon leakage status and adjustments (CSCF). In 2023, free allocation	About 65% of allowances were auctioned in 2024, which amounts to about 69 million UKAs. The total cap that year was around 107 million. • Power generation: 100% of allowances are auctioned. • Industry: The exact split between auctioning and free allocation for each industry is determined by benchmarks and carbon leakage risks. For example, in 2023 the cement and lime sectors received 99% free allocation and the steel sector 92%.	**Moderate degree of alignment** Currently, both systems exhibit a high and similar auction share. Moreover, with the introduction of the CBAMs, free allocation to the covered sectors will be phased out. This could align the auction shares even further, but since the timeline of UK free allocation phase out is not

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
	covered 84% of total industry emissions across all sectors.[25] • Aviation: Until 2023 85% for free allocation; stepwise reduction of free allocation until **full auctioning starting 2026**. • Maritime: After full integration from 2026, 100% of allowances will be auctioned. Free allocation to specific stationary sectors will be gradually phased out from 2026 to 2034, in parallel to the phase-in of the EU Carbon Border Adjustment Mechanism (CBAM) for third-country imports from those sectors.	• Aviation: partial free allocation that varies per operator (capped at 100% of verified emissions and subject to a fixed annual reduction of 2.2% of the initial 2021 benchmark volume). Full actioning for the aviation sector is introduced from 2026. As part of the December 2024 consultation, the UK ETS Authority put forward proposals to gradually adjust free allocation in CBAM-covered sectors following the introduction of the UK CBAM (currently planned from 2027). The UK ETS Authority has confirmed that the free allocation in 2026 will be calculated on the same basis as during the first allocation period, delaying the second allocation period to 2027.	known yet, there could be some further misalignment in the process. *Relevant for linking*
Carbon Leakage provisions (incl. CBAM)	Free allocation to industries at risk of carbon leakage, based on sector-specific benchmarks and historical activity levels. Adjusted annually for technological progress (fixed benchmarking). In Phase 4, sectors on the carbon leakage list receive free allowances up to 100% of the benchmark level of emissions.[26] Less-exposed sectors receive partial free allocation that declines over time, (reaching 0% by 2030 for sectors not on the leakage list). Free allocation in CBAM sectors will be gradually phased out in the period from 2026 until 2034, in parallel with the phase-in of the EU CBAM.	Free allocation in the UK ETS closely mirrors the EU approach (fixed historical benchmarking). Industries on the UK carbon leakage list receive free allowances covering 100% of their benchmarked needs (based on EU Phase 4 benchmarks), while those not on the list receive only 30% of benchmarked allowances. However, the upcoming revision of EU ETS benchmark values in 2026 may give rise to divergence. In the first allocation period (2021-2025), Phase IV EU ETS 1 benchmarks are used to ensure continuity for	**Low degree of alignment** Depending on when linking occurs, free allocation might (almost) be phased out in the CBAM sectors. Benchmark values might diverge from 2026 following the revision of ETS benchmarks. Full linking between the EU and UK ETSs would exempt exported goods originating

[25] Sandbag (2024). A closer look at 2023 emissions: steelmaking caused a quarter of industry pollution. https://sandbag.be/2024/10/07/a-closer-look-at-2023-emissions/ (last accessed on 15 December 2025).

[26] Benchmark values for the second allocation period (2026 to 2030) are currently being reviewed by the European Commission, with the official publication expected for early 2026.

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
	Free allocation for the aviation sector is being reduced to 50% in 2025 and zero by 2026 for intra-EEA flights. Maritime transport has been included in the EU ETS since 2024. It has not received free allocation. However, its surrender obligations were phased in over a three-year period. In 2026, maritime companies must surrender allowances for 100% of their verified emissions. **EU CBAM** The EU CBAM has entered its definitive phase on 1 January 2026. Free allocation for CBAM sectors will be gradually phased out from 2026 to 2034. Sectoral coverage: aluminium, cement, iron & steel, fertilisers, hydrogen, and electricity. Compliance obligations apply to direct emissions for all sectors, and to indirect emissions for fertilisers and cement.	operators. The UK carbon leakage list is currently identical as under the EU ETS 1 Phase IV. Free allocations for 2026 will be calculated on the same basis as in the first allocation period. The next free allocation period was moved from 2026 to 2027 to align with the planned start of UK CBAM, and consultations are ongoing about how to reduce free allowances for CBAM sectors. There is a cap on the maximum number of free allowances ("industry cap"), which is set at 40% of the total cap per year. In 2024, it was not fully exploited since only about 35% of allowances were allocated for free. Free allocation to sectors at risk of carbon leakage will be adjusted and eventually phased out following the implementation of the UK CBAM from 2027. **UK CBAM** The UK CBAM will be implemented from 2027 onwards for high-emission imports. Sectoral coverage: aluminium, cement, iron & steel, fertilisers, hydrogen. Compliance obligations apply to direct and indirect emissions for all sectors.	from each side from the respective CBAM. However, alignment of CBAM rules may be required to minimise administrative burden and avoid loopholes. *Relevant for linking*
Review provisions	The EU ETS 1 framework includes periodic reviews to adjust design and ambition. The European Commission produces an annual report on the carbon market's functioning. The next review is expected by July 2026 and requires the Commission to assess specific expansions or adjustments (e.g. accounting	There are mandatory whole-system reviews by the ETS Authority. The next review is expected to be published by the end of 2028.	**Moderate degree of alignment** The EU ETS and UK ETS currently have different review timelines. *Relevant for linking*

Design Feature	EU ETS 1	UK ETS	Considerations & Implications
	for carbon removals, lowering the 20 MW threshold for inclusion, including municipal waste incineration).		*(but it could be irrelevant depending on the design of the dynamic alignment process)*
Revenue use	Revenues from allowance auctions accrue to national budgets (with earmarking for climate spending) and EU-funded climate action initiatives (Innovation Fund, Modernisation Fund). Total revenue: [27] EUR 184 billion raised since the start of the system EUR 38.8 billion raised in 2024	Revenue accrues to the general budget, with no specific earmarking. Total revenue: GBP 17.2 billion (EUR 19.9 billion) raised since the beginning of the program (since 2021) GBP 2.6 billion (EUR 3.0 billion) raised in 2024	*Not relevant for linking.*

Sources: ICAP Status Report (2025), European Commission (2025), UK Government (2025).

[27] This includes revenues from Iceland, Liechtenstein, Norway, and the UK, as well as the Innovation and Modernisation Funds funded by the EU ETS 1.

The structured comparison demonstrates that the EU and UK ETSs share a common DNA to a considerable extent. There are several design elements in which they align moderately but the required changes seem feasible. Only on a few design elements do the EU ETS 1 and the UK ETS currently exhibit a low level of alignment. The most significant of these is the market stability mechanism. Currently, the UK has a price-based mechanism, while the EU operates a quantity-based mechanism. Yet, if the EU includes the UK ETS in its determination of the TNAC, the EU MSR would take UK ETS developments into account. The next section discusses the implications of the identified commonalities but also differences.

4 Discussion and Conclusions

The commonalities between the EU and UK ETSs are numerous: both are cap-and-trade systems with annual compliance requirements, cover similar sectors and GHGs, use almost identical MRV and enforcement rules, and currently employ comparable methods for free allocation and market oversight. Until 2023, the UK cap was slightly out of sync with the EU cap, but the UK meanwhile realigned its cap with its net zero emissions target for 2050. Likewise, the EU's ETS is aligned with its jurisdiction-wide climate targets for 2030 (at least 55% GHG emissions reduction), 2040 (90% reduction) and 2050 (climate neutrality). These similarities lay a strong foundation for possible linking. In particular, the environmental integrity mechanisms (MRV, penalties) and the overall ambition (declining caps aligned with net-zero by 2050) are well-matched. A UK allowance essentially represents the same environmental commodity as an EU allowance: one tonne of CO_2e reduced under stringent monitoring, which is a fundamental requirement for a credible link. The condition of Article 25 of the EU ETS Directive that linking may be negotiated with compatible mandatory GHG ETSs with an absolute cap is largely fulfilled. Compatibility on some aspects, however, still requires some more work. Moreover, chapter IV of the Common Understanding[28] between the UK and the EU already established several elements of the linking agreement that are to be negotiated. Some aspects, however, remain open and need to be explored.

The Common Understanding establishes that the linking agreement should cover all aspects of the functioning of an ETS link. As our analysis shows, there are some design elements that require further alignment. For example, the Common Understanding postulates that the linking agreement should clearly define the sectors in the scope of linking, including electricity generation, industrial heat generation (excluding the individual heating of houses), industry, domestic and international maritime transport and domestic and international aviation, and establish a procedure for expanding the sectoral scope. There are some differences in the sectoral scope of the two ETSs that could be aligned over the coming years with the planned scope expansions that have been announced and the upcoming reviews so that, by the time of linking, they are aligned. According to paragraph 41, the UK cap and reduction pathway should be at least as ambitious as the EU cap and reduction pathway. This is already fulfilled.

To avoid that changes after the time of linking distort the market, dynamic alignment of the UK with relevant EU rules has been agreed and recorded in paragraph 40 of the Common Understanding. The UK should be consulted at an early stage of the EU decision-making process, which however does not imply an inclusion in taking EU decisions. This is already applied to the EEA countries and will need to be elaborated in the UK-EU linking agreement. Ensuring the continuity of alignment is crucial for the endured well-functioning of the linked market since otherwise divergences could emerge over time and create market distortions. This is particularly important in core areas such as ambition, scope, MRV, enforcement and free allocation. Alignment however does not always mean identical measures. Interoperability for example with regard to MRV could be sufficient.

The UK agreed to contribute financial support associated with the EU's work related to the linked ETS. A dispute resolution mechanism and an independent arbitration panel are planned that uphold the European Court of Justice's ultimate authority for all questions regarding EU law. The linking agreement should be implemented through a joint governance mechanism, as stipulated in the Common Understanding.

[28] A renewed agenda for European Union–United Kingdom cooperation Common Understanding. https://ec.europa.eu/commission/presscorner/detail/en/statement_25_1267 (last accessed on 15 December 2025)

Paragraph 37 establishes that the conditions for mutual exemptions from the respective CBAMs should be created, subject to the provisions of EU and UK legislation.

However, there are some differences that could benefit from further alignment or would need to be managed. They are largely linked to specific aspects of the system and timing rather than fundamental structural mismatches:

- UK prices have been significantly lower than EU prices, suggesting a relatively more comfortable supply in the UK. The EU average auction price in 2025 was 73.43 EUR, while the UK average auction price in the same year was 47.36 GBP (54.46 EUR). Linking would equalise the price. That likely means UK prices would rise to the EU level or slightly below as the larger EU market strongly influences the equilibrium. However, the announcement of the linking negotiations nearing their conclusion could already change market expectations and prepare UK regulated entities for the anticipated price rise. As an alternative, transition arrangements could be explored to ease the shock. For example, the UK could slightly tighten its cap or increase its price floor to gradually narrow the gap before full linking. Nonetheless, cost-efficiency gains for achieving decarbonisation goals of linking would outweigh short-term costs.[29]

- UK government modelling shows that in 2035 in a linked UK-EU carbon market, the EU would be a net seller of allowances since the EU's marginal abatement costs are predicted to be lower once the markets are linked. The UK would be a net purchaser of allowances.[30] This demonstrates the cost efficiency a linked market would create. The EU would attract more investment in low-carbon solutions, and the UK would benefit from lower compliance costs.

- The EU's quantity-based measure for market stability is operational, but the UK has decided not to introduce a quantity-based market stability mechanism. Linking with this misalignment could cause challenges since the EU's MSR would be adjusting supply based on EU conditions, but the UK's surplus (if any) could unmitigatedly flow into the EU market, potentially undermining the MSR's effect. Yet, since the UK market is smaller than the EU, this effect could be limited. Conversely, if the UK faced a shortage, it could draw on EU allowances that the MSR had intended to remove. In essence, without coordination, the MSR might only consider part of the linked market. This could be achieved by including UK data in the EU's TNAC calculation (basically treating it as one pool for MSR purposes) or by each maintaining separate reserves but coordinating their operation. The UK could join the MSR framework (perhaps even contribute some initial volume to it or align the trigger thresholds). The price spike mechanisms (Article 29a and CCM) are already aligned in trigger and concept, so those would function smoothly together. Any extreme price event would trigger a similar response from authorities, acting in concert.

- The EU has already implemented a CBAM, and the UK is finalising its own border rules. To ensure a level playing field for regulated entities under both systems, alignment with regard

[29] Frontier Economics (2024). Linking UK and EU carbon markets. Supporting efficient UK-EU trade and delivery of low-carbon goals. https://www.frontier-economics.com/media/0j1h3gyw/frontier-economics-linking-uk-eu-carbon-markets-final.pdf (last accessed on 22 September 2025).

[30] HM Treasury (19 May 2025). Assessing the preliminary economic impacts of linking the UK-EU Emission Trading Schemes. https://www.gov.uk/government/publications/methodology-note-preliminary-economic-impacts-of-linking-the-uk-eu-emission-trading-schemes/methodology-note-assessing-the-preliminary-economic-impacts-of-linking-the-uk-eu-emission-trading-schemes#caveats-of-the-analysis (last accessed on 15 December 2025).

to the corresponding reduction of free allocation to CBAM sectors in both systems would be required. Once the two systems are fully linked, goods originating from either jurisdiction would be exempt from the other's CBAM. The CBAM design of the two systems should also be aligned to minimise administrative burden and address loopholes that could allow third-party exporters to circumvent the carbon border levy, which could result in carbon leakage for both jurisdictions. While free allocation rules are currently aligned, they could drift apart due to the new benchmarks in the EU starting from 2026, or if free allocation in the two ETSs is phased out with different timelines while the respective CBAMs are phased in. The EU has set a phase-out pathway, but the UK is still adopting its rules.[31] Linking the two systems with different free allocation rules for Emission Intensive, Trade Exposed (EITE) sectors could be problematic. If one of the two jurisdictions were to keep free allocation for longer, the respective sectors would have a cost advantage and no border adjustment since between the linked ETSs no CBAM applies. Free allocation in all EITE sectors therefore is a crucial area for alignment.

- Both the EU and UK ETSs allow biogenic CO_2 to be zero-rated. The EU has sustainability requirements via its Renewable Energy Directive (RED III) for biomass to count as zero and the UK has sustainability criteria similar to those in RED III. By the time of a potential linking, both would need to mutually recognise certification schemes. For example, if a UK factory uses biomass and does not surrender allowances for those emissions, the EU needs confidence that the biomass met specified criteria. This likely means aligning around common standards (perhaps both using an updated EU RED standard or a UK standard that the EU considers comparable).
- Both jurisdictions plan to encourage sustainable aviation fuels (SAF) by accounting them as zero-rated. They will however need to agree on a joint definition of what constitutes SAF to avoid distortions. Additionally, the EU ETS 1 has set aside 20 million free allowances for aviation from 2024-2030, to cover the price difference between Kerosene and SAF if airline operators use SAF on covered routes. The UK ETS currently offers only the zero rating as an incentive to aircraft operators for SAF use. Since the additional support in the EU ETS 1 will end in 2030, this would only need to be addressed if the UK and EU ETSs were to be linked before. These technical provisions would need to be harmonised so that one market is not effectively crediting something the other would not.
- The EU's integration of maritime shipping (intra-EU voyages) creates a slight scope misalignment since the UK has not yet covered this sector. However, the UK-EU Common

[31] On 26 November 2025, the UK ETS Authority published its response to the 2025 Free Allocation Review. In its response, the Authority announced that a gradual phase-out of free allocation for sectors covered by the UK CBAM will begin in 2027, with an indicative phase-out trajectory of nine years. The trajectory has only been fixed for the remainder of the current allocation period until 2030, but should be aligned with the EU's approach beyond that until free allocation for CBAM sectors in the UK ETS is fully phased out by 2035.

https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review (last accessed on 15 December 2025).

Understanding outlines that international maritime transport will fall within the scope of the envisioned linking agreement.[32]

- Both the EU and the UK are considering to include the waste sector into their ETS scope. Alignment on timing and scope would facilitate linking. Differences regarding the scope are, however, relatively minor.

While this paper focuses on the EU ETS 1 and UK ETS, there are related policies that influence their functioning and therefore should not be neglected. The EU ETS 1 regulation allows Member States to grant indirect cost compensation for the carbon cost component of electricity prices to entities regulated under the EU ETS 1, subject to certain conditions. This effectively represents a subsidy for those industries that offset a share of their carbon costs. Several member states provide indirect cost compensation to electricity-intensive industries to safeguard their international competitiveness and prevent carbon leakage. The UK government also offers compensation of indirect carbon costs to electricity-intensive entities covered under the UK ETS that are deemed to be exposed to a significant risk of carbon leakage. Entities from eligible sectors must demonstrate that their indirect carbon costs amount to 5% or more of their gross value added (GVA). These compensation measures are only moderately aligned, and eligibility criteria and terms of compensation would need to be aligned to level the playing field.

Both the EU and the UK plan revisions of their respective ETSs over the next few years, which provides a good opportunity for driving alignment forward and preparing the possible linking. Some central ETS design elements could be aligned at that occasion, especially free allocation rules (in conjunction with CBAM phase-in), scope expansion, CDR inclusion rules, and CBAM rules. By the end of July 2026, the European Commission will assess:

- How permanent domestic CDRs could be accounted for and covered by the EU ETS 1
- The feasibility of lowering the 20 MW total rated thermal input thresholds for the activities covered under the EU ETS 1
- Effective accounting and avoidance of double counting of CCU products under the EU ETS 1
- The feasibility of including municipal waste incineration
- The scope of the EU ETS 1 for aviation, including a review of CORSIA.
- The scope and implementation of the EU ETS 1 for maritime transport, including a possible extension to cover emissions from smaller ships and potentially necessary adjustments to align with the GHG pricing mechanism adopted at the IMO (with a view to avoiding double burden on maritime operators)
- The functioning and effectiveness of the MSR and its impact on growth, industrial competitiveness and the risk of carbon leakage
- The use of international offset credits

In addition, the EU CBAM has been reviewed for functioning and effectiveness at the end of the transitional phase in 2025, and another review will be conducted before January 2028.

[32] A renewed agenda for European Union–United Kingdom cooperation Common Understanding, https://ec.europa.eu/commission/presscorner/detail/en/statement_25_1267 (last accessed on 22 September 2025).

On the UK side, the UK ETS Authority has launched consultations on several topics on which decisions will be taken in the coming years:

- Expanding the scope of the UK ETS to cover emissions from domestic maritime activities from 2026 and from international maritime voyages from 2028
- Expanding the scope of the UK ETS to emissions from waste incineration and energy from waste from 2028 (preceded by a two-year MRV-only period from 2026 to 2028)
- Integrating engineered CDRs in the UK ETS by proposing different policy options how this could be done
- Recognise and implement non-pipeline transport for carbon capture and storage (CCUS) under the UK ETS
- How to calculate carbon leakage risk for industrial sectors and the approach to adjusting / phasing out free allocation levels for CBAM sectors following the implementation of the UK CBAM from 2027

Some of these review plans map well with the alignment needs for linking. Especially the scope expansions and the inclusion of CDR are aspects on which both jurisdictions could advance necessary alignment. Considerations in the UK about the phasing out of free allocation in parallel with the implementation of a CBAM could deliver necessary alignment with the EU ETS 1.

The high-level political commitment to linking both ETSs could deliver the political will that is needed to shape the policy-making processes in a way that considers alignment. If the planned reforms result in the drifting apart of both ETSs, linking will become challenging. While the various reform plans of both jurisdictions thus bear great alignment potential, they also bear risks since they are adopted in independent political processes of two sovereign jurisdictions.

Overall, the EU and UK ETSs have more commonalities than differences and the current review processes provide alignment opportunities. A linking negotiation process would need to systematically resolve all remaining issues. The experience of linking the Swiss ETS to the EU ETS 1 over the last decade has demonstrated that technical alignment is feasible. Yet, it also demonstrated that the politics of linking negotiations are more complicated than pure technical design questions, which can lead to a lengthy but ultimately fruitful process.

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