



CATAPULT
Energy Systems

Innovator briefing: What linking the UK and EU Emissions Trading Schemes could mean for competitiveness, investment, growth, and scale-up

Authors: Dr. Danial Sturge, Practice Manager - Carbon Policy, and Emily Ford, Senior Energy Policy Advisor - Carbon Policy

Date: August 2026

Introduction

Linking the UK and EU Emissions Trading Schemes could be one of the most significant policy changes affecting low carbon businesses since Brexit. It has the potential to strengthen investment signals, reduce trade barriers with Europe, and make it easier for UK innovators to scale internationally.

In the May 2025 UK-EU Summit, the UK and EU signalled working towards a formal link between their respective Emissions Trading Schemes (ETS).¹

If delivered, linking would reshape the carbon pricing environment currently facing UK businesses. It would improve market **liquidity**, influence investment decisions, and reduce trade barriers for businesses operating in UK-EU supply chains.²

There are clear benefits of linking for innovators through:

A more liquid carbon market, which would strengthen the case for low carbon investment.

Opening up access to markets, which reduces regulatory friction for businesses trading with the EU, particularly if linking supports mutual relief from the EU's **Carbon Border Adjustment Mechanism** (CBAM).

There remain uncertainties around governance, market rules, scope, timing, and the extent of UK-EU alignment, which will ultimately shape the long-term benefits that linking has for businesses.

In the near-term, it is essential for businesses to understand and plan for how carbon costs and trade exposure could potentially change investment and business decisions if linking is successful. Businesses that can translate policy change into commercial decisions quickly will be better placed to manage risk and take advantage of opportunities.

What an Emissions Trading Scheme is and why linking is being negotiated

The UK ETS and EU ETS are both cap-and-trade carbon pricing mechanisms. A **cap-and-trade** system is a market-based approach to carbon pricing, designed to incentivise emissions reduction in covered sectors. It does this by placing an overall cap on emissions and allows regulated participants to buy and sell **allowances** within that cap.³ The overall

¹ UK government (2025). UK-EU Summit - Common Understanding.

<https://www.gov.uk/government/publications/ukey-eu-summit-key-documentation/uk-eu-summit-common-understanding-html>

² Chatham House (2025). The UK government should prioritize linking carbon markets at the UK-EU summit. <https://www.chathamhouse.org/2025/05/uk-government-should-prioritize-linking-carbon-markets-uk-eu-summit>

³ UK government (2026). UK Emissions Trading Scheme (UK ETS): a policy overview.

<https://www.gov.uk/government/publications/uk-emissions-trading-scheme-uk-ets-policy-overview/uk-emissions-trading-scheme-uk-ets-a-policy-overview>

cap is then reduced over time, to increase the incentive to decarbonise. Participation is mandatory for operators over a certain size in several sectors (in the UK, this is heavy industry, power generation, and aviation). Participants have to surrender one **allowance** for each tonne of greenhouse gas emissions produced each year.

The EU ETS is the EU's primary carbon market in which the UK participated before Brexit and launching its own ETS in 2021 as a standalone system. While the two carbon markets retain similarities in design, there has been divergence over time, including scope and specific market rules. Table 1 sets out some of the key differences, including in policy design and in market outcomes. Linking requires a level of alignment that is politically palatable and an agreement on how differing approaches work with one another going forward.⁴

Table 1. Key differences between the EU ETS and the UK ETS

	UK ETS	EU ETS
Average allowance price 2025	£47.36	€73.43 (£64.28)
Sector coverage	Current: power generation, energy-intensive industry, domestic aviation, and domestic maritime. Planned expansions: waste, and engineered greenhouse gas removals.	Current: power generation, energy-intensive industry, intra-EEA aviation, and intra-EEA maritime. Planned EU ETS2 in 2028: road transport, domestic/commercial heating, and smaller industrial operators.
Emissions coverage	25% of UK emissions	40% of participating countries' emissions (EU, plus Iceland, Liechtenstein, and Norway)
Cap reductions	In line with UK's legally binding Net Zero by 2050 target, and with Carbon Budgets.	Steeper reductions, in line with the Fit for 55 package: a 55% emissions reduction across the EU by 2035 (compared to a 1990 baseline).

⁴ EU Parliament (2025). Linking the EU and UK emissions trading systems.

[https://www.europarl.europa.eu/RegData/etudes/BRIE/2025/775873/EPRS_BRI\(2025\)775873_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2025/775873/EPRS_BRI(2025)775873_EN.pdf)

Revenue hypothecation	None. Auction revenues are paid into general government revenues and not earmarked for climate spending.	Majority of revenues must be spent on climate- and energy-related purposes. The EU ETS2 will have specific climate and social measures, including a Social Climate Fund to offset costs for vulnerable households.
Market stability mechanisms	Cost Containment Mechanism: allowances can be redistributed, or additional ones released from reserves or from future caps, if price is too high. Auction Reserve Price: minimum price for allowances sold, rises each year with inflation.	Market Stability Reserve: absorbs surplus allowances when the total number in circulation exceeds a threshold, and releases additional allowances into the market if price increases are too large or too rapid.
Governance	Managed by the UK ETS Authority, made up of relevant government departments and devolved governments.	Managed through EU legislation by the European Commission and member states.

Discussion around linking stems from the UK government's reset in UK-EU relations. The Common Understanding published after the UK-EU Summit stated that "the United Kingdom and the European Commission should work towards establishing a link between carbon markets".⁵ In practical terms, linking would mean that **allowances** issued in one system could be traded and used for compliance in the other. Material work is already underway on both sides, but the final outcome will depend on negotiations.

The EU-Switzerland linkage, established in 2020, provides precedent for linking, and highlights the importance of alignment on technical details and clear timelines for

⁵ UK government (2025). UK-EU Summit - Common Understanding.
<https://www.gov.uk/government/publications/ukey-summit-key-documentation/uk-eu-summit-common-understanding-html>

businesses.^{6,7} Enabling ETS participants to use **allowances** from both systems, and creating an electronic link between **allowance** registries.

Actions for innovators: Understanding key changes

- Build internal capability to understand carbon market developments. These are increasingly linked to trade, industrial strategy, innovation funding, and financial performance.

Helpful questions

- Are current decarbonisation investments robust under different carbon price, **CBAM**, and linking scenarios?
- Which customers, suppliers, or investors will expect a clear view of carbon cost exposure and transition planning?
- Who in the organisation is responsible for tracking ETS, **CBAM**, and wider carbon market developments, and how will this feed into commercial decisions?
- Does the business have sufficient monitoring, reporting and verification (MRV), and data capability to operate across linked UK and EU carbon market rules?

Why linking carbon markets matters for businesses

At a basic level, linking the UK ETS with the EU ETS will affect the carbon price paid, either directly or indirectly, by businesses. This is because linking would result in price parity – where the price per allowance is the same across both trading schemes. Currently, UK ETS allowances tend to trade at an average discount of approximately £17 compared to EU allowances.⁸

At this stage, it is difficult to determine how a linked carbon price might evolve over time, but due to increased market **liquidity** it should reduce price volatility.⁹ The EU ETS currently covers over 12,000 power plants, manufacturing installations, aircraft operators and shipping companies, compared to the UK ETS's 1,000; linking them would significantly increase **liquidity**.¹⁰

⁶ Swiss Federal Office for the Environment (2024). Linking the Swiss and EU emissions trading systems.

<https://www.bafu.admin.ch/en/linking-the-swiss-and-eu-emissions-trading-systems>

⁷ EUR-Lex (2017). Agreement between the European Union and the Swiss Confederation on the linking of their greenhouse gas emissions trading systems. https://eur-lex.europa.eu/eli/agree_international/2017/2240/oj/eng

⁸ International Carbon Action Partnership (2026). ICAP Allowance Price Explorer.

<https://icapcarbonaction.com/en/ets-prices>

⁹ Frontier Economics (2025). The shared benefits of linking EU and UK carbon markets. <https://www.frontier-economics.com/media/fi4i4b2o/frontier-linking-uk-eu-carbon-markets-final-report.pdf>

¹⁰ International Carbon Action Partnership (2026). EU Emissions Trading Scheme. <https://icapcarbonaction.com/en/ets/eu-emissions-trading-system-eu-ets>. And: International Carbon Action

For businesses that participate directly in the ETS, this can affect investment decisions around the economic viability of decarbonisation technologies, as well as the types of products and services they offer. For businesses that do not participate directly in the ETS, indirect costs such as electricity or material prices may be affected.

Linking also affects decisions around location and opens access to markets where existing trade barriers might make it challenging. It changes how competitiveness impacts businesses that form part of UK-EU supply chains. For businesses that expect to be affected by either the UK or EU **CBAM**, linking could support mutual exemptions, reducing the overall administrative burden on importers and exporters, and levelling the playing field more effectively between UK and EU industry and manufacturers.¹¹ Mutual exemptions between the UK and EU CBAMs are expected to save £900 million in border tax for the UK's heavy industry by 2030.¹²

Actions for innovators: Identifying impacted areas

- Identify exposure to changes: direct compliance exposure, indirect exposure through energy and material costs, and commercial exposure through customers, exports, and cross-border supply chains.
- Identify areas where linking and **CBAMs** could affect product pricing, margins, and competitiveness. This is especially important in sectors where carbon reporting and **CBAM** requirements are already starting to shape commercial behaviour.

Helpful questions

- How exposed is the business to UK and EU carbon prices, directly through compliance or indirectly through energy, materials, logistics, and customer contracts?
- Does the level of exposure mean that it would be worthwhile quantifying or modelling the impact of different ETS prices?
- Do existing contracts allow carbon costs to be passed through, shared, or renegotiated if prices converge or compliance costs change?
- Would CBAM relief change the business case for exporting to, importing from, or locating activity in the EU?

Partnership (2026). UK Emissions Trading Scheme. <https://icapcarbonaction.com/en/ets/uk-emissions-trading-scheme-uk-ets>

¹¹ UK government (2025). Factsheet: Carbon Border Adjustment Mechanism.

<https://www.gov.uk/government/publications/factsheet-carbon-border-adjustment-mechanism-cbam/factsheet-carbon-border-adjustment-mechanism>

¹² Cabinet Office (2025). UK-EU Summit – Explainer. <https://www.gov.uk/government/publications/ukey-summit-key-documentation/uk-eu-summit-explainer-html#uk-eu-agreement-to-link-emissions-trading-systems-ets>

Implications for innovators and scale-up

The main opportunity of linking is a larger and more investable carbon market. It provides investors with confidence that a long-term carbon price will endure, which strengthens the case for low carbon products and services. In the energy system, it can drive electrification and carbon capture and storage (CCS), as well as improvements in energy efficiency and the role that digitalisation has in supporting decarbonisation.

There is also a broader growth opportunity in emission reporting and verification services, and engineering expertise across industrial decarbonisation. Businesses that can offer solutions across both the UK and EU markets may find it easier to scale-up, especially where customers are looking for services that work across jurisdictions.

While linking will result in a larger carbon market, there will still be the need to offer products and services that work across regulatory environments. Understanding these, and the specific customer requirements in the relevant jurisdictions, remains important.

Risks

Linking two carbon markets is technically complex and institutionally demanding. It requires agreement on governance, dispute resolution, market oversight and the degree of continuing policy alignment required to keep the systems linked over time. Public commentary around the current proposals suggests that **dynamic alignment** (see next section) with relevant EU rules could form part of the architecture.¹³

Although the UK ETS and EU ETS share the same basic **cap-and-trade model**, their detailed rules are not identical and may continue to diverge over time. Differences in scope, market stability mechanisms, cap trajectories, treatment of new sectors, and the interaction with wider carbon policy can all affect the feasibility of linking. For example, market stability arrangements in a linked scheme would need to be determined through negotiation with the EU. This means businesses cannot assume that current UK market mechanisms will be carried forward unchanged into a linked system.

Even if both sides remain politically committed, negotiations, legal drafting, and implementation can take time. During that period, businesses may face uncertainty about future price trajectories, **CBAM** treatment, and whether to plan on the basis of linking or not. This could create a temporary pause in decision-making for some businesses, especially where there are major investments.

¹³ EU Parliament (2025). Linking the EU and UK emissions trading systems.

[https://www.europarl.europa.eu/RegData/etudes/BRIE/2025/775873/EPRS_BRI\(2025\)775873_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2025/775873/EPRS_BRI(2025)775873_EN.pdf)

Actions for innovators: Scenario testing		
Consider the different possible outcomes of ongoing negotiations, and further actions that may be required as a result of each of these.		
Scenario	Potential outcome	Business planning implication
No linking	The UK ETS and EU ETS continue to operate separately, with different prices, rules, and CBAM treatment.	Businesses should plan for continued regulatory friction, possible CBAM exposure, and separate compliance assumptions for UK and EU markets.
Partial or phased linking	Linking proceeds gradually, potentially with transitional rules, limited scope, or staged mutual recognition of allowances .	Businesses should monitor implementation milestones and avoid assuming immediate price convergence or full CBAM relief.
Full linking with closer alignment	Allowances are mutually recognised across both systems, with closer alignment of relevant market rules and governance arrangements.	Businesses may be able to plan around a larger, more liquid market, reduced trade friction, and stronger cross-border investment cases.
Delayed or failed negotiations	Political or technical barriers delay implementation or prevent a final agreement.	Businesses should maintain contingency plans for separate UK and EU compliance regimes, including carbon cost pass-through and customer pricing impacts.

Sector-specific considerations

Table 2. Potential impacts of EU-UK ETS linking on specific sectors.

Energy-intensive and trade-exposed industries	- Likely to be the most affected sectors, particularly if linking results in CBAM relief between the two carbon markets. - If CBAM relief is agreed, and a consistent carbon price between the two markets is achieved, then it can go some way to allaying competitiveness impacts while retaining the incentive to decarbonise. - It does not, however, mitigate against ongoing high energy prices and broader global trade exposure.
Power sector	- Linking could affect wholesale market expectations, generation economics, and the investment case for low carbon capacity. - A more integrated carbon pricing framework may influence dispatch patterns and reinforce incentives for low carbon generation over time. - It will also be relevant for businesses exposed to electricity prices through their operational expenditure.

Aviation and maritime	• Public statements around negotiations indicate that domestic and international aviation and maritime transport could be within the intended scope. • If in scope, operators would need to consider how aligned compliance rules affect route economics and competition across jurisdictions.
Carbon capture and storage	• Linking would remove barriers, which would remove disincentives for EU emitters to storing CO₂ in the UK. • A more streamlined regulatory landscape could support the growth of the CO₂ storage industry in the UK, with potential for investment and jobs.

Understanding dynamic alignment

Dynamic alignment would be an agreement where the UK's ETS rules become aligned and maintained with relevant EU ETS rules over time. The aim would be to ensure that the two carbon markets remain compatible and minimise potential competitive distortion. It would mean that future EU carbon policy may increasingly shape the commercial environment facing UK businesses.

This would change the nature of the UK's carbon policy autonomy. The UK may retain domestic legal and parliamentary processes, but in practice it would have less freedom to diverge from EU ETS rules where divergence could undermine the linked systems. This matters because future EU reforms could affect scheme scope, monitoring and reporting requirements, free allocation rules, market stability mechanisms, benchmarks, maritime and aviation coverage, and the treatment of new sectors. UK businesses would therefore need to monitor EU policy development more closely, and not just UK government policy development.

The proposed architecture for linking appears likely to involve UK engagement at early stages of EU policymaking, subject to the UK's status as a non-Member State, alongside dispute resolution arrangements and a role for the Court of Justice of the European Union on questions of EU law.¹⁴

There may also be timing and transition challenges. For example, if the EU ETS reforms move faster than the UK's processes, government and regulators will need the capacity to transpose or approximate rules quickly while maintaining scrutiny and stakeholder engagement. Poorly managed alignment could create uncertainty, rushed implementation or unnecessary compliance burden. But well-managed alignment would give businesses a clearer direction of travel and reduce the risk of potentially disruptive divergence.

¹⁴ ICAP (2025). EU and UK commit to linking emissions trading systems in landmark cooperation agreement. <https://icapcarbonaction.com/en/news/eu-and-uk-commit-linking-emissions-trading-systems-landmark-cooperation-agreement>

Key Terms

Allowance: A tradable unit that permits the holder to emit a specified quantity (usually one tonne) of greenhouse gases.

Cap-and-trade: A market-based environmental policy, which sets a limit or “cap” on total emissions. Companies are then issued or can buy allowances that permit them to emit a certain amount of emissions within the overall limit and can sell unused allowances to others.

Carbon Border Adjustment Mechanism (CBAM): A policy intended to address carbon leakage by applying a carbon price to certain imports.

Carbon leakage: The risk that production or investment shifts to jurisdictions with weaker carbon policy.

Dynamic alignment: Ongoing alignment of UK ETS rules with relevant EU ETS rules to preserve compatibility between linked markets.

Linking: A formal arrangement allowing allowances from one emissions trading scheme to be recognised in another.

Liquidity: The ease with which allowances can be bought and sold in the market without causing large price movements.

Market Stability Reserve: A mechanism used to manage allowance supply and address market imbalances or price volatility.

Licence/Disclaimer

Energy Systems Catapult Limited Licence for **Innovator briefing: What linking the UK and EU Emissions Trading Schemes could mean for competitiveness, investment, growth, and scale-up**

Energy Systems Catapult is making this report available under the following conditions. This is intended to make the Information contained in this report available on a similar basis as under the Open Government Licence, but it is not Crown Copyright: it is owned by Energy Systems Catapult. Under such licence, Energy Systems Catapult is able to make the Information available under the terms of this licence. You are encouraged to Use and re-Use the Information that is available under this Energy Systems Catapult licence freely and flexibly, with only a few conditions.

Using information under this Energy Systems Catapult licence

Use by You of the Information indicates your acceptance of the terms and conditions below. Energy Systems Catapult grants You a licence to Use the Information subject to the conditions below.

You are free to:

- copy, publish, distribute and transmit the Information
- adapt the Information
- exploit the Information commercially and non-commercially, for example, by combining it with other information, or by including it in your own product or application.

You must, where You do any of the above:

- acknowledge the source of the Information by including the following acknowledgement:
- "Information taken from **Innovator briefing: What linking the UK and EU Emissions Trading Schemes could mean for competitiveness, investment, growth, and scale-up**, by Energy Systems Catapult"
- provide a copy of or a link to this licence
- state that the Information contains copyright information licensed under this Energy Systems Catapult Licence.
- acquire and maintain all necessary licences from any third party needed to Use the Information.

These are important conditions of this licence and if You fail to comply with them the rights granted to You under this licence, or any similar licence granted by Energy Systems Catapult, will end automatically.

Exemptions

This licence only covers the Information and does not cover:

- personal data in the Information

- trademarks of Energy Systems Catapult; and
- any other intellectual property rights, including patents, trademarks, and design rights.

Non-endorsement

This licence does not grant You any right to Use the Information in a way that suggests any official status or that Energy Systems Catapult endorses You or your Use of the Information.

Non-warranty and liability

The Information is made available for Use without charge. In downloading the Information, You accept the basis on which Energy Systems Catapult makes it available. The Information is licensed 'as is' and Energy Systems Catapult excludes all representations, warranties, obligations and liabilities in relation to the Information to the maximum extent permitted by law.

Energy Systems Catapult is not liable for any errors or omissions in the Information and shall not be liable for any loss, injury or damage of any kind caused by its Use. This exclusion of liability includes, but is not limited to, any direct, indirect, special, incidental, consequential, punitive, or exemplary damages in each case such as loss of revenue, data, anticipated profits, and lost business. Energy Systems Catapult does not guarantee the continued supply of the Information.

Governing law

This licence and any dispute or claim arising out of or in connection with it (including any noncontractual claims or disputes) shall be governed by and construed in accordance with the laws of England and Wales and the parties irrevocably submit to the non-exclusive jurisdiction of the English courts.

Definitions

In this licence, the terms below have the following meanings: 'Information' means information protected by copyright or by database right (for example, literary and artistic works, content, data and source code) offered for Use under the terms of this licence. 'Energy Systems Catapult' means Energy Systems Catapult Limited, a company incorporated and registered in England and Wales with company number 8705784 whose registered office is at Cannon House, 7th Floor, The Priory Queensway, Birmingham, B4 6BS. 'Use' means doing any act which is restricted by copyright or database right, whether in the original medium or in any other medium, and includes without limitation distributing, copying, adapting, modifying as may be technically necessary to use it in a different mode or format. 'You' means the natural or legal person, or body of persons corporate or incorporate, acquiring rights under this licence.

Energy Systems Catapult is an independent research and technology organisation. Our mission is to accelerate Net Zero energy innovation.

Launched in 2015 by Innovate UK, the Catapult has built a team of more than 250 people, with a range of technical, engineering, consumer, commercial, incubation, digital, and policy expertise. They draw on sector-leading test facilities, modelling tools, and data collected from our back catalogue of more than 500 research projects.

We use that 'whole energy' system capability to support innovative companies -- small and large -- to test, trial and scale their new products and services. Our impact comes when those innovators attract new customers, new investment, and new grants so they can thrive in the future energy system.

Based in Birmingham, Energy Systems Catapult is part of a network of nine world-leading technology and innovation centres, established by Innovate UK. The Catapult Network fosters collaboration between industry, government, research organisations, academia, and many others to transform great ideas into valuable products and services.

Energy Systems Catapult

7th Floor, 18 Priory Queensway
Birmingham
B4 6BS

es.catapult.org.uk

© 05/08/2026 Energy Systems Catapult