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EU Reinforces the Stability and Predictability of Its Carbon Market

Key policies: *EU Emissions Trading System (EU ETS), Market Stability Reserve (MSR), European Green Deal, EU Climate Law, Fit for 55 Package, Carbon Market Reform*

The European Commission has announced overwhelming industry interest in the 2025 Innovation Fund auctions, with companies across Europe submitting almost **€10 billion** in funding requests to support industrial heat decarbonisation and renewable hydrogen production.

he European Commission has proposed a targeted reform of the **Market Stability Reserve (MSR)** to strengthen the stability and predictability of the European Union Emissions Trading System (EU ETS).

The proposal, announced following President Ursula von der Leyen's commitment at the March European Council, represents the first concrete step in the broader review of the EU ETS planned for 2026. By adapting the operation of the Market Stability Reserve, the Commission aims to reinforce the resilience of Europe's carbon market while preserving the environmental integrity of the emissions trading system.

The initiative is intended to ensure that the EU ETS continues to provide a stable investment framework for industrial decarbonisation and clean energy while responding more effectively to changing market conditions.

Strengthening the Market Stability Reserve

The Market Stability Reserve was established to balance the supply of emission allowances within the EU ETS and reduce excessive market volatility.

Under the current rules, allowances held in the reserve above a threshold of **400 million allowances** are permanently cancelled.

The Commission now proposes to discontinue this automatic invalidation mechanism. Instead, allowances exceeding the threshold would remain within the reserve, creating a strategic buffer that could be released if future market conditions require additional supply.

The proposal maintains the rules-based nature of the Market Stability Reserve while increasing its capacity to respond to future fluctuations in demand and supply.

Supporting a more resilient carbon market

The proposed changes are designed to improve the long-term functioning of the EU carbon market.

The enhanced reserve would help:

- Reduce excessive market volatility
- Improve price predictability
- Respond more effectively to supply shortages

This project is supported by the Interreg Danube Region Programme co-funded by the European Union.

- Increase confidence among market participants
- Strengthen long-term investment certainty

According to the Commission, greater predictability will support investment decisions in low-carbon technologies while ensuring that the EU ETS continues to deliver effective emissions reductions.

The EU ETS remains central to Europe's climate strategy

The Commission underlines that the EU Emissions Trading System remains the European Union's flagship carbon pricing instrument and one of its most effective climate policy tools.

Since its introduction, the EU ETS has:

- Reduced fossil fuel consumption
- Stimulated investment in renewable energy
- Accelerated deployment of low-carbon technologies
- Strengthened Europe's energy security
- Reduced dependence on imported fossil fuels

The Commission notes that between **1990 and 2024**, domestic greenhouse gas emissions in the European Union fell by **39%**, while the EU economy expanded by **71%**, demonstrating that economic growth can be successfully decoupled from greenhouse gas emissions.

Responding to changing market conditions

Recent geopolitical developments, higher energy price volatility and evolving industrial challenges have highlighted the need for greater flexibility within the carbon market.

The proposed reform seeks to modernise the EU ETS without altering its fundamental market-based design.

The Commission emphasises that the revised Market Stability Reserve would remain fully rules-based while becoming better equipped to address future developments, including potential shortages of emission allowances during the coming decades.

The proposal therefore aims to preserve both:

- Environmental integrity
- Market stability

while improving the system's responsiveness to changing economic conditions.

Building on the success of the Market Stability Reserve

The Market Stability Reserve has operated since **2019** as an automatic mechanism that adjusts the number of emission allowances available on the market.

It was introduced to address the structural surplus of allowances that accumulated following the **2008 global financial crisis**, which weakened the carbon price signal.

According to the Commission:

- The reserve has successfully restored confidence in the EU carbon market.
- By the end of **2024**, approximately **3.2 billion emission allowances** had been permanently invalidated under the existing rules.

The proposed reform builds on this experience while adapting the system for the next phase of the EU's climate transition.

Next steps

The proposal to amend the **Market Stability Reserve Decision** will now be submitted to the:

- European Parliament
- Council of the European Union

The legislation will follow the ordinary legislative procedure before it can be formally adopted.

The Commission has also announced that a comprehensive review of the EU Emissions Trading System will be presented in **July 2026**.

That broader evaluation will examine whether additional adjustments are required to ensure that both the EU ETS and the Market Stability Reserve remain fit for purpose throughout the next decade.

Background

The **EU Emissions Trading System (EU ETS)** is the European Union's principal market-based instrument for reducing greenhouse gas emissions. Operating on a cap-and-trade principle, the system establishes an overall limit on emissions from covered sectors while allowing companies to trade emission allowances.

The **Market Stability Reserve (MSR)** was introduced in 2019 to improve the functioning of the carbon market by automatically adjusting the supply of allowances in response to changing market conditions.

The Commission's latest proposal represents the first legislative step in the forthcoming modernisation of the EU ETS. By strengthening the Market Stability Reserve while preserving the integrity of the carbon market, the European Union aims to provide greater certainty for investors, support industrial decarbonisation and reinforce the role of carbon pricing in achieving climate neutrality by 2050.

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