UK/EU SUMMIT EXPLAINER: ETS LINKING AGREEMENT

OVERVIEW

- The UK and EU have reached an agreement to link their respective carbon markets, the UK Emission Trading Scheme and the EU Emission Trading System. The legal agreement will be published in due course, as well as a detailed explainer setting out what the agreement means.

- Both parties are working to complete the relevant legislative and technical processes to operationalise the link for 1 January 2028. From this point ETS allowances issued in either the UK or EU can be used for compliance across either scheme.

- This agreement is a direct response to consistent calls from UK businesses to provide industry with access to a larger, more liquid carbon market and remove barriers to UK-EU trade through exemptions from our respective CBAMs. The agreement will also streamline regulatory processes for aviation and maritime operators who operate under both schemes.

- The linking agreement will:

    - **Exempt British exporters from new border taxes:** Linking carbon markets removes a major post-Brexit barrier to trade by exempting around £6.5 billion worth of UK exports from the EU Carbon Border Adjustment Mechanism (CBAM);
    - **Boost economic growth**: Adding up to £3.8 billion to the economy each year by 2040;
    - **Cut red tape for UK businesses**: UK manufacturers with operations in the EU, shipping companies and airlines will benefit from shared rules across both markets, cutting paperwork and compliance costs. Airlines will further benefit from no longer having to comply with two separate systems. UK importers will benefit from reduced CBAM administration costs when importing from the EU;
    - **Give industry confidence to invest**: This agreement creates the world's largest linked carbon market, giving British businesses access to a more liquid market, and the long-term price stability and confidence they need to invest in clean technology;
    - **Unlock cross-border carbon storage opportunities**: The agreement removes key regulatory barriers so British firms can sell CO2 storage services to European neighbours, and vice versa - the Carbon Capture and Storage Association (CCSA) estimates this market could be worth over £4 billion a year in export revenues and £7 billion in private investment.

- This Agreement includes dynamic alignment, which means to interpret and apply the same rules at the same time, on an ongoing basis. Where we dynamically align, the UK will have an early decision-shaping role on EU rules in development. This is essential for ensuring that UK interests are reflected, and that the treaties can function effectively.

- The benefits of linking will be felt by businesses throughout the UK. These are located across the breadth of the UK, with major concentrations in industrial heartlands, particularly the North West of England, Yorkshire and the Humber, the North East and the Midlands, as well as South Wales, central Scotland and in Northern Ireland.

- The UK ETS and EU ETS will operate as two separate but linked systems. The UK ETS Authority, comprised of the UK Government, Scottish Government, Welsh Government and Northern Ireland Department of Agriculture, Environment and Rural Affairs (DAERA), will

continue to exercise decision-making powers relating to the implementation and ongoing maintenance of the UK ETS.

BACKGROUND

- Emissions Trading Schemes are market-based systems that cap total greenhouse gas emissions and allow participants to buy and sell emissions allowances, creating a financial incentive to reduce emissions by investing in decarbonisation. The UK has been a consistent champion of carbon pricing because it is a proven and effective way to cut emissions, giving businesses a choice over how they decarbonise and therefore helping deliver the transition to net zero as cost-effectively as possible.

- The UK played an instrumental role in setting up the EU Emissions Trading System and following the UK's departure from the EU, set up the UK Emissions Trading Scheme in 2021. In the Trade and Cooperation Agreement (TCA), the UK and EU agreed to cooperate on carbon pricing and give serious consideration to linking their respective carbon pricing systems.

- In the years following the signing of the TCA, UK businesses led sustained calls for the Government to pursue a link and provide industry with access to a deeper and more liquid carbon market. In April 2021, forty leading industry bodies wrote to the UK government and European Commission, urging them to start the process of linking. Since then, there have been sustained calls by numerous business and industry groups to link the UK ETS and EU ETS.

- Reflecting the TCA commitment and in response to industry requests, the UK and EU committed to pursue ETS linking at the UK-EU Summit in May 2025 and published the broad parameters for these negotiations in the Common Understanding. Negotiations began in late 2025 following the approval of negotiating mandates. The Government is pleased to announce that we have now reached an agreement to link our carbon pricing systems.

- The UK Government and UK ETS Authority (the joint decision-making body for the UK ETS), is committed to continuing to engage stakeholders throughout the implementation process. In addition to the detailed explainer, there will be a programme of webinars to explain the agreement and take questions from stakeholders.

KEY OUTCOMES

ECONOMIC GROWTH

HMT analysis suggests that linking could add up to £3.8 billion to the UK economy each year by 2040.

REDUCING COSTS FOR UK BUSINESSES AND STRENGTHENING UK-EU TRADE

Linking will reduce costs for UK businesses by enabling an exemption from the EU CBAM, removing a major barrier to trade. UK exports of goods in scope of EU CBAM are worth around £6.5 billion. Without a CBAM exemption, UK exporters would face a significant administrative burden, and UK exports would incur financial costs, which would flow to the EU budget. Mutual CBAM exemptions will strengthen UK-EU trade flows. This will particularly support Northern Ireland businesses who trade large volumes of goods with Ireland.

REMOVES REGULATORY BARRIERS

By removing regulatory barriers, the agreement will enable the UK to capitalise on commercial opportunities for cross-border CO2 transport and storage between the UK and EU. A Europe-wide market for CO2 storage could generate significant value for the UK whilst reducing the cost of CCUS-enabled decarbonisation across the region. The agreement will also reduce the administrative burden on maritime and aviation operators who operate under both schemes.

ACCESS TO A LARGER, MORE STABLE AND LIQUID CARBON MARKET

This agreement creates the world's largest linked carbon market, providing UK industry with access to a larger, more liquid carbon market. This will create greater price certainty, providing industry with the stability and certainty needed to invest in decarbonisation in the UK.

CHEAPER PATH TO NET ZERO

A larger carbon market will enable a more cost-effective path to net zero. This will support the UK meeting its ambitious emissions reductions targets whilst supporting industry and competitiveness.

AMBITIOUS CLIMATE LEADERSHIP

ETS linking is precedent-setting globally and reaffirms UK and EU's international climate leadership. Creating the world's largest linked carbon markets sends a powerful signal that globally integrated carbon markets are achievable and demonstrates the UK's commitment to carbon pricing as an efficient and cost-effective tool for reducing emissions.

PROTECTING THE UK ETS

The agreement secures a range of important outcomes for the UK ETS, including:

- Flexibility to set the UK ETS cap in line with Carbon Budgets;
- UK–specific transitional arrangements for free allocation;
- Greater consistency of rules for businesses operating across the UK and EU carbon markets, including maritime and aviation operators participating in both the UK and EU ETS.
- Awarding UK ETS allowances to support the uptake of sustainable aviation fuel; and
- Protecting the UK's ability to move ahead with its own model for integrating Greenhouse Gas Removal.

IMPLEMENTATION

- The UK and EU are now working to implement this agreement and operationalise a link. This includes passing the necessary legislation in 2027 and delivering technical changes to the UK and EU's registries to allow trading of allowances.

- This work will enable the agreement to apply from 1 January 2028. From this date, UK and EU allowances can be used interchangeably across both schemes. The first surrender deadline where UK and EU Allowances will be accepted across both schemes will be 30 September 2028, with respect to operators' obligations for the 2027 compliance year.