

ENERGY COSTS AND EUROPEAN INDUSTRIAL COMPETITIVENESS

Food for thought ahead of the European Council from Czech Republic and Italy

The current energy shock is putting unprecedented pressure on European industry. While security of supply remains the immediate priority, the combination of some of the world's highest energy prices, high carbon costs and exceptional fuel prices risks further weakening European manufacturing and accelerating the relocation of production and investment.

A temporary suspension of the EU ETS would provide immediate relief to European industry from carbon costs. However, in the absence of sufficient support for such an option, it is worth considering a number of targeted and immediately actionable alternatives that the European Council could promote to alleviate the impact of the current shock and complement measures already announced at European level.

1. Use the MSR to avoid ETS amplifying the current energy shock

Building on the Commission's proposal to preserve the firepower of the Market Stability Reserve (MSR), a temporary adjustment of MSR intake thresholds could be considered in the current exceptional circumstances.

This could include reducing or, if necessary, temporarily suspending the intake of allowances by the MSR. Under the current rules, around 190 million allowances are due to be withdrawn from auctions between September 2026 and August 2027.

If market conditions deteriorate significantly, an extraordinary and rules-based release of allowances from the MSR might also be considered.

2. Protect European production where decarbonisation alternatives are not yet competitive

Building on the Commission's proposals on free allocation and sectoral benchmarks, further temporary flexibility could be considered for the most exposed sectors, where current allocation levels do not adequately reflect the availability and cost of viable decarbonisation technologies.

This should include reviewing the methodology for setting both sectoral and fallback benchmarks to ensure that they adequately reflect actual European production and capacity, while avoiding the triggering of the cross-sectoral correction factor. Consideration should also be given to temporarily pausing the phase-out of free allocation for CBAM sectors and further reductions in free allocation.

3. Limit the pressure on electricity prices

Carbon costs borne by fossil-fuel power generators are passed through into wholesale electricity prices, increasing costs for European industry, particularly when fossil-fuel generation sets the marginal price.

Under the current exceptional circumstances, the EU should examine temporary measures to reduce the impact of ETS costs from fossil-fuel power generation on electricity prices, taking into account differences in Member States' energy mixes. This could include temporary adjustments to ETS obligations for marginal fossil-fuel generation. Any intervention should be targeted and time-limited, while preserving long-term decarbonisation incentives.

The potential regional electricity deficit needs to be swiftly addressed in Taxonomy Regulation by extending transitional role of natural gas beyond 2035, as well as recognize nuclear energy as sustainable. This would provide sufficient incentives for investors and financial institutions to support further investments.

4. Remove regulatory constraints that could aggravate current supply pressures

The Commission should identify regulatory requirements affecting energy imports and supply that could be temporarily postponed or made more flexible under current exceptional market conditions. One immediate case for consideration is the EU Methane Regulation. Building on the pragmatic approach already taken to its implementation, the requirements under Article 28 applying from January 2027 should be temporarily suspended to avoid complicating access to alternative suppliers under current exceptional market conditions.

5. Increase transparency in the EU Allowances (EUA) market

The Commission, ESMA and ACER could intensify joint monitoring of EUA positions, market concentration and the interaction between carbon, gas and electricity markets, with greater transparency on compliance and hedging activity versus purely financial positions.

Financial intermediaries provide important liquidity and risk-management services. However, where evidence shows that specific market practices are amplifying exceptional price movements, appropriate supervisory measures should be considered.

6. Reconsider the introduction of ETS2

Given the current exceptional energy situation, the European Council should invite the Commission to reassess the introduction of ETS2 in 2028, taking full account of its potential impact on fuel and heating costs, industrial competitiveness and households. Its introduction should be postponed if these conditions risk aggravating the current energy and competitiveness crisis.

Immediate focus

These measures would complement existing Commission action, showing the European Council's capacity to provide political direction and impetus at a critical moment for Europe's industry, without altering the EU's long-term climate objectives.

The priority is to prevent exceptional energy and carbon costs from causing permanent losses of European industrial capacity, including refining capacity, investment and competitiveness.