

Energy UK explains: Linking the UK and EU Emissions Trading Schemes

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Key points

- The UK and European Union share legally binding Net Zero targets and clear incentives to cooperate on energy and climate-related issues.
- The Government has suggested that closer cooperation on carbon pricing would be of interest as part of its wider 'reset' with the EU.
- Linking the UK's and EU's Emissions Trading Schemes (ETS) would provide certainty for industry, remove barriers to trade and encourage investment in clean technologies.
- Linkage would reduce carbon prices over the next few years for British industry, bolstering the economy's competitiveness, and exempt UK exporters from payments of up to £800m annually from the EU's forthcoming Carbon Border tax, ensuring British companies remain competitive.
- ETS linkage is widely supported across UK industry by organisations such as the CBI, Make UK, UK Steel, and the TUC, in addition to diverse sectors of the economy like energy, glass, chemicals, paper, mineral products, and ceramics.

What is an Emissions Trading Scheme?

- An Emissions Trading Scheme (ETS) is designed to reduce greenhouse gas emissions over time. It works by placing an overall cap on emissions and auctioning allowances (permits that allow a certain amount of pollution) to companies that emit.
- Over time, this cap shrinks in size and fewer allowances are auctioned annually. This pushes up prices, making it more cost-effective to decarbonise than continue to pollute.
- The combination of a legally binding cap on emissions and strong market incentives means an ETS is the most efficient and effective way of pricing carbon emissions in an economy.

What happened to carbon pricing in the UK after Brexit?

- The UK was the first country in the world to pilot a national ETS in 2002. This became the basis of the EU ETS, in which the UK participated until Brexit.
- Prior to negotiations on the UK-EU Trade and Cooperation Agreement (TCA), there was an expectation that either the UK would remain within the EU ETS, or a standalone UK ETS would be linked to the EU ETS from the start. This did not

happen, and a new UK ETS was implemented from 2021, with a commitment to ‘seriously consider’¹ linking the two schemes in the future.

- The UK ETS is roughly 10 times smaller than the EU ETS (when combined with the Swiss ETS, with which it is linked). Being a smaller market, the UK ETS suffers from low liquidity, making the UK’s carbon price more volatile.

What does ETS linkage mean? How would ETS linkage work?

- An ETS linkage agreement allows companies to surrender an allowance purchased in one jurisdiction in the other jurisdiction, and vice versa.
- Linkage agreements have been implemented several times previously, including between the EU and Switzerland and between California and Quebec. Both the UK and EU have committed to give it ‘serious consideration’ in the Trade and Cooperation Agreement negotiated by the previous Government.²
- Linking is not the same as rejoining an EU institution. A linkage agreement would be a separate international treaty to the TCA, governed by its own dispute resolution mechanism.

What are the benefits of ETS linkage?

- ETS linkage would be a win-win for the UK and EU. The advantages of linkage are clear in terms of liquidity, price discovery, and the ability to attract abatement from across a larger area. This would enable the UK to achieve Net Zero quicker, and at lower cost.
- Linkage is supported by most of the industries covered by the UK ETS as it would make the UK carbon market larger, more predictable and less volatile. It also has widespread support across industry, unions and civil society in the UK and EU.³
- ETS linkage would exempt UK businesses from EU Carbon Border Adjustment Mechanism (CBAM) payments, exempting UK exporters from payments of up to £800m annually to the EU by 2030,⁴ and avoid significant uncertainty for the operation of the Single Electricity Market on the island of Ireland.⁵
- A unified UK-EU carbon market would send a strong global signal in support of the UK’s commitment to climate diplomacy and joint action on climate change.

How long would it take to negotiate a linkage agreement?

- The Government could have a linking agreement in place well before the next election. It could negotiate an interim agreement while negotiations are ongoing

¹ Article 392 of the [Trade and Cooperation Agreement](#).

² Article 392 of the [Trade and Cooperation Agreement](#).

³ [UK and EU Domestic Advisory Groups on the TCA \(2024\) Joint Statement](#).

⁴ [Frontier Economics \(2024\) Linking UK and EU carbon markets](#).

⁵ [Energy UK \(2025\) Borderline confusion: Carbon Border Adjustment Mechanisms in Northern Ireland](#).

to avoid any potential negative impacts from the EU's CBAM, which will be applied to British exports of certain goods from 1 January 2026.

- The last linkage agreement negotiated by the EU was with Switzerland and took several years to negotiate. However, this was significantly delayed by a breakdown in EU-Swiss relations over a referendum in Switzerland on freedom of movement with the EU.
- The UK is in a different position to this, with a clear government priority for a 'reset' in the UK's relationship with the EU, and both sides have legally binding targets for reaching Net Zero by 2050.
- While there are very few differences at present between the UK ETS and EU ETS, any differences will become greater over time as policies naturally diverge in the UK and EU. Not acting now to link ETSs could lead to a more difficult negotiation if the Government decides to do so at a later date.

What would ETS linkage mean for Carbon Border Adjustment Mechanisms (CBAMs)?

- Linking the UK and EU ETS would lead to carbon price convergence between the two jurisdictions, and exempt UK companies from the EU's CBAM.
- If there is no agreement to link the two schemes, there is a risk of a significant negative impact on UK businesses in sectors in scope of the EU CBAM. This could lead to payments of up to £800m by UK businesses to the EU by 2030.⁶
- The EU CBAM would have a major impact on electricity trading between the UK and EU countries, which both sides need for maintaining a secure electricity system.
- A CBAM would make electricity exported from the UK less competitive as it faces additional CBAM costs, making British electricity exports and investment in new technologies in the North Sea (such as multipurpose interconnectors, which would reduce the cost of delivering joint UK-EU North Sea offshore wind targets by up to £11bn⁷) less attractive.
- The EU CBAM also creates significant uncertainty for the operation of the Single Electricity Market on the island of Ireland. It could lead to barriers to trade between Northern Ireland and Great Britain and higher energy bills for Northern Irish consumers.⁸

Would ETS linkage lead to higher prices in the UK?

- ETS linkage will reduce volatility in the UK's carbon market and make investment in decarbonisation technologies more commercially attractive. This will reduce

⁶ [Frontier Economics \(2024\) Linking UK and EU carbon markets.](#)

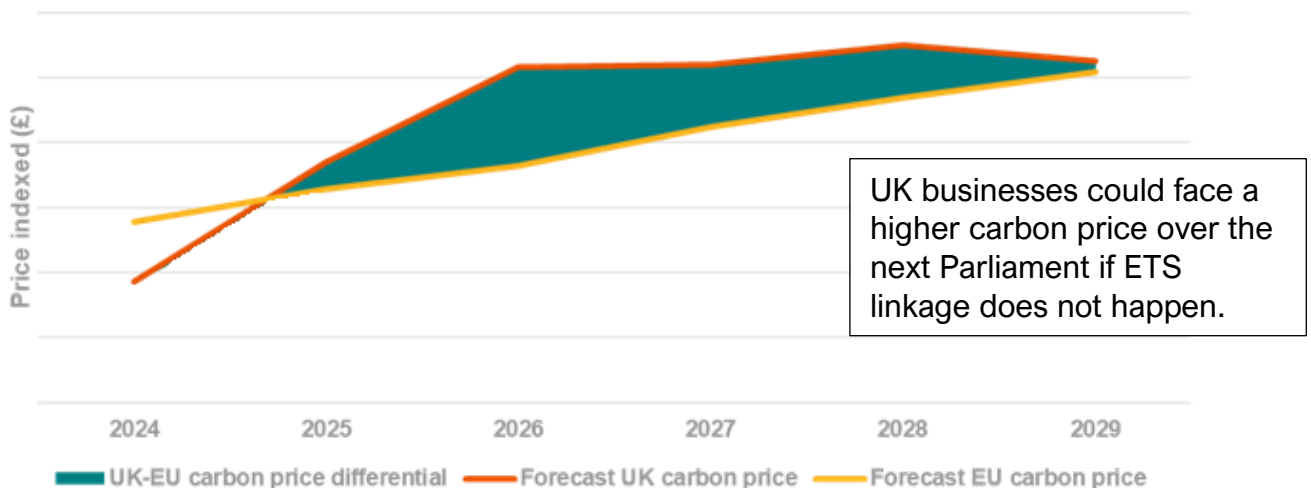
⁷ [Energy UK \(2024\) The Power of Partnership: UK-EU energy cooperation for a clean, secure future.](#)

⁸ [Energy UK \(2025\) Borderline confusion: Carbon Border Adjustment Mechanisms in Northern Ireland.](#)

prices in the medium term by enabling the use of more efficient, lower carbon technologies for industrial processes.

- In the short term, given the weakness of the UK ETS from 2023 until present, there may be some small upwards adjustments to carbon prices faced by UK businesses. However, due to predicted market tightening in the UK ETS from 2027, linking with the EU ETS in the near-term would mean the carbon price faced in the UK may actually end up lower than with a standalone UK ETS (see Figure 1).
- Linking would also exempt UK businesses from the EU CBAM, avoiding payments of up to £800m paid by exporters to the EU annually by 2030.⁹ This would make UK industrial exports significantly less competitive in EU markets. Any costs incurred could also be passed onto consumers.

Figure 1: relative UK and EU carbon prices over the current Parliament (2024-29)



Source: Energy UK analysis of HMT¹⁰ and Carbon Pulse data. Chart created with permission from Carbon Pulse.

Would ETS linkage mean a return to following EU laws in the UK?

- No. A linkage agreement would be its own international treaty. Both sides would need to agree on the sectors in scope of the linked ETS, although flexibilities between linked schemes can be maintained. For example, the EU ETS and Swiss ETS are linked but there are minor differences in scope and operational independence in the application of various market mechanisms.
- Linking carbon markets is not the same as re-joining the EU or the Customs Union. It is an international trade mechanism within which the UK would maintain

⁹ [Frontier Economics \(2024\) Linking UK and EU carbon markets.](#)

¹⁰ [HMT \(2024\) Traded carbon values used for modelling purposes, 2024](#)

its revenues and be able to set many of its own rules. This would ensure that such a mechanism is beneficial both for the UK's economy and sovereignty.

- The EU-Swiss linkage agreement uses the Permanent Court of Arbitration in The Hague as a dispute resolution mechanism. This is the same disputes court used by the TCA, which was negotiated by the previous Government.

What would ETS linkage mean for Northern Ireland?

- Northern Ireland and the Republic of Ireland operate a combined Single Electricity Market (SEM). The EU CBAM will apply to electricity, and to maintain the integrity of the SEM and avoid EU trade concerns, Energy UK believes it is likely that the EU will request that its CBAM applies to Northern Ireland.
- However, this would require action under the Windsor Framework, potentially reopening political debates on the post-Brexit status of Northern Ireland.
- ETS linkage is a simple solution for this complex, potentially highly politicised topic, as it would remove the need for a CBAM on goods traded between the UK and EU.

Further reading

- [AFRY \(2024\) EU CBAM impact assessment.](#)
- [Energy UK \(2024\) UK Emissions Trading Scheme.](#)
- [Energy UK \(2024\) The Power of Partnership: UK-EU energy cooperation for a clean, secure future.](#)
- [Energy UK \(2025\) Borderline confusion: Carbon Border Adjustment Mechanisms in Northern Ireland.](#)
- [Frontier Economics \(2024\) Linking UK and EU carbon markets.](#)