Investments Instead of Symbolic Politics

The ETS Reform as a Pivotal Economic Policy Decision

Joint statement by

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Berlin, 25 June 2026

Germany and Europe face one of the most important economic policy decisions of this decade. The decisive question is whether Europe mobilizes the investments necessary for competitiveness, resilience, and climate neutrality—or whether this capital, along with innovation and future technologies, increasingly migrates to other regions of the world.

Amid economic and geopolitical tensions, political pressure is mounting to call key pillars of climate policy into question. Under discussion are postponing the national climate neutrality target, far-reaching interventions in the European Emissions Trading System (ETS), and suspending the planned emissions trading scheme for buildings and transport (ETS2).

These debates fall short. The challenge is not to abandon targets or roll back successful climate instruments, but to successfully combine competitiveness, resilience, and climate protection while incentivizing investment.

Germany should join its EU partners in taking responsibility for Europe's future prosperity and should drive forward a reform agenda that is market-based, investment-oriented, and grounded in sound economic principles. Carbon pricing should remain the guiding instrument at the center of this agenda—rather than ever more granular regulation, technology-specific mandates, and permanent subsidies. Such an agenda strengthens Europe as a location for investment and innovation, improves the international compatibility of European climate policy, and enables fair cross-border competition along with a broader anchoring of carbon pricing.

Winning, Not Losing, the Investment Decade

Germany's economic problems are serious. High energy costs, skilled-labor shortages, bureaucracy, slow approval procedures, geopolitical uncertainty, and weak investment momentum are weighing on the country.

None of these problems would be solved by reversing course on climate policy. Quite the opposite.

Europe currently accounts for around 25 percent of the world's pipeline of industrial decarbonization projects. In the steel sector, that share is roughly 50 percent; in cement, over 70 percent. A large share of these projects are located in Germany or involve German companies. At the same time, more than 90 percent of these projects have yet to reach a final investment decision.

The decisive question is whether Germany and Europe can actually mobilize these and other necessary investments.

This is precisely why the German Council of Economic Experts' call for "stabilizing expectations" matters more today than ever. Companies invest on the basis of reliable conditions, not amid

shifting course and recurring debates over targets. In an increasingly uncertain geopolitical world, planning certainty itself becomes a competitive factor.

Why the ETS Reform Is the Real Crossroads

The decisive fork in the road for economic and climate policy will not be set by a debate over national climate neutrality in 2045 or 2050. It will be set in 2026, through the reform of the ETS.

Today, the ETS is far more than a normative climate instrument. It is an investment signal, an innovation driver, protection against carbon leakage, and increasingly an industrial-policy lever as well.

It creates a reliable framework for long-term investment decisions and combines climate protection with technology openness and market-based efficiency.

Since its introduction in 2005, emissions from sectors covered by the ETS have fallen by around 50 percent. The system is on track to achieve a 62 percent reduction in CO_2 by 2030. At the same time, the ETS has established itself as the world's most successful carbon market and has played a major role in triggering investment in renewable energy, innovative technologies, and climate-friendly production methods.

Experience from the past two energy crises also shows that the transformation of the power sector—partly driven by the ETS—and efficiency gains in industry have made Europe's energy supply more resilient.

But the system is now entering a new phase. As things currently stand, no new allowances would be issued toward the end of the 2030s. At the same time, the Carbon Border Adjustment Mechanism (CBAM) has come into effect, while free allocation—the instrument that has so far protected against carbon leakage—is being phased out step by step.

The ETS reform will determine:

- how carbon leakage will be prevented going forward,
- whether innovation and investment in industrial decarbonization are mobilized,
- what role carbon removals will play in the future,
- and how international cooperation for effective climate action under Article 6 of the Paris Agreement can be integrated.

Why Germany Must Take Responsibility Now

The ETS reform is about hard economic interests. Germany is Europe's largest industrial nation and a decisive voice in the European debate. If Germany calls its climate neutrality targets or EU-wide market-based carbon pricing into question, the upcoming EU reform risks turning into a fundamental debate about the ETS itself. The consequences for Europe as a business location would be severe: rising investment uncertainty, weakened incentives for innovation, and a lack of planning certainty for companies.

At the same time, we find ourselves in a global race for growth markets in hydrogen, new battery technologies, renewable energy, and the circular economy. Germany already holds a share of around 13 percent of the rapidly growing global trade in environmental and climate technologies—nearly twice its overall share of world trade. Germany and Europe therefore have

a fundamental interest in functioning global trade, technological leadership, and effective global climate action.

To advance these interests, Germany must champion a redefinition of Europe's strategic position. Both an inflexible European regulatory logic and a dismantling of climate policy that ignores global realities would undermine these interests—economically as well as geopolitically.

Four Elements of a Constructive ETS Reform

The right response to today's challenges lies in a robust emissions trading system that equally accounts for competitiveness, investment incentives, and climate protection. To this end, Germany should put four reform priorities at the center of the ETS reform:

- **Future-proofing carbon leakage protection**

With the phase-out of free allocation and the introduction of CBAM, Europe's carbon leakage architecture is in a period of transition. The introduction of CBAM is coherent from a regulatory standpoint and sends a signal that has already prompted economies such as China, India, and Brazil to develop their own carbon pricing instruments.

At the same time, CBAM protects only the single market, not exports. Parts of industry—large segments of the chemical sector, for instance—are not covered by the mechanism. Cascading effects along value chains are also a risk. The answer lies neither in a blanket weakening nor a blanket expansion of the system, but in targeted refinement focused on effectiveness, practicability, and international compatibility.

- **Reforming free allocation, incentivizing investment at home**

For sectors not covered by CBAM that face a high risk of carbon leakage, free allocations should remain available and be used more selectively. A more differentiated allocation can provide relief where it is most urgently needed and avoid a scattershot approach.

Free allocation should also be gradually transformed from a relief instrument—still necessary as it is—into an investment instrument.

Pragmatic, technology-open, and outcome-oriented requirements for companies can serve as a complementary incentive for investment in Europe, applying where companies receive additional support. Conditionality must not result in additional bureaucratic burden or rigid investment mandates.

Companies that invested early in decarbonization must not be put at a disadvantage relative to later investors.

- **Strengthening the ETS through greater flexibility**

The long-term credibility of the ETS depends not only on the level of the carbon price but also on its ability to respond to economic and technological change. Before any intervention in the emissions trajectory is discussed, existing flexibility options should first be fully exhausted:

    - Integrating high-quality carbon removals into the ETS can prevent extreme price spikes as fewer conventional allowances remain available within the system.
    - Reforming the Market Stability Reserve and suspending the cancellation of allowances under the market stability mechanism, to cushion price spikes like a shock absorber.

    - Enabling high-quality projects under Article 6 of the Paris Agreement to achieve cross-border emissions reductions at low abatement cost—allowing emissions trading to become a building block of international industrial cooperation with added geopolitical value.

This added flexibility helps strengthen the robustness and acceptance of the ETS without calling its integrity into question. After all, the stronger the steering effect of the carbon price, the fewer political mandates, bans, or complex regulations are needed.

The interplay with ETS2 also matters here. Once ETS2 is introduced in 2028 and establishes carbon pricing as the guiding instrument in the buildings and transport sectors, this will create more flexibility within ETS1—particularly for the industrial sector.

- **Returning ETS revenues, instead of using them to plug budget gaps**

Revenues from European emissions trading should flow back, more than they currently do, to companies that invest specifically in key technologies. There is considerable need for investment in the shift to climate-neutral production methods. The goal should be to mobilize private investment for the transformation, strengthen industrial competitiveness, and keep Europe an attractive location for climate-neutral production over the long term.

Likewise, revenues from ETS2 should flow back to citizens, enabling them to adjust to rising carbon prices in the future. Household investment can be accelerated by frontloading revenues from carbon pricing in the buildings and transport sectors, using them now as an investment lever. The European Investment Bank has already created an instrument for this purpose—the so-called frontloading facility—which should be scaled up further to prepare households for ETS2 and strengthen public acceptance of emissions trading across Europe.

A Reform Agenda, Not Symbolic Politics

Germany should not concentrate its political capital on symbolic debates over target years. The real economic policy decision will be made in the reform of the European Emissions Trading System.

The central task is not to weaken the ETS, but to further develop it so that, even in a new geopolitical reality, it continues to enable investment, competitiveness, and climate protection alike.

A strong and flexible ETS is not at odds with industrial and location policy—it is its foundation.

Signatories

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