

Why the EU's MSR Amendment Won't Deliver

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Summary

- The European Commission has proposed amending the Market Stability Reserve (MSR) to halt the permanent cancellation of allowances exceeding 400 million, instead retaining them as a stabilising buffer against future supply shocks. The authors argue that the proposal is a political signal with no practical effect: both MSR's release triggers are virtually impossible to activate under current market conditions; this means that having a larger reserve does not lead to any change.
- The first trigger – that the total number of allowances in circulation (TNAC) falls below 400 million – is unrealistic given current elevated gas prices and suppressed fossil fuel demand. The second, which needs allowance prices to exceed 2.4 times the two-year average, would require prices to surge above €168 – an implausible scenario today.
- Meaningful reform must start by accepting that EU decarbonisation needs to slow down to remain competitive. The authors recommend revising the 2040 emissions reduction target from 90% to 80% – a linear trajectory that remains fully compatible with achieving net zero by 2050.
- Overlapping instruments – such as renewable mandates, efficiency targets, and sectoral bans – inflate the implicit cost of carbon above its optimal level and should be scaled back.
- In the upcoming Emissions Trading System (ETS) revision, the EU should introduce a price band with a clear ceiling, calibrated to reflect international competitiveness and the cumulative burden of existing EU climate policy.
- The authors recommend abolishing the MSR entirely and replacing it with a transparent, rules-based mechanism to manage allowance supply that is directly tied to emission targets, reducing uncertainty for long-term investors.

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Introduction

The Commission has put forward an amendment¹ to the Market Stability Reserve (MSR) decision to reinforce the mechanism that underpins a stable and effective carbon market.² Currently, any allowances held in the reserve beyond 400 million are permanently cancelled. The proposed change will halt this cancellation process, enabling those allowances to be retained as a stabilising buffer. The MSR works by withdrawing allowances from the market during periods of oversupply and releasing them when supply runs short.

The MSR has been operating since 2019 as a rules-based tool for managing the allowance supply within the EU Emissions Trading System (ETS). It was aimed to tackle the structural surplus that accumulated in the wake of the 2008 financial crisis. By the close of 2024, a total of 3.2 billion allowances had been invalidated.

The EU emissions trading market is not a free market, as the issuer largely controls the supply of allowances. Although there are rules regarding the regular reduction of the number of allowances issued, which is currently 4.3% annually,³ the European Commission decides each year how many allowances will be put into circulation. It makes this decision based on the total number of allowances in circulation (TNAC). A correction mechanism is applied if the volume of allowances in circulation exceeds 833 million. The latest known figure for 2024 is 1.15 billion allowances in circulation, based on which the issuance of new allowances was cut by 24%. These 276 million unissued allowances were then transferred to the MSR. At the same time, another rule applies: if there are more than 400 million allowances in reserve at the end of the year, the excess amount is cancelled. This mechanism occurs every year; for example, based on 2024 results, 271 million allowances were invalidated.

When is the MSR activated?

Allowances from the reserve may be released onto the market in only two cases:

1) The total volume of permits in circulation falls below 400 million. In this case, up to 100 million permits may be released from the MSR.⁴

¹ 'Proposal for a decision of the European Parliament and of the Council amending Decision (EU) 2015/1814 as regards the amount of allowances to be doubled in the Market Stability Reserve until 2030 (COM/2026/153 final)', European Commission, 1 April 2026 (https://climate.ec.europa.eu/document/download/ea54bb9d-505e-47ec-b81e-f635443182d3_en).

² The amendment proposal will be submitted to the European Parliament and Council and will need to pass through the ordinary legislative procedure – known as co-decision – before it can be formally adopted.

³ 'EU ETS emissions cap', European Commission, 2026a (https://climate.ec.europa.eu/eu-action/carbon-markets/eu-emissions-trading-system-eu-ets/eu-ets-emissions-cap_en).

⁴ 'Directive (EU) 2023/959 of the European Parliament and of the Council of 10 May 2023 amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union and Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading system', Official Journal of the European Union, 10 May 2023 (<https://eur-lex.europa.eu/eli/dir/2023/959/oj/eng>).

2) Allowances in the reserve may be used if the price of an allowance exceeds 2.4 times the two-year average price of an allowance over the past six months. In this case, 75 million allowances shall be released from the MSR in accordance with Article 1(7) of Decision (EU) 2015/1814 (Article 29a).⁵

The Commission claims that the proposed modification will better prepare the MSR to handle future market shifts, including the possibility of tighter supply in the decades ahead. It is true that with a larger MSR, the Commission would have more ‘firepower’ to address future supply shocks, which could improve the system’s ability to respond to market imbalances and reduce the risk of excessive price volatility. Nevertheless, under the current MSR management rules, the MSR reserve cannot be effectively used, no matter how many allowances are in its books.

Due to the current high price of natural gas in particular, there is no realistic possibility of excessive growth in fossil fuel consumption. Consequently, the demand for allowances cannot rise dramatically to exhaust TNAC and so trigger thereby triggering the first measure. At the same time, the price of allowances is as of April 2026 significantly lower now than at the beginning of the year. However, this decline can be attributed to market expectations around the upcoming ETS revision. As the average price of allowances over the past two years has been approximately €70, their price would have to rise to more than €168 in just six months. As such a scenario is unimaginable, it is unlikely to trigger the second potential measure.

Conclusions and policy recommendations

The European Commission’s new proposal does not represent any real change in its ability to influence the development of the emissions trading market or the price of allowances. The new proposal is more a political signal than direct action towards emissions trading. For this to actually happen, the Commission would have to introduce fundamental changes in ETS management.

What should the fundamental change be?

- 1) The pressure to reform the ETS is more than palpable today. However, the need to change its rules cannot be attributed solely to the current conflict in the Persian Gulf. High energy prices and low competitiveness have been persistent problems for the EU’s economy since 2021. At the same time, it would be incorrect to assume that an increase in the share of renewable energy sources will necessarily lower energy costs in the foreseeable future. On the contrary, existing subsidy commitments for renewable energy production and the need to keep reliable sources in operation and import fossil fuels – which are often forbidden to be mined in Europe – represent ongoing costs that will keep energy-related expenditures high for the next two decades.
- 2) Any meaningful reform of the EU ETS must therefore be based on the fundamental premise that the decarbonisation of the European economy will have to proceed slowly if it is to remain competitive. Therefore, the first step in effectively reforming the EU ETS should be to adjust the 2040 90% target.⁶ As we argued in a previous EPICENTER briefing, a linear target (or 80% in 2040) would be sufficient to achieve net zero in 2050 without incurring excessive transformation costs (Đurana et al. 2025). The second prerequisite for a rational adjustment

⁵ ‘Consolidated text: Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve’, Official Journal of the European Union, 6 October 2015 (<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02015D1814-20240101>).

⁶ ‘EU climate law: A 2040 emissions reduction target of 90% for the EU’, European Parliament, 10 February 2026 (<https://www.europarl.europa.eu/news/en/press-room/20260205IPR33620/eu-climate-law-a-2040-emissions-reduction-target-of-90-for-the-eu>).

of the EU ETS is prioritising the system itself as the primary tool for reducing emissions by limiting existing targets that define the shares of renewable energy sources and energy efficiency, as well as other sectoral targets (e.g., ban on internal combustion engines, amount of hydrogen produced, etc.).

- 3) In the upcoming ETS revision, the EU should consider introducing a meaningful ceiling on allowance prices, possibly setting a price band that the Commission will maintain through active intervention in the allowance supply (Stagnaro and Zieliński 2025). The ceiling should reflect the reality that emissions trading systems around the world remain rare, with carbon prices well below the European level, which hurts the international competitiveness of European producers and other support mechanisms or energy taxes that increase the implicit cost of carbon above the 'optimum' level. The upper limit of the price band should be set to encourage the reduction of high-emission fuels (e.g., coal), but not be so high as to allow for a sudden increase in energy prices in the event of a gas shortage, as is the case today.
- 4) The Commission should consider terminating the MSR, as it creates another level of uncertainty (Brøns-Petersen and Anderson 2025). Since the Commission can control the volume of emissions under new permits, it has a tool to regulate the supply of emissions. The ETS should be subject to market principles, which require both a clear declaration of the trajectory of future permit allocations and free entry for any forward-looking investors willing to trade allowances. This would stabilise the market and lower price volatility.
- 5) The Commission should make a credible commitment that, if the economy slows and the demand for allowances falls, it will not activate the MSR by retrieving allowances from the market. Even if prices fall, given high gas prices, the Commission should not intervene by raising prices, as the short-term priority is to keep the economy running.
- 6) The EU ETS is an important market instrument, and the price of allowances reflects the expectations not only of financial investors but also of investors in energy and industry. The current value of allowances on the market exceeds €70 billion; interventions that cause significant decreases in allowance prices would lead to economic losses and loss of return on many investment projects. The Commission should consider reducing the price of allowances (while maintaining it within a predefined band) only in clearly defined situations that presuppose a state of, or declaration of, an energy emergency.
- 7) ETS reform should be based on a strong political commitment to comply with the new rules, since predictability is key to the energy sector and heavy industry, where investments are designed to yield returns over decades. Above all, applying the price band requires deciding the pace of decline in total emissions, as described in point 2. Otherwise, the ETS will remain a crisis instrument that fails to reflect the need to maintain the European economy's competitiveness.

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