10 June 2026

Reforming the EU Emissions Trading System: three pillars for a fair and effective Phase 5

With the Commission's ETS Directive revision expected in July 2026, the European starch industry sets out its priorities on carbon market architecture, free allocation, and the unresolved question of export carbon leakage.

The EU Emissions Trading System is the cornerstone of European climate policy, and it is about to be reopened. The Commission's July 2026 proposal to revise the ETS Directive will set the parameters for Phase 5 (2031-2040), making this the critical window for political decision. **Starch Europe sets out three priorities** — on carbon market stability, free allocation methodology, and export carbon leakage — grounded in the realities of the bioeconomy.

CARBON MARKET FUNDAMENTALS

Stability over disruption: align Phase 5 with long-term climate objectives

After years of carbon price increases and considerable market volatility, industry needs predictability above all. **The fundamental architecture of the ETS should be preserved** while avoiding cliff-edge changes that would jeopardise long-term investment planning.

The transition to Phase 5 should follow a gradual trajectory aligned with the EU 2040 climate objective. Large one-off rebasing of the cap must be avoided, as must abrupt changes to the Linear Reduction Factor. Investment horizons in energy-intensive industry — and particularly in bioeconomy sectors where capital assets span full industrial cycles — typically extend to 15–20 years. Policy discontinuity on that scale is incompatible with committed decarbonisation capital.

> **KEY ASK**
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> A fully-fledged carbon price corridor, underpinned by a strengthened and redesigned Market Stability Reserve, should replace the current reactive posture, providing both a floor and ceiling that markets and long-term investors can price into decisions.

Recommendations:

- **No cliff-edge cuts** to the cap or Linear Reduction Factor in Phase 5: gradual trajectory adjustments only, allowing for decarbonisation investment continuity.
- **Redesign the Market Stability Reserve** to function as a genuine price corridor, reacting to both price spikes and collapses.
- **Recognise negative emissions**: installations should be able to use high-quality permanent removals certified under the CRCF for ETS compliance, and to account for removals generated from their own activities.

THE FUTURE OF FREE ALLOCATION

Soften the reduction curve, and make benchmarks reflect reality

Free allocation remains the primary instrument to address carbon leakage for sectors exposed to both trade and emission intensity. **A premature or steep reduction in free allocation undermines rather than accelerates decarbonisation**: it erodes the financial foundation on which green investment depends, before alternatives are commercially viable at scale.

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The bioeconomy deserves particular attention here. **The starch sector sits at the intersection of agriculture, food processing, pharmaceuticals and biochemistry**, supplying critical value chains from animal nutrition and human food to healthcare. This multi-value-chain position means that carbon costs cascade across downstream sectors, many of which have no direct decarbonisation lever of their own. A reduction in European starch production is not a decarbonisation outcome: it is a displacement of activity (and emissions) to non-EEA competitors.

> **KEY ASK**
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> The benchmark methodology must better reflect technology and market reality. The feasibility of energy source substitution, the commercial availability of scalable low-carbon alternatives, and the exceptional macroeconomic conditions facing European manufacturers since 2022 should all be factored into the next benchmark revision.

Recommendations:

- **Maintain targeted free allocation in Phase 5** for sectors meeting Phase 4-equivalent trade and emission intensity thresholds, including starch and bioeconomy sectors.
- **Reform the benchmark methodology** to incorporate energy substitution feasibility, low-carbon technology availability, and macroeconomic conditions, notably in the bioeconomy.
- **Conditionality option**: link a share of free allocation to verifiable investment in decarbonisation pathways.

EXPORT CARBON LEAKAGE

The gap CBAM was not designed to fill: a structural solution is overdue

CBAM addresses one half of the carbon leakage problem: imports from non-EEA producers not subject to a comparable carbon price. But **CBAM was never designed to address export carbon leakage**, which does not fit into its structural design.

Before CBAM, free allocation addressed both import and export leakage in a single framework. As free allocation is progressively phased out, European producers who export to non-EEA markets face a widening asymmetry: they bear the full ETS carbon cost on their production while competing against third-country suppliers who face none. For European starch producers (who generate a substantial share of their turnover through exports) **this is not a theoretical risk but a structural competitive disadvantage that grows with every annual ETS compliance cycle**.

> **KEY ASK**
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> The framing of export carbon leakage as a “residual issue” to be addressed later is no longer tenable. The 2026 ETS revision is the opportunity to build a durable solution into the Directive, not to defer it to a future instrument that may never materialise.

Recommendations:

- **Ex ante solution via free allocation**: introduce eligibility parameters ensuring continued access for sectors where a substantial share of EEA turnover derives from exports to non-EEA markets.
- **Ex post solution via a permanent decarbonisation fund**: targeted financial compensation proportional to export sales in markets where no equivalent carbon price applies.
- **Address the transition window explicitly**: any mechanism must be operational before further reductions of free allowances.

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