

Factsheet

Factsheet for the Dutch House of Representatives

On the amendment to the Market Stability Reserve of the EU Emissions Trading System.

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1. Summary

- ▶ The Market Stability Reserve (MSR) of the EU Emissions Trading System (EU ETS) was established in 2019 to remove a surplus of emission allowances from the market that had accumulated over a decade.
- ▶ The MSR functions as a buffer mechanism, aiming to contribute to more stable CO₂ prices by removing excess allowances from the market and releasing them during shortages.
- ▶ Over time, the accumulated surplus of allowances grew to such an extent that the European Commission introduced a cap on the buffer's maximum size.
- ▶ This cap, combined with further tightening of the EU ETS and the Fit for 55 package, strengthened the credibility of EU climate policy, incentivising businesses to take additional climate action.
- ▶ Under pressure from industrial stakeholders and certain Member States, the Commission now proposes, as part of the broader EU ETS revision due in July, to remove the cap on the buffer's maximum size.
- ▶ If the amendment is adopted:
 - Cumulative emissions under the EU ETS will increase;
 - Credibility of the EU ETS could be undermined, reducing investments in emission reductions;
 - Costs for supporting sustainable innovation may rise; and
 - Pressure to reduce emissions would shift to non-ETS sectors, such as agriculture, transport, the built environment, and land use.

2. Central Research Question

On the 1st of April 2026, the European Commission proposed an amendment to adjust the functioning of the Market Stability Reserve (MSR) of the EU Emissions Trading System (EU ETS).¹ This factsheet outlines the introduction and operation of the MSR. It then describes the content of the amendment and the circumstances under which it was brought about. Finally, the factsheet examines the direct effects and indirect consequences of the amendment for European and Dutch (climate) policy.

¹The amendment focuses on the ETS1. [ETS2](#), which will start in 2028, covers the CO₂ emissions from fuel combustion in buildings, road transport and additional sectors.

3. The EU Emissions Trading System

The EU ETS was established by the EU to achieve emission reduction targets in a cost-effective way and to stimulate sustainable innovation. The current ETS1 covers approximately 40% of the EU's greenhouse gas emissions, including emissions from large-scale installations (>20 megawatts) in industry and electricity generation; aviation within the European Economic Area (EEA)²; and large cargo and passenger ships (>5,000 gross tonnage).³

The EU ETS operates as a 'cap-and-trade' system. The cap sets the limit on total emissions within the system and determines the number of emission allowances available each year. One allowance corresponds to one tonne of CO₂ emissions. The cap decreases annually, reducing the number of issued emissions over time.

Companies covered by the system must account for their emissions using allowances. Firms facing significant international competition, such as the steel industry, receive free allowances. Others, such as coal-fired power plants, must purchase allowances at an auction. If companies hold more allowances than needed to cover their emissions, they can bank them or trade them on the carbon market. If a company lacks sufficient allowances, they can buy them on this market. Through the auctioning and trading of allowances, a price for emissions is established, ensuring reductions occur where they are most cost-effective. The EU ETS is not a tax; it is an emissions standard where allowances can be traded, creating a carbon price.

The EU ETS has been in place since 2005 and has undergone several revisions, including the introduction of the Market Stability Reserve (MSR) to better balance supply and demand in the carbon market.

4. The Market Stability Reserve

The MSR was introduced into the EU ETS in 2018. The timeline below and Figure 1 outline the rationale, the development of the number of allowances on the market, and the CO₂ price from 2008 to the present.

2005–2007	Trial phase of the EU ETS. Allowances were allocated by Member States to domestic companies, leading to over-allocation. After an initial speculative peak, the price dropped to near zero. This prompted centralised allocation from Brussels.
2008–2013	The financial and eurozone crises reduced industrial production, allowing companies to bank allowances (which were still allocated free of charge

² EU Member States, Norway, Iceland and Liechtenstein.

³ 100% of the emissions of maritime transport between two harbours in the EEA. 50% of the emissions of maritime transport departing from or arriving in a harbour in the EEA.

at the time). This surplus is referred to as the 'total number of allowances in circulation' (TNAC) (yellow in Figure 1a).

The growing number of allowances in circulation led to a low carbon price, reaching a minimum of €3.50/tCO₂ in 2013 (Figure 1c). Since emissions were relatively inexpensive, innovation was scarcely incentivised.⁴

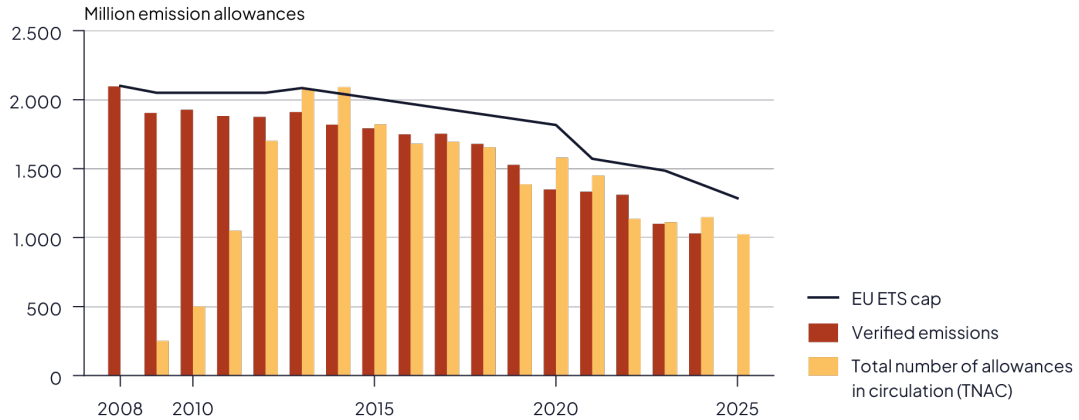
- | | |
|--------------|--|
| 2014–2018 | To reduce the surplus, the European Commission administratively withdrew 900 million allowances from the market. These were temporarily withheld from auction to be released later. |
| 2019–2022 | In 2018, the Council of the European Union and the European Parliament reached an agreement on a structural solution to the surplus: the Market Stability Reserve (MSR). The 900 million allowances withdrawn between 2014 and 2018 were transferred to the MSR. From 2019 onwards, the MSR absorbed a portion of the surplus annually. As a result, the MSR grew to 3 billion allowances within four years (dark blue in Figure 1b). The carbon price rose from €25/tCO ₂ in 2019 to over €80/tCO ₂ in 2022. |
| 2023–present | Between 2021 and 2023, the EU ETS was revised to align with the legally binding EU climate target of a 55% emission reduction by 2030, as part of the Fit for 55 package. In this revision, the European Commission proposed a maximum volume for the MSR of 400 million allowances. Any allowances exceeding this threshold would be invalidated. As a result, the MSR invalidated a total of over 3.1 gigatonnes of CO ₂ allowances between 2023 and 2025 (i.e., declared void or administratively cancelled; shaded in Figure 1b). This number is more than three times the global emissions from aviation. ⁵ |

⁴ Koch et al. (2014); Knopf et al. (2018).

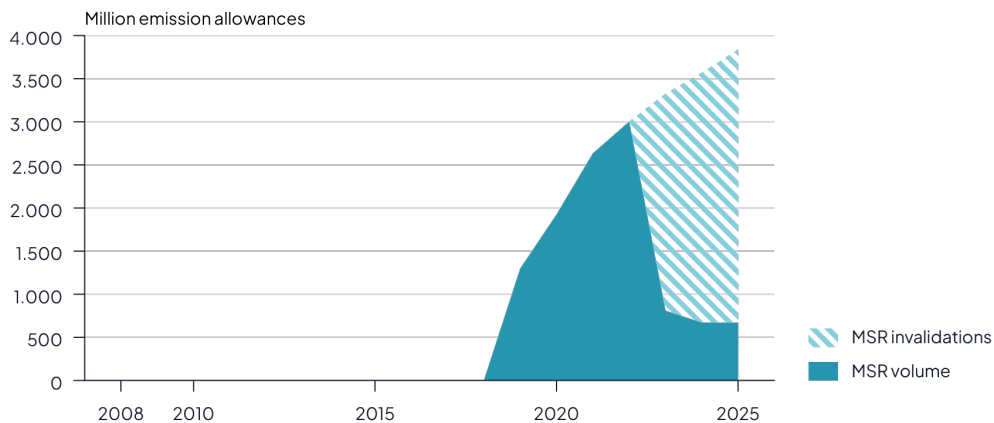
⁵ Aviation - IEA.

Development of the EU ETS and the MSR since 2008

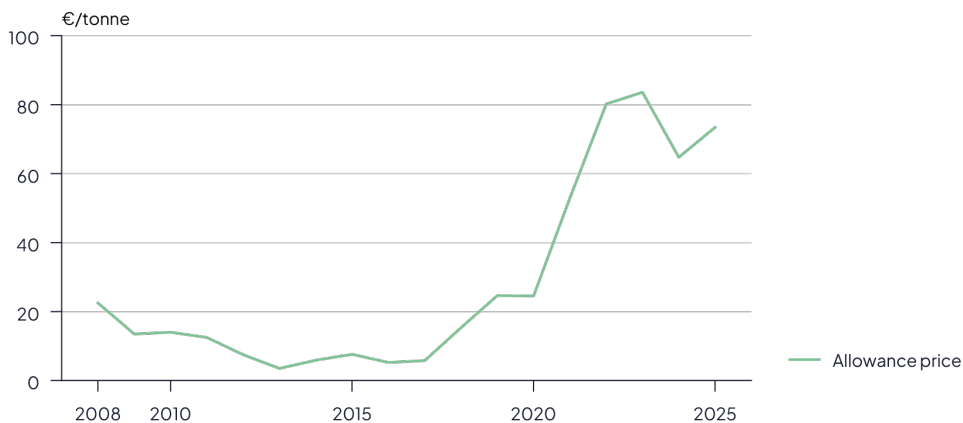
A. Emissions are structurally lower than emission cap, leading to a growing number of allowances in circulation



B. MSR removes allowances from circulation from 2019 onwards; 2023 onwards the excess allowances in the MSR are invalidated



C. The price for emissions allowances was lower than 10 euro per tonne when there were many allowances in circulation; simultaneously with the introduction of the MSR the allowance price sharply rose



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Figure 1: Operation of the EU ETS and the MSR since 2008. Data for verified emissions from the [EU ETS Data Viewer - EEA](#), data for allowances in circulation, MSR volume and MSR invalidations from annual [Commission Communications on the TNAC](#), data for the EU ETS emissions cap from the [EC](#), and data for the ETS price from [energy.instrat](#). Data for the cap and allowances in circulation between 2008 and 2012 rounded from the [EC impact assessment of the EU ETS in 2021, Part 3, Figure 27](#).

4.1 Technical Operation of the MSR

The MSR stabilises the CO₂ allowance market by maintaining a buffer managed through a set of calculation rules. These rules are based on the *total number of allowances in circulation* (TNAC) and are outlined in Table 1. Each year around May, the European Commission publishes the number of allowances in circulation and how many will be absorbed by the MSR in the following year.

Total number of allowances in circulation (TNAC)	Operation of the MSR
More than 1096 million	MSR absorbs allowances equal to 24% of the TNAC
Between 1096 and 833 million	MSR absorbs allowances equal to the TNAC minus 833 million
Between 833 and 400 million	No MSR operation
Less than 400 million	MSR releases 100 million allowances to the market

Table 1: Current MSR operation based on the total number of allowances in circulation (TNAC)

4.2 The Invalidation Mechanism

The invalidation mechanism has been in operation since 2023 and means that all emission allowances in the MSR above 400 million are invalidated (declared invalid or administratively written off).⁶

Prior to the introduction of the invalidation mechanism, if a company achieved significant emission reductions, the total number of allowances in circulation was not reduced. As a result, additional space was created elsewhere in the EU to emit CO₂, a phenomenon known as the *waterbed effect*. **The MSR's invalidation mechanism punctures this waterbed: by invalidating a portion of the surplus allowances, there is a net emission reduction across the entire system.**⁷

4.3 Price Formation and the Effect of the MSR

Figure 1 shows that the introduction of the MSR coincided with a rise in the price of emission allowances. Various factors may contribute to this price increase, including speculation⁸, exogenous economic developments, or geopolitical events.⁹

A key driver of the price increase influenced by the MSR is scarcity. The absorption of emission allowances by the MSR reduces the number of allowances auctioned, which exerts upward pressure on prices.

⁶ The invalidation takes place on 1 January each year, whilst the MSR is topped up on a monthly basis. As a result, the number of emission allowances in the MSR at the time of the Commission's publication in May is not exactly 400 million.

⁷ Danish Climate Council (2017); Carlén (2018).

⁸ Jeszke & Lizak (2021), Quemin & Pahle (2021).

⁹ Like COVID-19. See Gerlagh, Heijmans & Rosendahl (2020) en Arazova (2021).

However, researchers argue that scarcity is not the only explanation for the price increase since 2019.¹⁰ The number of allowances issued continues to exceed verified emissions, and a surplus of over one billion allowances persists (see Figure 1a).

Researchers have found that a significant factor in the price of emission allowances lies in the credibility of climate policy.¹¹ The price increase in Figure 1 coincided with the tightening of the EU ETS in 2018 and the Fit-for-55 package. Both signalled to the market that emissions must decrease and that sustainable investments would pay off. As a result, the credibility of the EU ETS was strengthened. Companies that trust that allowances will become scarce in the future will anticipate this by purchasing allowances or by investing in sustainability and banking the freed-up allowances.¹² This behaviour, in turn, drives up the price of emission allowances.

Conversely, (the announcement of) policy weakening can undermine the credibility of the EU ETS. It may lead companies to anticipate further weakening and delay climate measures. Anticipating future intervention thus becomes a self-fulfilling prophecy: it makes policy weakening more likely.¹³

5. Amendment to the Market Stability Reserve

In April 2026, the European Commission proposed to no longer invalidate emission allowances in the MSR. This was done through an amendment¹⁴ of the decision on the establishment and operation of a market stability reserve.¹⁵ The proposal was introduced in an unusual manner, namely without a public impact assessment.

The MSR amendment forms part of a broader revision of the EU ETS, but it has been presented separately and is being negotiated independently. The Commission's full revision proposal is expected on 15 July 2026. This revision aims to align the EU ETS with the new European climate target for 2040 (a 90% emission reduction, with a maximum of 5% of EU emissions offset through international carbon credits) and includes a broader review of the MSR.¹⁶

The Commission presented the MSR amendment as a concrete measure to reduce the short-term impact of fluctuating energy prices on industry.¹⁷ However, the effect of the ETS

¹⁰ Sitarz et al. (2024).

¹¹ Brunner, Flachsland & Marschinski (2012); Burtraw (2015); Quemin & Trotignon (2021); Dolphin et al. (2023); Sitarz et al. (2024).

¹² Perino et al. (2022).

¹³ Pahle et al. (2022).

¹⁴ Proposal for a Decision of the European Parliament and of the Council amending Decision (EU) 2015/1814 as regards ceasing the invalidation of allowances in the market stability reserve (2026).

¹⁵ Decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and amending Directive 2003/87/EC (2015).

¹⁶ For an indication of the revisions under consideration, see European Commission, 18 May 2026:

https://climate.ec.europa.eu/news-other-reads/news/commission-holds-high-level-stakeholder-roundtable-eu-ets-review-2026-05-18_en

¹⁷ European Commission (2026).

price on energy costs is limited: on average, it accounts for 11% of industrial users' energy bills.¹⁸ The amendment is intended to allow more allowances to be retained to stabilise the market. All new allowances absorbed by the MSR will eventually be auctioned rather than invalidated, at which point they can be used by companies to cover their emissions.

The MSR amendment was prompted by discussions at the informal European Council on 12 February 2026 regarding EU competitiveness,¹⁹ particularly the impact of high energy prices on European industry. Several Member States have long criticised European climate policy and the EU ETS.²⁰ This criticism focuses on the impact of climate policy on the cost of living and the competitiveness of European industry.²¹ Other Member States²² have indicated that targeted adjustments may be considered, but fundamental changes to the EU ETS should be avoided.²³

The war in Iran further increased energy prices, intensifying pressure on the Commission to introduce concrete measures. In the lead-up to the European Council in March 2026, Commission President von der Leyen announced a review of the MSR.²⁴ The European Council endorsed this proposal.²⁵ If an agreement is reached between the Council of the European Union and the European Parliament in autumn 2026,²⁶ the invalidation of allowances will be halted from 2027.²⁷ The Dutch government has emphasised that the MSR amendment should be considered as part of an integrated decision alongside the broader EU ETS revision.²⁸

6. Direct Effect of the MSR Amendment

The direct effect of the MSR amendment is that all allowances placed in the reserve will eventually be auctioned and thus can be used to cover emissions.

No impact assessment has been published, which is unusual for legislative changes in the EU. Without one, it is difficult to determine how many additional allowances will be auctioned compared to the situation with invalidation.²⁹ The Commission expects to publish an impact assessment with the overall revision in July 2026.³⁰

The Dutch government has been critical of both the process and the content of the proposal and does not support this targeted amendment to the MSR.³¹ Without alignment with the broader MSR and ETS revision, including an impact assessment, the proposal's effects on energy prices, investment certainty, and the climate remain unclear.³² The

¹⁸ Dutch parliamentary document 21 501-33 nr. 1200.

¹⁹ See also Dutch parliamentary document 21 501-20, nr. 2376 and 21 501-20, nr. 2378.

²⁰ Including Poland, Bulgaria, Hungary, Italy, Romania, Slovakia and Slovenia.

²¹ See for instance: Toygür, I., & Sojka, A. (2026).

²² Including the Netherlands, Denmark, Finland, Luxembourg, Spain, Portugal and Sweden.

²³ Agence Europe (13 March 2026).

²⁴ European Commission (2026).

²⁵ Conclusions of the European Council (19 March 2026) and Parliamentary document 21 501-20, nr. 2397.

²⁶ <https://carbon-pulse.com/519028/>.

²⁷ Invalidation of allowances takes place every year on the 1st of January.

²⁸ Parliamentary document 21 501-33, nr. 1199.

²⁹ It is expected that the impact assessment by the Commission will provide an estimate.

³⁰ European Commission (1 April 2026).

³¹ Parliamentary document 21 501-33, nr. 1199.

³² Parliamentary document 21 501-33, nr. 1200.

government has stated that an integrated approach for the decision-making on the amendment and broader revision is preferable.

Market analyst Enerdata has calculated that between 300 and 500 million additional allowances are expected to be added to the MSR.³³ In 2023, the European Commission estimated that the MSR would absorb around 670 million allowances between 2026 and 2030.³⁴

The ultimate effect of the amendment depends on the extent of emission reductions. If emissions from ETS-covered companies fall sharply, a larger number of unused allowances will enter the MSR, increasing the impact of ending invalidation. If emissions remain high, fewer unused allowances will enter the MSR, reducing the effect of stopping invalidation.

By removing the maximum volume of the MSR, the amendment also allows the reserve to continue releasing allowances for a longer period.

7. Implications for Climate and Industrial Policy in the EU and the Netherlands

The MSR amendment has several consequences for climate policy: for greenhouse gas emissions, the credibility of the EU ETS, the waterbed effect, and for sectors not covered by the ETS. Many of these consequences are similar to the consequences of adjusting the reduction pathway.³⁵

1. **Halting the invalidation rule will lead to an increase in the number of allowances that can re-enter the market via the MSR, and thus an increase in emissions.** This rise could amount to hundreds of megatons of CO₂.³⁶
2. **Both the MSR amendment and the way it was introduced affect the credibility of the EU ETS.** The tightening of climate policy between 2018 and 2023 sent a signal that strengthened the credibility of the EU ETS, contributing to a rise in the price of emission allowances.³⁷ Conversely, policy weakening and deviations from standard procedural steps may reduce confidence in the EU ETS. Low policy credibility can lead companies to focus on short-term gains and invest in business models without a future, potentially resulting in stranded assets.³⁸
The signal of weakening also impacts the price of emission allowances, reducing the incentive for innovation.³⁹ This price impact disadvantages companies that have

³³ Enerdata (April 2026).

³⁴ Internal calculations by the European Commission shared with Member States.

³⁵ See also: <https://english.wkr.nl/latest/news/2026/06/15/european-climate-councils-urge-leaders-in-joint-letter-to-stand-firm-on-emissions-trading>

³⁶ As described in the section on direct effects, the scale depends on the emission reductions achieved in the coming years.

³⁷ Sitarz et al. (2024).

³⁸ Kang & Létourneau (2016); Pahle et al. (2022).

³⁹ See also: <https://english.wkr.nl/latest/news/2026/06/15/european-climate-councils-urge-leaders-in-joint-letter-to-stand-firm-on-emissions-trading>

already implemented emission reduction measures, lowers the expected returns for those considering sustainability investments,⁴⁰ and rewards companies that have taken no action. Finally, weakening in response to high prices may set a precedent, potentially leading to a vicious cycle of interventions to lower prices that permanently undermine the credibility of the ETS.⁴¹

3. **Halting the invalidation rule reintroduces the waterbed effect under the ETSI.**⁴² The MSR's invalidation mechanism punctures the waterbed: by invalidating a portion of the surplus allowances, there is a net emission reduction across the system. When the invalidation rule is discontinued, all allowances freed up through sustainability efforts will eventually flow back into the market. While Member States may voluntarily invalidate freed-up allowances⁴³ (as Germany did when closing several coal-fired power plants⁴⁴), but this becomes significantly more expensive without the invalidation rule.
4. **A lower price for emission allowances leads to reduced revenues for Member States from allowance auctions and higher costs for supplementary climate policies.** Over the past five years, the auctioning of emission allowances has generated approximately €1 billion annually for the Dutch state.⁴⁵ A lower allowance price means reduced income. The costs of the SDE++ scheme also rise when CO₂ prices fall, as it subsidises the difference between carbon-intensive production and the CO₂ price. Additionally, a low allowance price weakens the business case for sustainable technologies. The cost disadvantage of biomass-fired power plants compared to coal plants increases, and sustainable alternatives such as e-boilers, green chemistry, and green hydrogen production also become relatively more expensive. One way to continue incentivising these options is, for example, to introduce a national CO₂ tax.
5. **Finally, reduced mitigation under the ETS means that greater emission reductions will be required in other policy areas, such as agriculture, transport, the built environment, and land use, to achieve the 2050 climate neutrality target.**⁴⁶ Climate policy in these sectors is largely shaped at the national level, increasing the pressure on national governments.

⁴⁰ See for instance: <https://www.tatasteelnederland.com/nieuws/tata-steel-nederland-en-natuur--milieu-roepen-op-europees-klimaatbeleid-niet-te-verzwakken>

⁴¹ Pahle & Edenhofer (2021); Pahle et al. (2022).

⁴² Danish Climate Council (2017); Carlén (2018); Perino (2018).

⁴³ See article 12(4) of the ETS Directive.

⁴⁴ European Commission (2 May 2024).

⁴⁵ See also the yearly monitor of the Dutch Emissions Authority

<https://www.emissieautoriteit.nl/documenten/2026/02/12/veilingmonitor-2025>

⁴⁶ See also: <https://english.wkr.nl/latest/news/2026/06/15/european-climate-councils-urge-leaders-in-joint-letter-to-stand-firm-on-emissions-trading>

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