Brussels, 14 October 2026

Restoring carbon leakage protection to safeguard the global competitiveness of Europe's circular bioeconomy

Cepi's policy recommendations for the 2026 EU ETS Directive and MSR Regulation reviews

While, the European pulp and paper industry fully supports the EU objective of climate neutrality by 2050, **Cepi calls on policymakers to restore robust carbon leakage protection offered by the EU Emissions Trading System (ETS) Directive**.

Decarbonisation investment and international competitiveness are already severely undermined in our sector. For 2026-2030, 10 of the 11 pulp and paper product benchmarks face the maximum reduction rate, fallback benchmark installations see similarly steep cuts, and around 40 installations relying at least 95% on biomass lose free allocation entirely. Together, these measures are expected to cut annual revenue by roughly €1 billion by 2030. This excludes any further losses of free allocation due to the current conditionality, which can only be assessed at a later stage.

Europe's carbon cost gap is widening. The pulp and paper industry faces both direct EU ETS costs and indirect costs embedded in electricity prices. AFRY's analysis[i] made for our sector identifies a growing carbon cost gap between 2025 and 2030, with the disadvantage compared with key global competitors potentially doubling for some products over the next five years.

OECD data[ii] show that, although carbon pricing systems exist outside Europe, effective carbon costs on industry can be negligible. This is further confirmed by the EU alone generating the majority of the global carbon pricing revenue: roughly 60% of global ETS revenue in 2025[iii], acknowledged in the Commission's impact assessment, and 40% of total carbon pricing revenue (ETS and taxes) in 2024[iv].

The pulp and paper sector has participated in the EU ETS since its inception and has already reduced greenhouse gas emissions by **more than 55% compared with 2005**. To continue this trajectory while remaining competitive in global markets, Europe must avoid further deterioration of the operating environment. While staying within the agreed ETS cap, we advocate for policymakers to:

1) **Freeze the 2021-2025 benchmark values and apply them unchanged to the 2031-2040** period to limit further exposure to rising carbon costs.
2) **Stop the exclusion from the EU ETS based on the 95% threshold in Annex I** to avoid unjustified loss of carbon leakage protection for frontrunners is investing in decarbonisation.
3) **Increase the free allocation share** to ensure sufficient free allocation and prevent non-targeted reductions across sectors.
4) **Remove the conditionalities of free allocation** to ensure risk-free effective carbon leakage protection and reduce unnecessary administrative burden.
5) **Reduce the Market Stability Reserve intake rate to zero** to avoid artificial tightening of the market and unwarranted increases in carbon costs.

Indirect cost compensation must also be maintained. Evidence shows that the decarbonisation of the power system will not automatically lower electricity prices before 2030[v] as gas-powered plants will keep setting wholesale prices for most hours. EU producers face a persistent cost disadvantage compared to key international competitors in China and the United States, where energy costs are estimated to be at least 20% lower.

The impact on the pulp and paper mills: three cases

1) Limiting the carbon costs of mills, example from Spain

For a mill, a 20% annual shortfall in free allocation, as proposed by the Commission, can translate into millions of euros in additional annual carbon costs. These costs cannot be passed on to customers because pulp, paper and board products are traded in competitive international markets.

As benchmark values tighten and free allocation declines, installations will increasingly purchase EUAs to cover its emissions in 2031-2040. Freezing benchmark values and increasing the free allocation share would therefore provide a more predictable investment environment while preserving incentives to decarbonise.

In addition, the requirement to invest an amount equivalent to the value of free allocation in decarbonisation will place further strain on companies' investment budgets and increase the overall cost of operating and investing in Europe. Rather than strengthening the business case for industrial decarbonisation, this requirement could increase the risk of investment leakage and undermine Europe's industrial competitiveness.

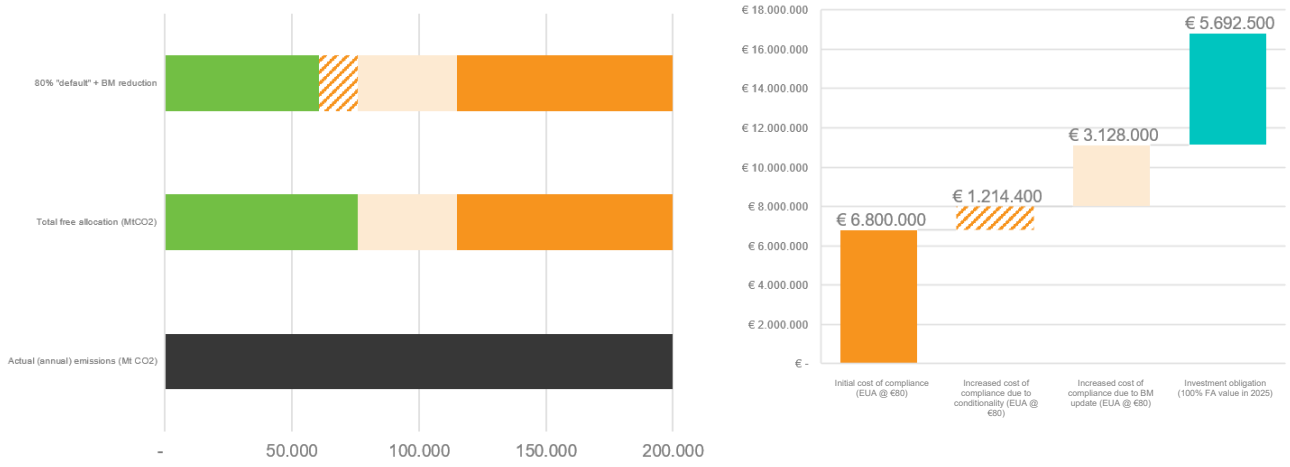


Figure 1. Illustrative example of the cumulative impact, assuming an EUA price of €80, of benchmark reductions (■), the free allocation shortage resulting from the proposed new conditionality requirements (■), and the obligation to invest an amount equivalent to the value of free allocation (■) (based on an EUA price of €75 in 2025). ■ represents a mill's emissions, ■ represents a mill's free allocation, ■ represents a mill's surrendering obligation.

2) Reversing unintended consequences for early investors in decarbonisation, example from Portugal

A Portuguese installation has invested in replacing fossil fuels with biomass. Because at least 95% of the installation's emissions come from biomass, the installation has been excluded from the EU ETS and lost its free allocation. This alone can represent an EBIDA loss of 20%.

The exclusion of the pulp installation gives rise to a further loss of free allocation across the integrated production process. In this case, the fully integrated mill is operated by separate legal entities on the same industrial site, requiring technical interconnections for steam and pulp exchanges. As a result, papermaking installation also faces an additional reduction in free allocation due to the heat import rules under the EU ETS.

The value of the lost free allocation is estimated at €4 million per year (at price of €80/EUA). From 2028, the inclusion of these installations in ETS2 will expose them to higher carbon costs driven by the anticipated ETS2 allowance prices. This creates a clear policy paradox: an installation that invested early in renewable energy and substantially reduced its fossil emissions can lose carbon leakage protection precisely because it has decarbonised. Removing the 95% threshold would correct this unintended penalty and better reward early decarbonisation investments.

3) Limiting the cost of recycling, example from Italy

Recycling paper requires the removal of non-paper materials, such as plastics, metals, and other unavoidable contaminants. These materials, known as paper rejects, are separated during preparation of recovered paper and during recycling and are often incinerated on site or sent to an external waste treatment facility to generate energy.

Rejects can represent between 0,5 and 3% of purchased paper for recycling, depending on the paper for recycling grade and the quality of domestic collection. If emissions from the fossil fraction of these rejects become subject to EU ETS allowance surrender obligation, the cost of recycling increases. The Commission's proposal could result in an additional carbon-cost exposure of a mill, depending on its size, up to €3 million per year (at price of €80/EUA) as presented by an illustrative mill from Italy.

This creates a potential unintended consequence when Europe is seeking to strengthen the circular economy. The more paper for recycling a mill uses, the greater its exposure to the carbon costs associated with treating the resulting rejects. The EU ETS rules should therefore avoid creating an unintended carbon penalty on recycling. Emissions from the incineration of unavoidable residual waste generated in the recycling process should therefore be excluded from the scope of the EU ETS.

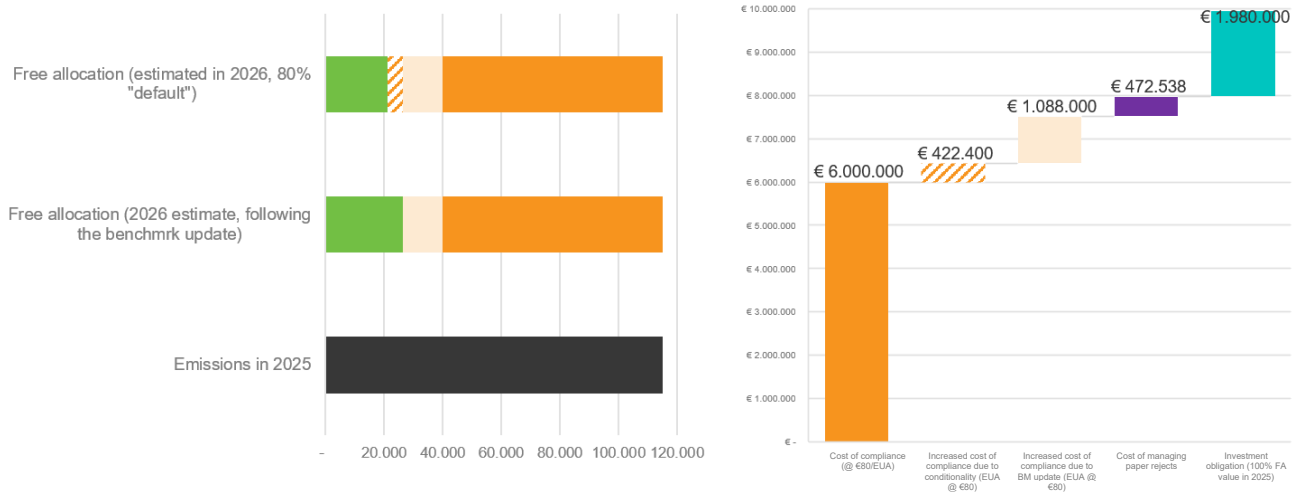


Figure 2. Figure 1. Illustrative example of the cumulative impact, assuming an EUA price of €80, of benchmark reductions (■), the free allocation shortage resulting from the proposed new conditionality requirements (■), the cost of emissions stemming from rejects incineration (■), and the obligation to invest an amount equivalent to the value of free allocation (■) (based on an EUA price of €75 in 2025). ■ represents a mill's emissions, ■ represents a mill's free allocation, ■ represents a mill's surrendering obligation.

Cepi brings together the pulp and paper industries of 19 European countries, representing 740 pulp, paper and board mills, including around 140 biorefineries across Europe. Our sector directly employs over 175,000 people and generated a turnover of €95 billion in 2025. The industry invests around €5 billion annually, primarily in clean energy and decarbonisation solutions, and plays a central role in Europe's circular bioeconomy through renewable, recyclable, and locally sourced wood-based fibre products.

Contact person: Małgosia Rybak, Climate Change and Energy Director, email: m.rybak@cepi.org, mobile: +32 471 21 07 61

[i] AFRY (2025) *Global trade developments and carbon cost impacts on the pulp and paper sector.*
[ii] OECD (2025) *Effective Carbon Rates 2025: Recent Trends in Taxes on Energy Use and Carbon Pricing*.
[iii] ICAP (2026) *Emissions Trading Worldwide: Status Report 2026*.
[iv] I4CE (2025) *Les Comptes Mondiaux du Carbone, édition 2025*.
[v] Joint Research Centre (2023) *The Merit Order and Price Setting in European Electricity Markets*.