

Gambling on our low carbon future: Finance and the UK ETS

The UK Emissions Trading Scheme (UK ETS) is one of the UK's key industrial decarbonisation policies. It works on a 'cap-and-trade' principle. A cap is set on the total amount of greenhouse gases that can be emitted by sectors covered by the scheme. The cap is then reduced over time so that total emissions must fall. Within this cap, participants must buy emission allowances at Government auctions and/or trade allowances on the secondary market.

Trading allowances is an important part of the scheme design. The cost of cutting emissions varies across industries and businesses. Some participants will be able to reduce their emissions economically in the near-term, whereas others will face high abatement costs and must wait for innovation and investment to bring down the cost of low carbon technology. Trading allows those with lower cost reductions to sell excess allowances to those who cannot make immediate cuts. The emissions cap is met but society pays less by allowing the market to find the most cost-efficient reductions. This is the advantage of a cap-and-trade scheme.

However, rules governing who can trade in the UK carbon market are interfering with this fundamental market dynamic, artificially driving up the cost to UK ETS participants at a time when UK industry is struggling to maintain international competitiveness. The UK ETS Registry permits non-ETS participants to hold and trade allowances on the secondary market, meaning banks, traders, financial institutions, and others can buy and sell UK allowances, regardless of whether they have a compliance obligation.

The impact of speculation in the carbon market is substantial. [ICE data](#) shows that >80% of UK allowances are currently held by speculators, trading funds or commodity trading advisors, many of which are US-based. Since late last year, bullish sentiment has encouraged the finance sector to pile into the UK carbon market, taking a net long position on the expectation that the allowance price will increase. This surge in speculative purchases has helped drive a rally in the price of allowances, which jumped from ~£50 last summer to ~£70 in early 2026. As of late January, investment funds held a net long position of approximately 20 million allowances, over

seven times the annual emissions of the chemical sector. The same situation is being played out in the EU's carbon market, to which the UK Government has stated its [intention to link](#).

Financial prudence on the part of UK ETS participants means they must “buy-to-comply”, covering their liabilities within the scheme at regular intervals, regardless of price. For UK industry, speculation in the market not only drives up the direct cost of compliance with the scheme, it drives up the cost of electricity too. This is because [carbon pricing also affects the power sector](#), which is better able to pass-through its cost to electricity users, industrial and domestic.

Speculators will argue that by adding liquidity to the market and anticipating tighter supply in the years ahead, they are smoothing the transition to higher carbon prices. Yet evident price volatility, driven by speculation, suggests otherwise. Others argue that a high carbon price is what is needed for industry to invest in net zero technology. Yet this ignores the primary issue that industry's low carbon options - [electrification](#), [hydrogen](#), [biomass](#) and [CCUS](#) – remain inaccessible or uneconomic in the UK. It also ignores the underlying economic theory of a cap-and-trade scheme: cap-and-trade allows the market to discover the lowest marginal abatement costs, limiting the cost to the UK economy.

The result is that [businesses are closing UK sites](#) and investing elsewhere. UK ETS ‘activity level’ data points to [a 61% decline in UK chemical production since 2021](#). The emissions data shows [we have lowered our emissions 38% since 2021 through site closure](#). The places attracting low carbon chemical investment have one thing in common: [access to low cost energy](#).

As the UK negotiates a linking agreement with the EU, speculation should be high on the priority list. The single biggest advantage of a cap-and-trade system is that emissions are limited while capital is free to discover the lowest cost opportunities for investment. This limits the cost we all pay for the transition to net zero. The UK must move to restrict speculation in the carbon market, returning it to its original principles. [With the right policy in place](#), the UK's chemical sector will drive growth in a clean and circular economy. Let's not gamble on our low carbon future.

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About the CIA

The Chemical Industries Association (CIA) is the organisation that represents chemical and pharmaceutical businesses throughout the UK. Our activities are split between lobbying and provision of advice and services. Our policy agenda stretches across the economy and competitiveness; our products and the way we work; health, safety & environment and employment issues. We represent all sizes of chemical and pharmaceutical businesses, of which approximately 70% are overseas headquartered. This illustrates the increasingly international nature of the industry.