# Carbon pricing done right

## Key elements for fair and effective emissions trading systems that work for people and climate

CARBON MARKET WATCH

# Executive summary

## 01 Integrate carbon pricing into a wider policy mix

A well rounded policy mix, with clear climate targets, fossil fuels phase-outs, and investment incentives in renewable sources and energy efficiency measures, is essential.

## 02 Set carbon ceilings

Aligning the carbon market with existing international commitments like the Paris Agreement targets is a straightforward way to ensure the CO2 price on CO2 delivers emission reductions, rather than being a purely financial signal.

## 03 Tackle polluting activities

Emissions are not distributed evenly across the economy: the power sector is a primary concern, and research shows that often the biggest chunk of emissions is in the hands of major power and industry conglomerates.

## 04 Safeguard transparency and accountability

How much did each carbon market player actor emit, receive, and achieve? The more information is publicly available to civil society, the more likely it is that watchdogs will hold polluting companies, and economic entities, accountable.

## 05 Make polluters truly pay

Free allocations, rebates, energy cost compensations, all minimise the price signal and divert investments. They must be kept to a minimum.

## 06 Avoid the carbon leakage strawman

There is very little proof that carbon pricing has globally caused significant levels of carbon leakage. Don't overcompensate for a risk that may never materialise: long-term clarity for investments is key.

## 07 Ensure the carbon price is right

The selection of desired price levels can be adjusted through volume adjustments or direct price adjustments: keep in mind that the price should steadily increase.

## 08 Reinvest revenue into climate and people

A proper carbon price means revenue for public institutions. Use it for energy efficiency, adaptation, protection of vulnerable households and communities, nature conservation, and clean mobility.

## 09 Consider a carbon border levy or tariff

You can't replace CO2 production with CO2 imports: a border carbon tax can help reduce this risk. But first, the priority remains building a strong carbon price signal internally.

## 10 Carbon removals and offsets don't replace emission reductions

Domestic and international offsets do not replace emission reductions. They do not keep emissions out of the atmosphere. One tonne of CO2 offset is not equivalent to a tonne of CO2 saved.

# What is carbon pricing?

Mandatory carbon pricing is implemented around the world through two main frameworks: emissions trading schemes (ETS) and carbon taxes.

An ETS caps the total quantity of emissions, while the carbon price is determined by market dynamics. A carbon tax does the opposite: it fixes the price per tonne of emissions, leaving the total level of reductions to be determined by market dynamics.

Both instruments share certain strengths. They assign a price to greenhouse gases, making polluting activities more expensive and low-carbon alternatives more attractive.

They also generate public revenue that can be reinvested in climate action and a just transition. While they rest on the same principles, they operate differently.

A carbon tax is quite straightforward because it can easily be built into existing fiscal systems and enable authorities to set the carbon price, offering them the opportunity, if they wish to seize it, to reflect the real environmental cost of pollution.

Although an ETS is more complex, and requires a sufficiently large and liquid market to function well, it offers more flexibility (and potentially more loopholes): allowances can be traded, banked, and even linked across borders, which can create a larger system and enable cooperation. Both carbon taxes and ETSs require robust monitoring, reporting and verification (MRV).

Taxes may be an administratively simple choice for small or diffuse sources of emissions, while larger, energy-intensive sectors can benefit from the flexibility offered by trading of emissions. ETSs have the advantage of a clear emissions cap, in theory guaranteeing the environmental outcome, while taxes provide a stable price signal. However, price adjustment and market stability mechanisms can help reduce price volatility in ETSs.

More and more jurisdictions are introducing carbon pricing, either through ETSs or taxes, or a mix of both. To date, there are 80 direct carbon pricing instruments operating worldwide, covering around 28% of global GHG emissions and some global schemes have even emerged. Approaches vary widely, particularly between national, regional and international systems.

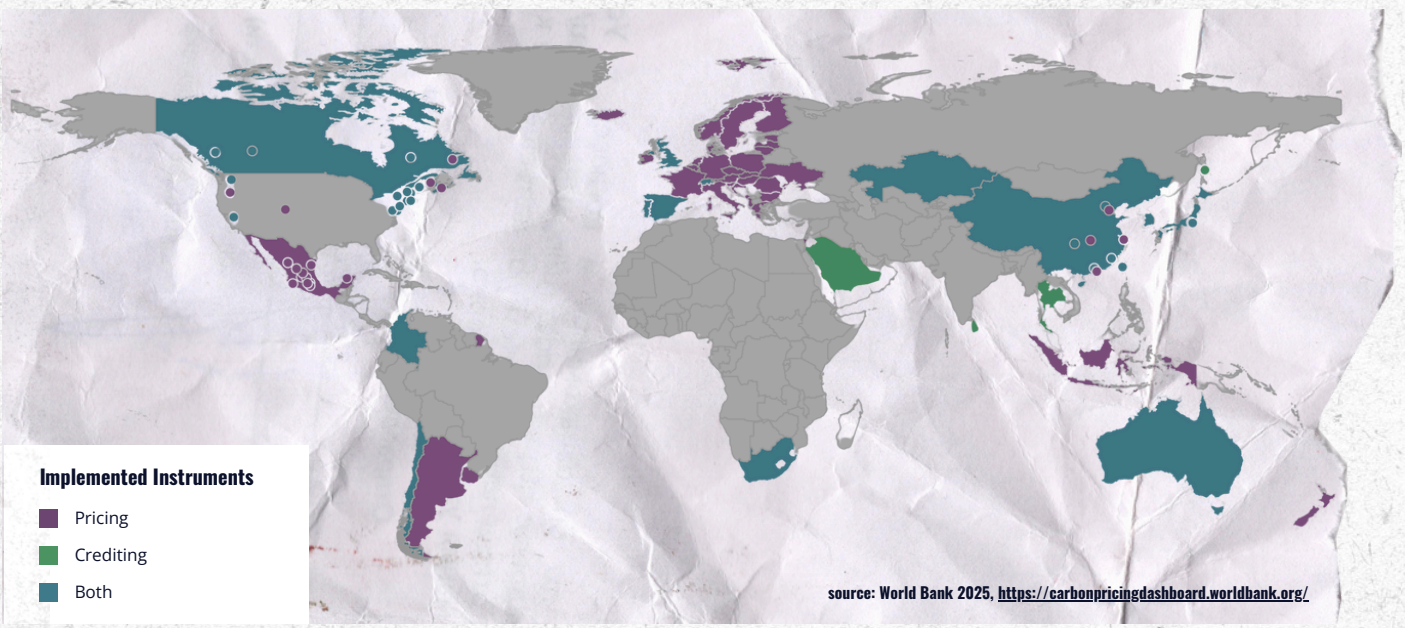



**Fig 1: Carbon pricing instruments around the world 2025**

Carbon pricing systems can be technical and complex to engage with, but they are an important component of many climate policies around the globe and, if done right, can act as a way to effectively and fairly reduce greenhouse gas emissions.

Based on our long-standing experience in the field, we, at Carbon Market Watch, have developed a 10-point list of essential features for civil society to look out for when a country is developing a new carbon market or carbon tax, to ensure real polluters pay the price, and the system works for households, small businesses, and the planet.

## Carbon pricing vs carbon crediting

**Carbon pricing through taxes or ETSs must be clearly distinguished from carbon crediting schemes**, including voluntary carbon markets and Article 6 of the Paris Agreement, that have weak track records of delivering real and permanent emission reductions.

**These systems do not directly price emissions but allow companies or countries to "buy" compensation instead**. In practice, this has undermined climate ambition: heavy polluters can avoid costly internal decarbonisation while presenting themselves as climate leaders, using offsets as a greenwashing tool.

**The problem is compounded by poor-quality credits, projects that result in little to no additional climate benefits**, and serious transparency gaps in voluntary market registries, making it difficult to verify actual climate impact.

# 01 Integrate carbon pricing into a wider policy mix

The ultimate goal of climate policies is eliminating emissions, but carbon pricing alone is no silver bullet. A credible pathway to net zero requires a mix of policy instruments applied in ways that reinforce each other rather than undermine ambition. These policies must reflect an overall commitment to climate protection in each country's policymaking, starting with credible national and international efforts to accomplish the goals of the Paris Agreements. Climate policies must tackle a variety of issues and sources of pollution, which means a smart mix of policy instruments is needed.

Climate justice between richer and poorer countries and individuals, intergenerational justice and the right to a healthy environment are some of the guiding principles that should inform and enable the mainstreaming of climate protection in national law and international frameworks.

Wales's Future Generations Act and the constitutions of Peru and Ecuador provide outstanding examples of mainstreaming climate protection in general policymaking. This can translate into assessing the potential emissions caused by new policies, to linking public funding disbursement to clear decarbonisation milestones, as well as banning certain activities, like extracting energy from coal or waste landfilling, rather than simply making them more expensive. It also means reinforcing markets for sustainable products, such as renewable energy systems, through public funding and procurement. Permitting can play a role too, for instance, by blocking new fossil fuel infrastructure or restricting high-emission industrial installations. At the same time, strict environmental standards drive the production and consumption of cleaner alternatives.

Within this mix, carbon pricing can give visibility to the social and environmental costs of emissions, that at present are mostly left to the public and future generations to both be impacted by and to clean up. Practically, it can direct investment away from polluting activities towards sustainable ones.

# 02 Set carbon ceilings

In emissions trading schemes, a cap sets an overall limit on the total volume of GHG emissions that polluters covered by the system are collectively allowed to emit. Importantly, the cap must decrease over time to align with Paris Agreement targets and provide a clear pathway for keeping within our remaining carbon budget. When carbon taxes are introduced (normally with no cap attached), they should support the achievement of the emission reduction targets, and increase as the target for emissions reductions also increases.

A declining cap ensures that emissions fall over time and gives companies predictability: they know that emission permits will become increasingly scarce and costly, incentivising investments in decarbonisation.

There is a direct correlation between how fast the cap decreases and the level of climate ambition. The trajectory of the cap has a massive impact on the environmental effectiveness of the carbon pricing system and the behaviour of the companies governed by it.

Experience from the EU ETS illustrates why setting the right cap and reduction rate is crucial. In the early years, the cap was set so high that it exceeded the sum total of all the verified emissions. This led to a massive oversupply of allowances and the carbon price fell to well below €5 per tonne of CO2. This glut eliminated incentives to reduce emissions.

Caps can be designed in different ways, but absolute caps, which set a fixed ceiling on total emissions, are the most environmentally robust approach. Used in the EU, California and South Korea (K-ETS), they enable governments to align their carbon markets with their decarbonisation targets and guarantee a predictable emission reduction trajectory. Some systems, like China's and Indonesia's emissions trading systems, use intensity-based caps, which, instead of setting a fixed volume of emissions, link the number of allowances to a unit of output, for example per unit of GDP, per tonne of steel, etc. This means the cap adjusts with economic activity: if production grows, the total number of allowances, the cap, and therefore total emissions also rise, even if emissions per unit fall. In practice, this means a company could improve its carbon efficiency but still increase its overall climate impact. Unlike absolute caps, intensity-based caps don't guarantee overall emissions reduction.

Caps can also be developed and applied at different levels, to the economy as a whole, to specific sectors, or even to individual installations. Each option has implications for the environment, economic cost and administrative complexity. Sectorial or installation-level caps can help ensure that all major emitters contribute to reductions, while a single economy-wide cap delegates this process to market forces. The most suitable approach depends on national context and policy goals, but clarity is essential from the start.

# 03 Tackle polluting activities

Often a handful of large companies are responsible for the overwhelming majority of emissions. For example, a recent Carbon Market Watch study on the EU ETS showed that the 30 most polluting companies were responsible for over half of total ETS emissions. Ideally, carbon pricing should cover as many emissions as possible, but starting with or prioritising top emitters, even within selected sectors, can be a cost-effective solution that shields small companies and enterprises.

For example, the upcoming mandatory Japanese ETS will focus on corporate "ownership" of emissions and will cover companies that emit over 100,000 tonnes of CO2 per year. This will cover over 50% of Japan' s emissions with just 600-700 companies participating. This comes on top of the existing sectoral carbon tax, a scheme covering fossil fuel usage. Utilised wisely, mixing the coverage of sectors, companies and installation can be a very effective solution to balance emissions reductions and just transition concerns.

Similarly, a carbon tax can tackle top polluting activities of fuels (coal and oil, then natural gas), to quickly reap the benefits of an added cost to their consumption, especially for big consumers like industrial players (gas use in steelmaking, or oil refinement in chemicals manufacturing): fuels taxes can effectively act as emission reductions policies when applied following the "polluter pays" principles.

There are activities that are highly polluting but also directly affect the livelihoods of citizens and families: road transport, heating of buildings, and agriculture. It must be taken into consideration to link pricing initiatives for these sectors with strong protection nets for citizens. Since emissions come from millions of diffuse sources like cars and homes, compliance obligations are typically placed upstream on a smaller number of fuel suppliers, however they could then pass the costs directly to citizens through higher fuel and energy prices. Recognising this, when the EU announced its ETS2 on road transport and buildings, a Social Climate Fund was set up in parallel to shield non-commercial final consumers from the harshest effects of full pricing of fossil fuels.

# 04 Safeguard transparency and accountability

Transparency and accountability are vital components of well-functioning carbon taxes and emissions trading systems. This includes accurately measuring and verifying the volumes of GHG emitted, the amount of revenue generated, how this revenue is invested, and any exemptions or subsidies received by polluters. Anyone interested must be able to access public documentation or a registry that contains clear information on all this. Civil society should also be able to monitor declared decarbonisation milestones and objectives for companies and installation.

Monitoring and taking action against violations is also vital. In addition to official monitoring channels and mechanisms, it is important that regulators set up systems for the public to report, including anonymously, the misreporting of emissions data or other transgression, and for these statements to be investigated by the public authorities.

Documentation relative to pollution sources and relevant actors need to be disclosed and accessible to ensure public oversight by independent third parties (media, civil society, other industries): ways to do this can be a centralised website or portal, regularly updated by public authorities, or a point of contact tasked with providing information upon request: failure to provide access should be supported by a substantial motivation.

Similarly, verification should be performed by independent third parties, accredited through pre-approved processes via public authorities. This is essential to guarantee impartial evaluation as relying on self-reporting can lead to inaccuracies or omissions.

# 05 Make polluters truly pay

The polluter pays is a guiding principle of environmental policies, yet there exist too many exemptions and subsidies for fossil fuels around the world. When it comes to carbon prices or taxes, most existing systems provide frameworks that effectively shield certain companies and sectors from actually paying their dues.

For example, aviation in the European Union is exempt from paying fuel taxes. In addition, most active ETSs currently shields polluters through free allocations: the Chinese national ETS grants allowances free of charge that fully cover the emissions falling under the scheme, the K-ETS currently only auctions 3% of its allowances, and the EU ETS still provides free allowances to heavy industry and started applying full pricing to its power sector only in 2013, and more recently to aviation and shipping. Other systems that rely on free allocations include the California-Quebec carbon market, and the forthcoming Japanese GX-ETS and Turkish ETS.

In addition to undermining the climate effectiveness of the carbon price, handing out pollution permits for free often leads to the over-allocation of allowances (handing out an excessive volume compared to actual emissions) which can, perversely, result in undue profits for the companies who receive them, especially when prices start climbing. Heavy industry in the EU, for example, has cashed in on these windfall profits.

However, there are other ways to render the carbon price ineffective. A full rebate for companies that are subject to the carbon price is one way of doing this. For example, the Swiss CO2 Levy grants a payroll-based rebate to firms. Another approach is to grant subsidies for fossil-based industrial energy consumption. Rebates can however be designed to support higher decarbonisation efforts, such as the UK exemptions from the Climate Change Levy for businesses that enter a climate change agreement with the government.

Granting free allocations, compensation, or blanket rebates tends to undermine the carbon price's ability to provide incentives to decarbonise. However, other solutions exist to decrease the pressure of a carbon price without compromising environmental integrity. For instance, a rebate can be offered to cover investments in decarbonisation technologies, or revenue raised from carbon pricing can be rechannelled into climate-proofing companies and households. Ultimately, the price set by the tax or emerging from the market should be paid in full to deliver emission reductions and any further support provided should come with clear climate strings attached.

# 06 Avoid the carbon leakage strawman

Carbon leakage has long haunted carbon pricing debates. It describes the hypothetical situation where industries relocate production, and therefore emissions, to countries with weaker or no climate policies, potentially undermining climate goals and even increasing global emissions. Different systems approach this alleged risk in different ways: while the EU develops and regularly reviews a list of sectors through a mainly quantitative assessment, where all sectors receive 100% protection up to a benchmark level, other systems, such as the California-Québec carbon market, have tiering carbon leakage risks, with different protection levels from 90% to a 100%.

These lists capture potential risks based on hypothetical shifts of trade and investment flows caused by carbon prices, without taking into account the price threshold that could trigger these shifts, and with no consideration of the extent to which each activity can be fully decarbonised. Activities such as oil refining or steam cracking, have little decarbonisation potential without costly and inefficient carbon capture technologies, and will need to be scaled down significantly.

Current carbon leakage lists are based on existing trade flows and hypothetical opportunities for cost transfer to final consumers. This backward looking approach risks fossilising today's highly polluting production processes instead of replacing them with clean alternatives. Rather than supporting or shielding polluting production processes, the goal needs to be to help direct investment choices toward decarbonisation of heavily polluting sectors.

In some cases, this means supporting the deployment of low-carbon options where they exist. In others, it means recognising that certain activities and sectors, such as oil and gas, will need to shrink over time. Free allocation often does the opposite: it protects polluting industries from the carbon price signal, slows the shift to cleaner technologies, and diverts resources away from innovation. A more forward-looking approach would consider each sector's decarbonisation potential and target support where it is genuinely needed.

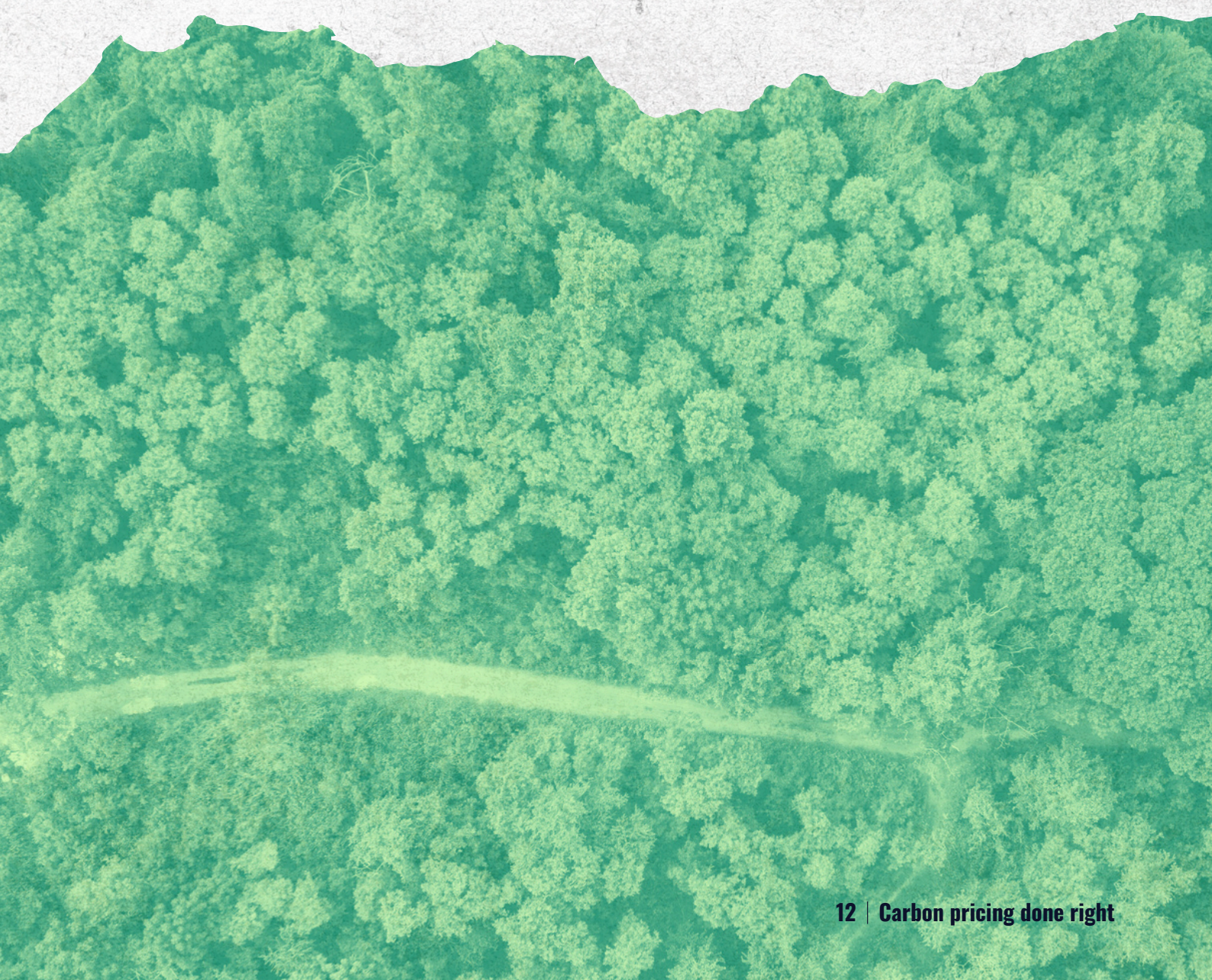
Yet despite the enormous political attention it receives, there is little to no historical precedent to suggest that carbon pricing has actually caused leakage. For sectors such as steel, cement and chemicals, empirical evidence shows that it has largely remained a theoretical risk rather than a reality and research indicates this is unlikely to change, even as carbon prices rise. The link between carbon pricing and relocation is far from straightforward: shifting production abroad involves high costs and risks and is influenced by various factors beyond policy intervention, like trade patterns and supply chain dynamics, among other things.

**Even if a small amount of carbon leakage occurs, the benefits from ambitious carbon pricing far outweighs the risk**

And even if a small amount of carbon leakage occurs, the benefits from ambitious carbon pricing far outweighs the risk: tackling the climate crisis and future-proofing the economy. The only evidence of leakage, currently limited to a recent OECD study, notes that carbon leakage through international trade offset only around 13% of these domestic emission reductions. Academic evidence confirms that there is no evidence of leakage above 14%.

This risk, if proven, can be monitored and if needed, a policy response that is proportionate, targeted, time-bound and conditional can be deployed. Protection should focus on genuinely at-risk sectors or installations and be phased out as cleaner alternatives emerge. Overestimating leakage risk threatens to lock in polluting systems.

Moreover, building climate policy around the fear of leakage can appear defeatist; it assumes that other parts of the world won't act to resolve the climate crisis. In reality, momentum is clearly moving in the opposite direction, as reflected in the rapid global deployment of renewable energy and the introduction of carbon pricing in many parts of the world. Instead of preparing for a race to the bottom, policymakers should recognise this growing momentum and position their economies for a race to the top, one centred on decarbonisation, innovation and climate leadership.



# 07 Ensure the carbon price is right

What is the right price for carbon?

This is one of the most important questions and challenges facing carbon pricing. While there's no single figure as to what the price should be (or become), several studies have assessed that the social and environmental cost of carbon is around $190 per metric tonne of CO2. No carbon pricing system currently reaches this figure, or gets close to it. The UN has called for companies to move towards an internal price of $100 per metric tonne of CO2. Price targets can also be calculated based on the marginal estimated cost of meeting a defined emission reduction target, or based on the investment needs of certain sectors to achieve full decarbonisation.

Studies also show that there is potential for significant emissions reductions even with a modest carbon price, provided the cap tightens over time and a portion of the auctioned revenue is reinvested in other emissions-reduction activities.

As prices on carbon tend to be politically divisive, especially when set as carbon taxes, the issue is setting a price that is high enough to ensure the polluter pays, directs investment towards decarbonisation and a just transition, and is politically feasible.

Price models show how efficiency can be reached through different paths: while traditional models plan for a gradual price increase over time, new studies show that setting a higher price at the beginning leads to higher immediate abatement costs but much lower long-term costs.

While centralised price setting works for carbon taxes, and is used for example in Ireland and South Africa (their carbon tax price increases over time following a pre-set trajectory), ETSs can feature different mechanisms to manage prices. In New Zealand and the UK, price tunnels establish an auction floor and a cost containment reserve. Another option is to put in place an ad-hoc price cap mechanism which is triggered when prices become suddenly too low or too high.

Another option is to manage over- and undersupply. Volume containment tools, such as the EU ETS Market Stability Reserve, can help reduce or increase the amount of allowances available and stabilise the price over time.

# 08 Reinvest revenue into climate and people

Carbon pricing done right raises significant revenue for climate action and justice. These funds need to be spent wisely so as to maximise emission reductions, to facilitate the energy transition for industries and households, and to minimise the social costs for vulnerable segments of society.

To maintain fairness and build public support, revenue should be reinvested in climate action that improves quality of life and supports people and not in prolonging business-as-usual polluting activities. Programmes that help households renovate their homes or switch to cleaner heating, cooling and transport, with greater support for those who need it most, can lead to better quality of life, cleaner air, and a fairer transition.

The spending of carbon pricing revenue must be both targeted and transparent, so that people can clearly see the benefits rather than watch the money disappear into general budgets. Spending should favour the most impactful investment, able to deliver environmental and social co-benefits: primary spending avenues include renewable energy systems and infrastructure, energy savings, climate adaptation, tackling energy poverty, and public mobility.

This revenue should add to, not replace, existing climate budgets, and investments must be additional and sustainable.

The EU ETS offers a cautionary tale in this regard. Initially, national governments had almost complete freedom over how to use revenue, which meant that much of it was not invested in climate action and often disappeared into the general budget. Later reforms required first half and then all of the revenue to go to climate and energy purposes. Yet even under these rules, practice has fallen far short. The list of eligible activities has remained broad and reporting by member states inconsistent and often opaque. Between 2013 and 2021, less than 60% of the €88.5 billion raised went to genuine climate investment, with some member states even funding fossil fuel projects. Such misuse undermines effectiveness and trust in the system and delays needed investments for the clean transition, risking locking in polluting infrastructure.

The lesson is clear: revenue must be transparently earmarked and independently monitored, so that all funding contributes to accelerating decarbonisation, protecting communities, and making clean options cheaper than fossil fuels.

# 09 Consider a carbon border levy or tariff

Carbon tariffs or levies are often presented as a solution to tackle carbon leakage, unfair competition and imported emissions from economies with laxer environmental safeguards by taxing imports in a way that mirrors the carbon price paid by domestic producers.

Although a carbon tariff can help level the playing field, its design should be built on fairness and equity. Many developing countries view these mechanisms as unilateral measures that could penalise them for supplying goods to meet rich-country demand. Over the past two decades, OECD countries have consistently consumed more emissions than they produce, with the EU importing around a fifth of its annual emissions from abroad. This highlights the need to confront unsustainable consumption patterns and the dumping of polluting production activities on low-income countries.

From a climate perspective, the aim of a carbon border adjustment mechanism, such as those set up by the EU and UK is to ensure the pollution avoided by putting a price on domestic carbon is not replaced with imported products with high embedded emissions.

For a carbon tariff to act as a climate rather than a protectionist tool, it must be clearly and transparently linked to climate action. That means applying equal treatment to domestic and imported products, relying on robust accounting of imported emissions, deducting carbon prices paid in the production country, and channeling revenue towards global decarbonisation and climate action.

Designing effective carbon tariffs requires careful consideration of the international dimension. While such mechanisms can help price carbon globally, they risk fuelling trade tensions or undermining climate equity if not rooted in a cooperative global framework. This makes multilateralism is essential and climate diplomacy essential.

**For a carbon tariff to act as a climate rather than a protectionist tool, it must be clearly and transparently linked to climate action.**

Carbon tariffs have huge potential to promote a virtuous circle of climate action. For instance, the EU's CBAM is already prompting several countries to explore carbon pricing but establishing such systems takes time. International coordination, technology transfer, financial support, and capacity-building are crucial to ensure that developing economies are not unfairly penalised for lacking equivalent measures.

Another key issue is how carbon tariffs align with the polluter pays principle and the principle of common but differentiated responsibilities, which underpins the United Nations Framework Convention on Climate Change.

Making importers pay for the carbon in their products follows the logic that the polluter should bear the cost of their emissions, but it's essential to keep in mind historical responsibilities and global inequalities when designing carbon border tariffs. There can be ways of minimising financial strain on vulnerable actors, such as channeling all the revenue from a carbon tariff to the world's least industrialised countries.

Ultimately, carbon tariffs must not be treated as unilateral defensive tools but as stepping stones toward a global carbon pricing system that is equitable and consistent with climate justice.

# 10 Carbon removals and offsets don't replace emission reductions

Loopholes, such as carbon removals or offsetting, are often introduced to give industries more time to adapt or to offer them a backdoor out of their climate commitments.

Carbon dioxide removal (CDR), often referred to as carbon removals or negative emissions, are processes through which CO2 is taken out of the atmosphere and stored away from it permanently. There are technical (or engineered), natural and mixed processes to do so. Many land-based solutions face significant permanence risks as carbon stored in, say, vegetation or in the soils can be rapidly re-released through fires, disease, or land-use change. Carbon removal methods that can store carbon for at least several centuries should be considered permanent because this is a timescale that can benefit the climate and can therefore be used to compensate for residual emissions.

In the EU, at the UN, and in other jurisdictions, industrial lobbies and business-friendly policymakers are increasingly pushing for removals to be treated as a get-out-of-jail-free card for polluters. But this approach is risky as it weakens the pressure to cut emissions at source and slows down the already slow decarbonisation transition, while delivering little to no real benefits to the climate

Offsetting also creates a false sense of security, suggesting that continued pollution can be "cancelled out" when, in reality, it is next to impossible to truly neutralise the climate impact of fossil emissions, while sustainable removals are scarce, uncertain and often impermanent.

There are also voluntary and mandatory regimes which incentivise the implementation of mitigation projects through a system allowing project developers to earn revenue from the sale of carbon credits. These are commonly referred to as offsets: offsets can be domestic, taking place within the country of reference through national frameworks, or international, such as the new carbon markets linked to Article 6 of the Paris Agreement.

The EU ETS was considerably weakened by the integration of international offsets in its early phases. More than 1.5 billion credits flowed into the system by 2012, creating an enormous oversupply that depressed carbon prices to around €5-10/tonne for much of that decade. Beyond the economic distortion, confidence in offsets also collapsed due to persistent concerns about their lack of environmental impact, as many projects failed to demonstrate additionality or relied on inflated baselines and, in some cases, caused social harm to local and indigenous communities.

In response to these failures, the EU first tried to improve the scheme by imposing limits on offset use. Yet even under these tighter rules, companies could still exchange cheap credits for more valuable emissions allowances, turning compliance into a source of profit rather than a driver of decarbonisation. The EU finally decided to phase them out by 2021, focusing on domestic emission reductions.

The South Korean ETS (K-ETS) still overrelies on offsets. A recent CMW study demonstrated that the majority of international credits under the K-ETS come from project types with a track record of over-crediting, including cookstoves, hydropower and gas leakage projects. Cookstoves dominate credit use, yet our analysis found that they overestimate emission reductions by a factor of over 18.

These experiences underline that introducing offsets into emissions trading schemes undermines environmental integrity, shifts the burden of domestic decarbonisation abroad, often to poorer countries, distorts the carbon price and allows industries to avoid paying the true cost of their pollution. That is why these loopholes must be scrapped where they exist and never be allowed to enter new schemes or re-enter existing ones.

**Introducing offsets into emissions trading schemes undermines environmental integrity, shifts the burden of domestic decarbonisation abroad, often to poorer countries, distorts the carbon price and allows industries to avoid paying the true cost of their pollution.**

# Not by markets alone

Carbon pricing alone is not enough to achieve deep decarbonisation. To drive real change, it must be combined with targeted regulations, strategic investment, and bans of the most polluting activities. Some activities, like coal burning, deforestation, or plastic pollution, can't simply be priced into acceptability; treating pollution as permissible as long as one pays undermines climate limits and risks becoming a licence to pollute rather than a driver for transition.

This is where just transition considerations and citizen engagement become crucial. Decisions about which activities must stop, and how costs and benefits are shared, cannot be left to markets alone. Polluting activities impose social and environmental costs, and communities should have a voice in whether and how such industries are allowed to operate and how they should deliver their fair share to the climate transition.

Yet, the 2024 OECD Trust Survey shows that while almost 70% of citizens think their government should prioritise reducing GHG emissions, only 30% feel their political system gives them a voice. Collective democratic debate must guide climate decision-making, ensuring legitimacy for transformative policies that reshape production and consumption practices and transform entire high-emission industries.

Governments are increasingly experimenting with deliberative processes to bridge this divide, and experiences show that when citizens are engaged, climate policies become more legitimate, effective, and durable. Citizens' assemblies (such as in France, Ireland, and the Netherlands) have shaped ambitious legislation, while global public mobilisation and citizen reporting channels in China have strengthened pollution controls. At the same time, a global surge of court cases related to climate change, brought by NGOs and individuals, is pushing governments and companies to uphold environmental law and raise ambition.

Embedding justice, participation and accountability into climate governance must become a central pillar of the transition, ensuring that transformative policies from phasing out fossil fuels to reshaping industrial systems are grounded in social consent and deliver a fair path to net-zero.

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