

Carbon border adjustment mechanism (CBAM) – carbon price paid in a third country

Carbon Market Watch's Feedback

The implementing act laying out criteria for the carbon price already paid in a third country is the missing piece of the puzzle to make the Carbon Border Adjustment Mechanism part of the climate diplomacy strategy of the EU, and ultimately a global climate policy in itself.

With carbon pricing now covering [nearly one third of global emissions](#), the momentum is increasing: the EU CBAM already has a role in increasing demand for carbon pricing systems. But a key question remains: will the CBAM lead to higher environmental integrity and stringency carbon pricing systems in third countries? **This implementing regulation clearly incentivises other countries to allow the use of domestic and international credits for compliance. A very worrying signal from the EU**, especially considering some jurisdictions (see for example [Japan](#), [South Korea](#), [Turkey](#)) already allow the use of offsets for compliance, or are planning to - putting EU producers at a disadvantage and reducing climate incentives. **The CBAM's push for meaningful carbon pricing abroad is being weakened with this approach to domestic and international offset credits.**

A carbon price that isn't really "paid" as it is refunded through rebates and compensations can not be accounted against the CBAM levy (Article 9 of the CBAM Regulation). The same approach should be taken regarding international credits and domestic offsets.

During phase 3 (2013-2020) over 1.6 billion credits entered the ETS, and wrecked the price signal, delaying emission reductions and completely undermining the effectiveness and credibility of the ETS for a decade. The use of Kyoto credits [hampered the functioning of the EU ETS](#) by inflating the oversupply of emission allowances, thereby lowering the incentive for European industry to decarbonise.

In addition, confidence in the climate benefits of these (often cheap) credits plummeted due to their lack of environmental integrity and the harm some of these projects caused

to local and indigenous communities. The amount of scandals in offset and crediting schemes and proof of their lack of climate benefit has been overwhelming - and fraud has been widespread.

There is no reason to believe that bringing international credits (for example from the Article 6 system under the Paris Agreement) into the EU ETS and CBAM framework now would lead to significantly different results. And domestic offsetting schemes are even more likely to continue the deeply problematic track-record of voluntary carbon markets and Kyoto-era crediting schemes (this has already been well-documented in [Colombia](#)). Even with the stricter Article 6 rules compared to Kyoto credits, [over-crediting](#) remains a huge issue: offsetting projects do not play the same role as emission reductions, and [must be kept separate](#) from compliance carbon pricing schemes.

In the context of the CBAM, allowing the use of such credits weakens the mechanism's ability to reflect real carbon costs, distorts competition between EU and non-EU producers, and reduces incentives for genuine emissions reductions both within and outside the EU. As the rules stand now, the Article 6 framework [is simply not robust enough](#) to ensure the transparent trade of high-quality carbon credits, raising concerns about environmental integrity and the effectiveness of the CBAM as a tool to support global climate action. And again, domestic offsetting schemes are likely to be of far lower quality and standards.

The openness for using international credits and domestic offsets for CBAM compliance is a significant step back. We identify as main issues:

- ✗ **Environmental integrity of third country carbon pricing is not a core principle**
- ✗ **No distinction is made between cap-and-trade or baseline-and-credit**
- ✗ **Lack of significant signal to international partners that the quality of credits matters**

Environmental integrity is the main worry. The EU CBAM rules boil everything down to the cost of CO₂: whether it's cap-and-trade or baseline-and-credit doesn't matter. It's a missed opportunity by the EU to signal internationally that the quality of carbon pricing schemes, and the quality of credits matters, and risks opening the door to low-quality, higher-price credits to fulfil the pricing obligation of the CBAM without committing to significant CO₂ emission reductions.

The implementing regulation does contain a few key safeguards to limit potential damage. These do not sufficiently limit environmental risks and credibility concerns - and must be strengthened rather than weakened. These safeguards are:

- **Credits (domestic and international) must at least be embedded in a domestic carbon pricing system**
- **Price differential: focus on price rather than quantity**
- **Limit of 10% of emissions declared to Article 6 credits used for compliance**

The impact to drive demand for low-quality (and low-price) offsets and international credits may end up limited. Making the link based on price, quantitative limit to article 6 credits, and on integration in domestic carbon pricing schemes do limit risks somewhat. But the risks do remain, as do perverse incentives to drive up the notional price of credits from domestic schemes just to lower CBAM compliance costs. **The limit for international credits should be extended to domestic credits; the lack of qualitative safeguards, which would be very difficult to verify for domestic offsets, should lead to a quantitative limit in their use.**

Implementing meaningful national/sectoral climate targets backed by a strong carbon price signal remains a better alternative and a better goal for CBAM to support than the inclusion of zero-sum and likely hot air-base offset mechanisms in carbon pricing schemes.

Effective carbon pricing globally is the end goal and it's important to ensure this stays a race to the top, not to the bottom. **The Commission is sending a wrong signal on offsetting to our international partners, and this will contribute to hollowing out carbon markets across the world. It also sets a worrying precedent for those seeking to undermine the EU ETS itself with international credits (again) or domestic offsets.**

References:

[By the book: How effective are Article 6 carbon market rules?](#)

[Out of the frying pan, into the cookstove: Too many carbon credits enter UN carbon market](#)

[Legal framework for the possible use of international credits towards the 2040 EU climate target under the European Climate Law](#)

[Recipe for greenwashing - Carbon Market Watch](#)

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