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From Climate Policy to Climate Partnerships:

A European Strategy for Competitiveness, Investment and Global Decarbonisation

From Climate Policy to Climate Partnerships: A European Strategy for Competitiveness, Investment and Global Decarbonisation

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EXECUTIVE SUMMARY

Europe faces a dual challenge: keeping its carbon pricing and industrial investment framework credible enough at home to hold capital in the transition and turning decarbonisation into an economic and geopolitical proposition compelling enough abroad to draw partners in alongside it. The first is a policy task; the second, which splits into building a credible partnership offer and making decarbonisation bankable, is an investment and partnership task that policy alone cannot complete. Europe hosts around a quarter of the global pipeline of clean industrial projects, but more than 90% of these still await a final investment decision, making policy credibility the decisive variable.

In a more fragmented geopolitical environment, neither weakening European carbon pricing nor relying primarily on unilateral border measures such as the Carbon Border Adjustment Mechanism (CBAM) will mobilise the capital or the coalitions Europe needs abroad. The EU therefore needs to better connect its climate, industrial and trade policies. Credible carbon pricing and carbon leakage protection at home, complemented internationally by partnerships that mobilise investment, reduce financing costs and create mutual economic benefits from decarbonisation.

This challenge is acute at a pivotal moment. The EU Emissions Trading System (ETS) is entering a decisive reform phase, while CBAM has entered its definitive phase, against a backdrop of growing concerns over European competitiveness, geopolitical fragmentation and international trade tensions. Within Europe, the CBAM is under pressure over administrative complexity, its knock-on effects along value chains and the export gap.

Internationally, the EU's approach is widely perceived as unilateral, even protectionist and Eurocentric. An approach that imposes the cost of decarbonisation on trading partners without providing sufficient support to enable their adaptation and transition: 'a stick without a carrot'.[1]

The answer to this is neither to weaken the ETS nor to continuously expand the role of EU border measures. Europe should preserve a credible carbon price and effective carbon leakage protection while developing a complementary partnership architecture around investment, finance, technology cooperation and international carbon pricing.

This policy brief outlines such an approach. It argues for complementing a better-embedded carbon leakage protection by a complementary partnership agenda around investment, finance, technology cooperation and international carbon pricing, which is currently missing.

This requires action on three fronts:

- **Protect:** keep carbon leakage instruments targeted and predictable, close the export gap and avoid unnecessary complexity.
- **Partner:** turn Europe's climate policy into a more credible international added value proposition through revenue recycling, MRV cooperation and differentiated approaches for vulnerable partners.
- **Invest:** make decarbonisation economically viable through guarantees, offtake arrangements, co-investment and, where appropriate, robust international carbon-market cooperation.

1 This policy brief was developed on the basis of a *Policy Accelerator workshop held in April 2026 by EPICO and Konrad-Adenauer-Stiftung Multinational Development Policy Dialogue. The workshop aimed to bring in a third-country perspective to a debate usually conducted from within Europe. The CBAM was examined not in isolation, but through the eyes of the partners whose cooperation determines whether it succeeds.*

1. INTRODUCTION

A Critical Moment for European Climate Policy in a Changing Economic and Geopolitical Environment

The geopolitical and geoeconomic environment in which European climate policy operates has fundamentally changed. Climate, industrial and trade policy are increasingly intertwined, while geopolitical fragmentation, strategic rivalry and economic nationalism are making international cooperation more difficult. Russia's war against Ukraine, instability in the Middle East, the retreat of the United States from multilateral climate cooperation and intensifying industrial competition with China have increased uncertainty over whether other major emitters will match European climate ambition or benefit from it without undertaking comparable efforts based on a level-playing field.

Energy and industrial policy are at the same time used explicitly as geopolitical instruments. Global competition over clean technologies, critical raw materials and strategic value chains has created dependencies that no border measure can resolve. These external pressures reinforce Europe's domestic competitiveness challenges: High energy costs, skills shortage, bureaucracy, slow permitting procedures and weak investment dynamics weigh on Europe as an industrial location. Yet, reversing European climate policy would address none of these structural constraints.[2] The challenge is therefore not to choose between climate ambition and competitiveness, but to design a climate policy architecture that supports investment and industrial transformation under fundamentally changed economic conditions.

Within Europe, the EU Emissions Trading System (ETS) and the Carbon Border Adjustment Mechanism (CBAM) sit at the centre of this challenge. The CBAM ranks among the most innovative and most complex policy instruments ever introduced at the intersection of climate policy, trade governance, and industrial competitiveness.[3] As the CBAM enters its definitive phase in 2027, importers must soon begin purchasing and surrendering CBAM certificates, following the reporting-only transitional period that began in October 2023. However, CBAM is now implemented in a political environment fundamentally different from the one in which it was conceived: Europe faces high energy prices, intense concerns about the competitiveness of its energy-intensive industries, and a geopolitical context in which climate policy is increasingly coming under scrutiny. Both the ETS and the CBAM are under pressure, including growing demands for flexibility from international carbon credits under Article 6 of the Paris Agreement to the inclusion of carbon removals and requests for a longer availability of more ETS certificates.

The ETS reform raises the stakes

The 2026 reform is not just a technical adjustment. It will determine the future balance between carbon-price credibility, investment certainty, carbon leakage protection and industrial competitiveness. In the run-up to the ETS review in July 2026, parts of industry and several Member States have suggested weakening the carbon price trajectory, prolonging free allocation, or abandoning the ETS entirely.[4] Decisions now being taken in 2026 will shape Europe's climate and industrial policy and investment framework for the next decade, while determining also external climate, trade and industrial policy.[5]

2 Edenhofer, Kolev, Löschel and Weber, 2026.

3 Pietras, 2026.

4 EPICO and Frontier Economics, 2026.

5 EPICO and Frontier Economics, 2026.

The Commission's proposal of 17 July 2026 responds to these pressures by combining a more gradual cap trajectory with additional flexibility. It reduces the linear reduction factor from 4.4% to 3.7% between 2031 and 2035 and to 1.7% from 2036, with a fallback of 2.7% if suitable international credits are not available. It also provides for 250 million tonnes of permanent domestic carbon removals and international credits of up to 2% from 2036.

For the future carbon leakage architecture, two changes are particularly important. First, free allocation for sectors genuinely exposed to carbon leakage is set to continue beyond 2034, and its phase-out for CBAM goods would run until 2038 rather than ending in 2034. Second, free allocation would become conditional from 2031 on companies investing the full value of their allocation in decarbonisation within Europe, which shifts the instrument from carbon leakage protection towards a de facto investment obligation and may increase leakage risks where the required investment is not yet economically viable.

With political agreement targeted for the first quarter of 2027, the negotiations now entering a decisive phase will therefore shape not only the ETS and carbon leakage protection, but also the economic and political environment in which international partnerships operate.

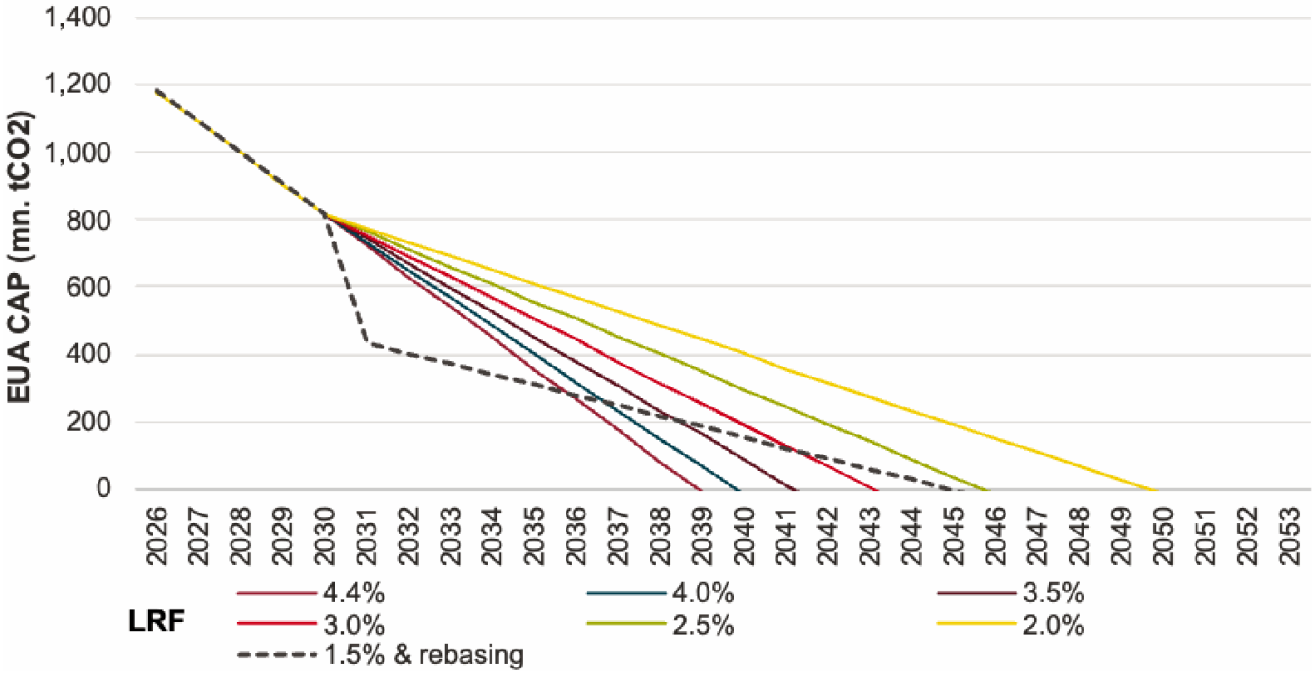


Figure 1: Development of the EU ETS cap under different LRF scenarios. Source: EPICO KlimaInnovation and Frontier Economics "The EU ETS at a Turning Point: Balancing Competitiveness and Decarbonisation", Figure 4.

Reform to preserve—not reform by dilution

Against this background, two temptations should be resisted: the first is to weaken the ETS in response to short-term political pressure, which would undermine the credibility of EU carbon pricing and the investment signals on which industrial transformation depends. The second is to continuously broaden CBAM in an attempt to solve problems it was not designed to address. While it seems tempting to pursue various goals with one tool, overloading CBAM with additional objectives would create a different problem: greater administrative complexity, stronger trade frictions and increasing demands on trading partners, which it cannot accept, while doing little to address the structural drivers of European competitiveness.[6]

6 Pietras, 2022.

There is a better path: Europe can reform its carbon pricing architecture to preserve what makes it valuable: a credible long-term carbon price, effective carbon leakage protection and predictable incentives for investment. Legitimate competitiveness concerns should therefore be addressed through targeted reforms rather than systemic dilution.[7] This means using flexibility without undermining long-term scarcity, concentrating free allocation where carbon leakage risks are genuinely highest, addressing the export gap directly and improving CBAM rather than continuously expanding its objectives and scope.[8]

The investment stakes are considerable. Europe hosts around a quarter of the global pipeline of clean industrial projects – roughly 50% in steel and over 70% in cement – but more than 90% of these projects still await a final investment decision (FID), making policy credibility the decisive variable. A reversal of climate policy would solve none of Europe's structural problems (e.g., high energy costs, skills shortages, slow permitting) while undermining the investment signals of the world's most successful carbon market, which has cut covered emissions by around 50% since 2005.[9]

From a border instrument to a broader partnership architecture

The strategic question is therefore no longer simply whether CBAM should be expanded. It is how to make CBAM work better while recognising the limits of what a border instrument can deliver. This requires looking at CBAM not only through a European lens, but also from the perspective of trading partners whose cooperation will ultimately determine its international effectiveness. CBAM can protect European carbon pricing against carbon leakage, but it cannot on its own mobilise investment, lower the cost of capital, transfer technology or create durable international partnerships.

The EU therefore needs a better-embedded rather than an ever-broader CBAM. The instrument itself should remain targeted, predictable and focused on carbon leakage protection. Its genuine design gaps should be addressed directly. Beyond the border, it should be complemented by a more ambitious partnership architecture built around investment, finance, technology cooperation, interoperable carbon-accounting systems and international carbon pricing.

Partnerships with strategically important third countries—particularly middle powers[10] whose investment and technology choices will shape future global emissions and clean-technology markets—should become an integral part of this architecture. Clean trade and investment partnerships, co-investment and, where appropriate, cooperation under Article 6 of the Paris Agreement can connect European competitiveness with global decarbonisation while creating tangible benefits for both sides.

7 EPICO and Frontier Economics, 2026.

8 EPICO and Frontier Economics, 2026.

9 EPICO and Frontier Economics, 2026.

10 Canadian Prime Minister Mark Carney used the term "middle powers" throughout his speech at the World Economic Forum's Annual Meeting in Davos on 20 January 2026, arguing that such states must combine forces rather than compete individually for the favour of the great powers, and calling for new, issue-specific coalitions grounded in shared values and interest.

2. GETTING THE POLICY MIX RIGHT

The Role and Limits of CBAM

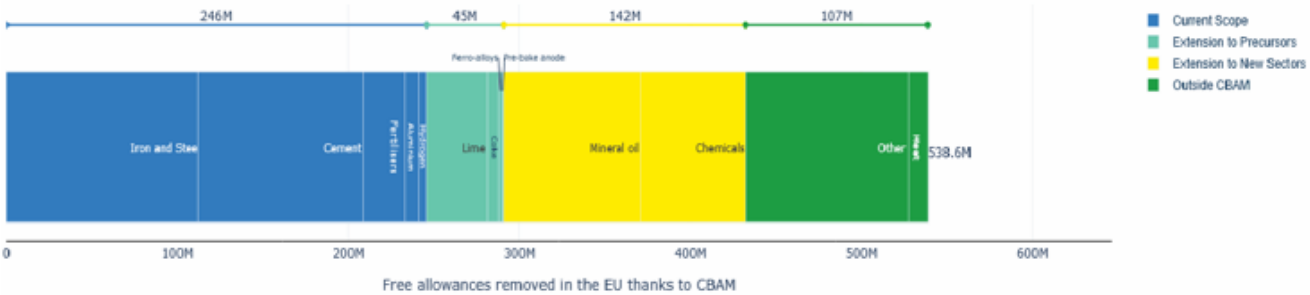
CBAM is an essential part of Europe's carbon leakage architecture but it cannot carry Europe's broader competitiveness and international decarbonisation strategy on its own. Within Europe's broader climate and industrial policy architecture, CBAM has a clear core function: to protect the integrity of EU carbon pricing by addressing carbon leakage as free allocation is phased out.

The CBAM regulation defines its purpose accordingly: to address embedded emissions in covered imports "in order to prevent the risk of carbon leakage", while also contributing to global emissions reductions and creating incentives for cleaner production in third countries.[11] It explicitly links the mechanism to the gradual replacement of free allocation under the EU ETS.[12] At the same time, the Regulation expects CBAM to support emissions reductions beyond Europe.[13]

CBAM can strengthen carbon leakage protection but it cannot replace a broader competitiveness strategy

Free allocation primarily compensates producers exposed to carbon-cost disadvantages vis-à-vis competitors that do not face comparable carbon constraints. When targeted at sectors genuinely exposed to carbon leakage and calibrated against appropriate benchmarks, it provides protection without removing the incentive to reduce emissions.

CBAM gradually replaces this protection at the border. Its introduction could enable the removal of up to 432 million free allowances per year, worth around €35 billion, that would otherwise be allocated to European installations.[14] Unlike free allocation, the CBAM is not constrained by the shrinking cap, generates revenues, and can in some cases – such as fertilizers imported from North Africa – offer even stronger protection.[15] Figure 2 shows how these removed allowances are distributed across sectors, in the current scope and under possible extensions.



Source: Sandbag, using data from the EU Transaction Log

Figure 2: Free allowances removed after full CBAM implementation, compared to 2023 (millions of EUA per year). Source: Sandbag (2025) "The EU CBAM: A Two-Way Street to Climate Integrity?", Figure 8.

The mechanism also creates an economic incentive for cooperation. Analyses estimate that, under business-as-usual trade, the CBAM in its current scope could collect €11.3 billion in fees annually, falling to €7.3 billion if third-country producers engage in resource shuffling, and to €7.0 billion if their governments introduce carbon pricing.[16] The important point is not only the scale of the potential burden for partners, but also that this burden can decline when producers decarbonise or countries develop credible domestic carbon-pricing policies.

Important gaps remain in carbon leakage protection

The CBAM does not fully solve the carbon leakage problem it is designed to address. Most importantly, it levels the playing field between European and non-European producers inside the EU market but provides no equivalent protection for European producers competing in third-country markets.[17]

Other limitations arise along value chains. Sectors outside CBAM's scope remain exposed to international competition, while higher costs for covered inputs can affect downstream European producers competing with imported finished goods. Circumvention and resource shuffling can further weaken the mechanism's effectiveness, while administrative requirements impose significant fixed costs, particularly on smaller companies.

These are genuine design challenges and should be addressed. But they do not justify continuously broadening the CBAM's objectives or turning it into a general instrument for European competitiveness.

Beyond protection: CBAM needs a partnership architecture around it

Equally, the CBAM's limitation applies internationally. It can create pressure to decarbonise, but it cannot create partnerships on its own. For many trading partners, the mechanism imposes an additional cost of accessing the European market without providing an equally visible economic proposition for making the transition. This is the central external challenge. The relevant question is not primarily, how Europe can make CBAM more acceptable to its partners, but what would make cooperation economically rational for them.

The answer to this lies beyond CBAM itself. Investment finance, guarantees, technology cooperation, interoperable MRV systems, market access and international carbon-market cooperation can help turn the incentive created by European carbon pricing into economically viable decarbonisation.

16 Sandbag, 2026.

17 EPICO and Frontier Economics, 2026.

3. FROM BORDER PROTECTION TO CLIMATE PARTNERSHIPS

Three Strategic Challenges

Europe's overarching challenge is to embed carbon leakage protection in a broader strategy that preserves European competitiveness while making international cooperation and decarbonisation economically attractive to partner countries.

Three dimensions of this challenge should be distinguished:

- First, **protect:** CBAM must provide effective carbon leakage protection without triggering an ever-expanding cycle of additional coverage, complexity and circumvention.
- Second, **partner:** Europe needs to address the political and distributional tensions created by a unilateral border measure and offer third countries a credible economic proposition for cooperation.
- Third, **invest:** cooperation will only translate into decarbonisation if low-carbon projects become economically viable and bankable.

This distinction matters because the appropriate policy response differs across these dimensions. Problems of carbon leakage require better-designed protection; problems of international acceptance require partnership; and investment barriers require finance and risk-sharing.

3.1 PROTECT: CLOSING CARBON LEAKAGE GAPS WITHOUT OVERLOADING CBAM

The challenge is to close the EU's carbon leakage gaps without responding to every new vulnerability by continuously expanding CBAM.

Circumvention can weaken environmental effectiveness

Avoidance incentives are inherent in a mechanism that creates a growing carbon-cost differential between EU and non-EU production. Companies can restructure supply chains, alter product classifications or shift processing steps to avoid coverage. Most importantly, resource shuffling can reduce CBAM liabilities without reducing global emissions, by directing cleaner production towards Europe while carbon-intensive output continues to serve other markets. The April 2026 amendment addresses some of these risks by extending coverage to around 180 downstream goods and pre-consumer scrap. Yet further expansion creates its own trade-off: Each attempt to close one leakage channel can extend CBAM deeper into increasingly complex value chains, raising compliance costs and potentially creating new distortions.

Downstream protection risks creating a cycle of continuous expansion

Because CBAM initially covers carbon-intensive upstream inputs, European downstream producers can face higher input costs while competing against imported finished products that bear no equivalent carbon adjustment. OECD modelling confirms this tension: CBAM can reduce carbon leakage in covered sectors while only partially offsetting value-added losses and imposing costs on downstream European

industries.[18] This creates political pressure for further scope expansion. But continuously extending CBAM down value chains is not a sustainable substitute for a clear assessment of where carbon leakage risks are genuinely material.

The export gap remains the most important structural weakness

CBAM levels the playing field in the European market, but not in third-country markets. European exporters therefore continue to face the full EU carbon cost while competing against producers without comparable carbon constraints. As free allocation is phased out, this asymmetry becomes increasingly significant. The Commission has recognised the problem through its proposed Temporary Decarbonisation Fund. Yet support concentrated in 2026 and 2027 arrives precisely when CBAM exposure remains comparatively limited. A durable carbon leakage architecture therefore requires a credible long-term solution for exports rather than temporary compensation.

Complexity can become a competitiveness problem of its own – particularly for SMEs

For many firms—particularly SMEs—the fixed cost of CBAM compliance can matter more than the carbon payment itself.[19] Reporting, verification and administrative requirements risk concentrating trade among larger operators able to absorb these costs. The policy challenge in this dimension is therefore to make carbon leakage protection more precise: close material gaps, prevent circumvention and simplify compliance without turning every downstream competitiveness problem into another extension of the border mechanism.

3.2 PARTNER: MOVING FROM A UNILATERAL APPROACH TOWARDS A COOPERATIVE PROPOSITION

The EU's approach is a "stick without a carrot"

From outside the EU, the CBAM-driven approach is primarily experienced as a unilateral condition for accessing the European market. Its uniform application across countries with vastly different income levels, historical emissions and capacities to decarbonise sits uneasily with the principle of differentiated responsibilities that has shaped international climate diplomacy.[20]

This is not a hypothetical irritation. At their 30th ministerial meeting, the BASIC countries (Brazil, South Africa, India and China) jointly voiced grave concern over unilateral carbon border adjustment as a discriminatory trade barrier that runs against the principles of equity and common but differentiated responsibilities.[21] The deeper problem is that the CBAM pressures other countries to move faster than they committed to under the Paris Agreement – unilaterally, rather than through negotiation.[22]

Partners may reasonably question the climate impact of CBAM itself: "once implemented, the CBAM's impact on trade will be considerable, whereas the environmental gains may be limited."[23] The CBAM's reach is confined to goods actually shipped to Europe, for some large exporters that represents less than 1% of their domestic production.[24]

18 Dechezleprêtre et al., 2025.

19 Pietras, 2026.

20 Pietras, 2026.

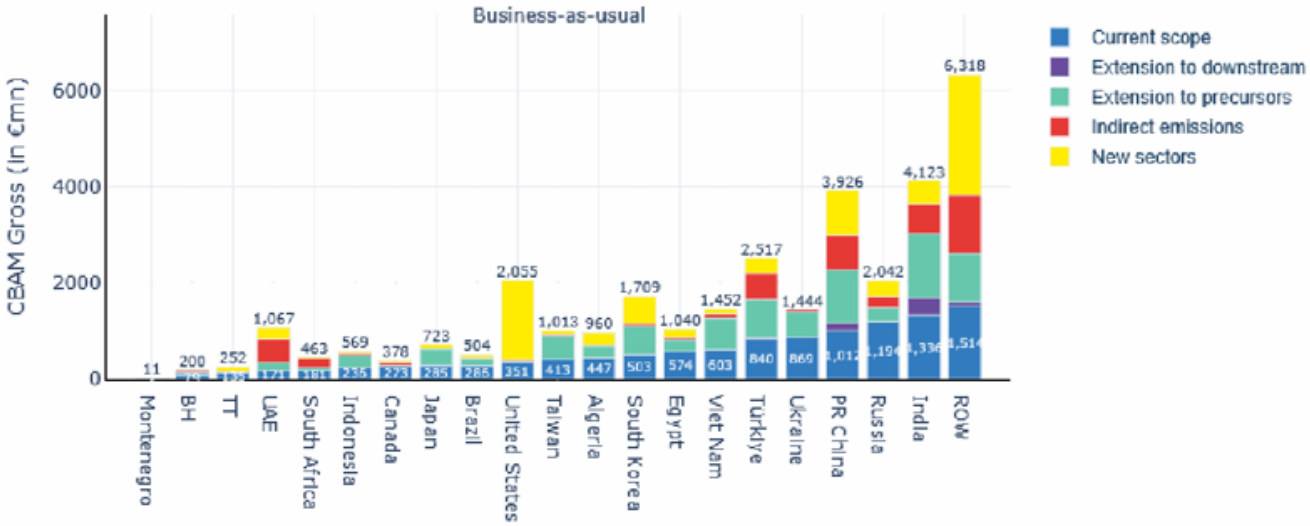
21 Joint statement of the 30th BASIC Ministerial Meeting on Climate Change (8 April 2021), as quoted in Pietras, 2022.

22 Pietras, 2022.

23 G. Zachmann and B. McWilliams. 2022. "A European Carbon Border Tax: Much Pain, Little Gain" Bruegel, as cited in Pietras, 2022.

24 In 2025 Japan produced 80.7 million tonnes of steel but exported only 0.8 million tonnes of CBAM-covered steel to the EU, while China produced nearly one billion tonnes and exported just 8.9 million tonnes of CBAM steel goods to the EU. See also Sandbag. 2026.

Where the EU sees an instrument to safeguard carbon pricing, many partners primarily see an additional cost of accessing the European market. Figure 3 shows how the gross fee burden would be distributed across exporting countries. The flipside of this burden is also an opportunity. Revenues collected at the EU border could, if partially recycled into partner countries' decarbonisation, become the most visible proof that the CBAM is more than a protectionist tool.



Source: Sandbag, based on data from Eurostat, the European Commission and academic sources.

Figure 3: Estimated CBAM fees in the business-as-usual scenario, per country (€ million), under the current scope and possible extensions. Source: Sandbag "The EU CBAM: A Two-Way Street to Climate Integrity?" Figure 15

A fragmenting trade order raises the costs of unilateralism

The CBAM was designed for a rules-based trading order that is eroding. The EU has been hit by US border tariffs and has lost ground in the Chinese market, while EU steel and aluminium producers face increased competition from third countries diverted away from the US market.[25] US policy disrupts energy flows and supply chains, actively questioning climate change, while China combines a dominant position in critical raw materials and clean-tech manufacturing with huge industrial overcapacity, showing only selective "à la carte" interest in making parts of its export industry CBAM-compatible. A unilateral border measure introduced into a fragmenting trade order risks accelerating that fragmentation rather than containing it. Analysis suggests the CBAM tends to reduce overall EU trade with the rest of the world, an effect that would grow with every extension of its scope.[26]

At the same time, the United Kingdom, Canada and others are developing or considering their own carbon border mechanisms.[27] Without convergence on methodologies and carbon accounting, multiple CBAMs risk creating a patchwork of overlapping requirements rather than a coherent international carbon-price signal. When larger importers restrict demand, exporters are pushed toward other markets and small exporters suffer the resulting price pressure the most.[28]

Partners have fundamentally different capacities to respond

The capacity to respond to the CBAM differs radically across affected countries. Industrialised and larger middle-income economies with diversified production and access to capital may find adjustment comparatively easy to manage; less and least developed countries (LDCs) struggle with limited

25 Sandbag, 2026.

26 EPICO and Frontier Economics, 2026.

27 Pietras, 2026.

28 Pietras, 2026.

financial resources, technological constraints, and insufficient monitoring and verification systems.[29] For least developed countries, the stakes are existential rather than marginal. Even small export volumes can represent a significant share of foreign trade, and the core problem the CBAM poses for them is that it restricts their prospects for development.[30] The CBAM's demonstrated push towards carbon pricing materialises almost exclusively in high- and upper-middle-income economies, while lower-income countries lack the fiscal, administrative and regulatory capacity to respond in kind.[31] This criticism has recently moved from analysis into open diplomatic conflict, as the CBAM was raised as a "protective unilateral measure" by developing economies at the African Leaders Summit ahead of the G20 in November 2025. It became a flashpoint at COP30 in Belém, where several major emerging economies pushed to place "unilateral trade measures" on the agenda during the Just Transition Work Programme discussions.[32]

There is also a disconnect between European capacity-building offers and what developing countries actually need. This includes support for establishing monitoring, reporting and verification (MRV) systems, adopting low-carbon technologies and designing instruments such as green taxonomies suited to their circumstances. The CBAM regulation requires the Commission to report on its impact on developing countries, with particular attention to LDCs, and on the effects of the technical assistance given.[33] It also requires an evaluation how Global Europe financing has contributed to decarbonising manufacturing in LDCs.[34] The Commission delivered the first of these obligations in December 2025, concluding that CBAM's aggregate impact on LDCs' GDP is negligible and cataloguing the technical assistance already provided.[35] That assessment, however, measures the EU's own inputs and CBAM's economic footprint rather than developing countries' needs, so it does not resolve the disconnect it is meant to address. The second obligation, evaluating how Global Europe financing has contributed to decarbonising LDC manufacturing, only applies from the end of the transitional period and has not been confirmed as delivered. Reporting obligations, however, even where met, are not yet a strategy that engages with developing countries' needs from a third-country perspective.

The EU's unilateral approach therefore interacts with highly unequal capacities to adjust. A credible partnership strategy needs to recognise this difference. The strategic objective should be to shift the relationship from compliance with a European instrument towards cooperation around a shared economic interest in decarbonisation.

29 Pietras, 2026.

30 Pietras, 2022.

31 Bahí et al., 2026.

32 Trasi and Mazzocco, 2025.

33 CBAM Regulation (consolidated version), Article 30(2)(f).

34 CBAM Regulation (consolidated version), Article 30(8), referring to Regulation (EU) 2021/947 (Global Europe/NDICI)

35 Report from the Commission to the European Parliament and the Council on the application of the Regulation on the Carbon Border Adjustment Mechanism, COM (2025) 783 final, 16 December 2025: "the expected impact of the CBAM on the GDP of LDCs in aggregate is negligible, at less than 0.01% by 2035"

3.3 INVEST: MAKING DECARBONISATION ECONOMICALLY VIABLE

A partnership will remain at the entry point unless it changes the economics of investment. In many partner countries, the major constraint on industrial decarbonisation is not a lack of climate ambition, but the cost of capital and the absence of bankable low-carbon projects.

Europe's partnership offer remains fragmented

European support for decarbonisation in partner countries is dispersed across development financing, trade agreements and cooperation under Article 6 of the Paris Agreement, each with its own logic, timeline and administrative entry point. Seen from a partner government's perspective, it is correspondingly difficult to identify what the EU is actually proposing and on which terms.

The central bottleneck is bankability

In most partner countries the major constraint on decarbonisation investment is not the level of ambition but the cost of capital and the absence of projects that are bankable at that cost. Cooperation that is politically attractive but not economically viable does not mobilise private investment, which is why concrete incentives such as access to markets, finance and technology cooperation matter more than declaratory frameworks.[36] Where capital costs are high and low-carbon technologies remain more expensive, the EU's frameworks will not mobilise investment unless projects become commercially viable. A carbon price signal changes relative prices; it does not automatically finance the investment required to respond to them.

CBAM revenues can make the partnership tangible

CBAM makes the asymmetry particularly visible. Partner-country exporters face a measurable financial cost at the European border, while the revenues largely flow into the EU budget. As long as there is no visible link between these revenues and investment in partner-country decarbonisation, CBAM will continue to be experienced primarily as a cost.[37] The mere reporting obligations of the CBAM regulation for the European Commission to report on its effect on third countries is insufficient to address this issue, as it will not change the perception in third countries, unless it is followed up by clearly stated actions and adaptions.[38] Recycling part of the economic value generated by CBAM into additional decarbonisation investment would not only improve fairness; it could turn the mechanism from a source of friction into an anchor for cooperation.

36 Kumar, et al. 2023.

37 Pietras, 2026.

38 See Chapter 3.2 on CBAM Regulation Article 30 (2) and Article 30 (8).

4. POLICY RECOMMENDATIONS

How to Protect, Partner, Invest

Europe should not continue to pursue its unilateral approach. Instead, a more balanced approach is required: The EU needs to strengthen carbon leakage protection where it remains incomplete and use complementary instruments where cooperation and investment are required. The following recommendations therefore follow the three strategic dimensions mentioned above: protect, partner and invest.

4.1 PROTECT: MAKE CARBON LEAKAGE PROTECTION MORE PRECISE, NOT BROADER

Improve existing legislation rather than expand it

The first guiding principle is restraint. CBAM should remain focused on its core function: protecting the integrity of EU carbon pricing against carbon leakage. Adding further policy objectives increases complexity, weakens predictability and risks reinforcing perceptions of CBAM as a protectionist instrument.

The EU should therefore:

- **Avoid a multitude of objectives.** CBAM should remain a focused carbon leakage instrument rather than becoming a general lever for raising third-country climate ambition.
- **Extend coverage only where evidence shows that leakage has materially shifted downstream.** Overly broad coverage risks disproportionally shielding European industries from global competition.[39]
- **Strengthen targeted anti-circumvention measures.** Customs controls, data sharing and systematic monitoring of trade patterns should address emerging loopholes before any further scope extensions are considered.[40]
- **Preserve Predictability.** Article 27a's proposed emergency mechanism risks turning CBAM into a moving target for investors and should be reconsidered and dropped.[41] Instead, the EU should articulate early on what the post-transition architecture of carbon pricing will look like to create planning security.[42]

Close the export carbon leakage gap

CBAM levels the playing field in the European market, but it does not provide equivalent protection for European producers competing in third-country markets. As free allocation declines, this asymmetry will become increasingly relevant.

The EU should therefore:

- **Extend transitional export protection beyond 2027.** The proposed Temporary Decarbonisation Fund can bridge the transition, but support should cover the period in which declining free allocation creates material carbon-cost exposure for exporters.[43]

39 Pietras, 2026.

40 EPICO and Frontier Economics, 2026.

41 Sandbag, 2025.

42 Pietras, 2026.

43 EPICO and Frontier Economics, 2026.

- **Assess a benchmark-based refund mechanism for exports.** A WTO-compatible approach should preserve competitiveness in third-country markets without weakening the domestic carbon-price signal.[44] The reported emergence of a possible qualified majority for export rebates suggests the political window is currently open.[45]
- **Protect early movers from competitive disadvantage.** European producers that decarbonise early should not be disadvantaged when competing against producers facing no comparable carbon constraint.

4.2 PARTNER: TURN CARBON PRICING INTO A COOPERATIVE ADDED VALUE PROPOSITION

Climate ambition should primarily be advanced through climate diplomacy, while trade and partnership dialogues should focus on practical cooperation, including implementation, methodological convergence and recognition of equivalent policies. CBAM creates an incentive to decarbonise, but incentives alone do not constitute a partnership. Europe should complement the cost imposed at the border with a credible proposition for cooperation.

Turn CBAM revenues into a visible partnership dividend

For many trading partners, CBAM represents a tangible additional cost of accessing the European market. Linking part of the resulting revenues to decarbonisation abroad could make the benefits of cooperation equally tangible.[46]

- **Dedicate a meaningful share of CBAM resources to international decarbonisation.** CBAM-scale resources (several billion euros annually) should be channelled, through the Global Europe instrument in the next multiannual financial framework (MFF), into decarbonisation projects in partner countries, integrating private actors and local authorities. The building blocks for this already exist in legislation. Article 30(8) of the CBAM regulation obliges the Commission to evaluate how Global Europe financing contributes to the decarbonisation of manufacturing in least developed countries.[47]
- **Make funding additional.** CBAM-related support should complement rather than substitute existing development and climate-finance commitments.
- **Prioritise impact.** Funding should be allocated according to emissions-reduction potential and its ability to mobilise additional private investment, rather than spending volumes alone. The principle of maximising decarbonisation impact per unit of public money should be the explicit selection criterion.
- **Concentrate resources where they can demonstrate results.** Initially, support should focus on a limited number of high-impact industrial partnerships and demonstration projects rather than a large number of fragmented programmes.

Protect vulnerable partners without undermining carbon leakage integrity

Trading partners differ substantially in their capacity to respond to CBAM. Least developed countries account for a small share of global emissions and EU imports, but often face particularly severe financial, technological and administrative constraints.

The EU should therefore:

- **Differentiate according to partners' capacity to adjust.** CBAM implementation should avoid disproportionate burdens on particularly vulnerable countries where the climate benefit is limited.

44 EPICO and Frontier Economics, 2026.

45 Sandbag, 2026.

46 Pietras, 2026.

47 CBAM Regulation (consolidated version), Article 30(8), referring to Regulation (EU) 2021/947 (Global Europe/NDICI).

- **Protect traditional Least Developed Countries (LDC) trade without incentivising new carbon-intensive capacity.** Grandfathering existing trade volumes could be explored while applying CBAM to new export-oriented production.[48]
- **Assess alternative revenue-based approaches for LDCs.** Refunds or arrangements allowing partner countries to retain equivalent carbon revenues domestically could provide alternatives to outright exemptions. Since there is no genuine carbon-leakage issue for traditional LDC exports, such an exemption would not compromise the mechanism's environmental integrity. For the EU's traditional allies in the developing world this is not a question of economic impact but a matter of principle.[49]

Make MRV interoperability the foundation of cooperation

Effective international carbon-pricing cooperation requires credible and comparable emissions data. MRV interoperability should therefore be treated as strategic infrastructure for cooperation, rather than merely as a technical requirement of CBAM.

The EU should therefore:

- **Pursue interoperability rather than regulatory replication.** Credible MRV systems should be mutually recognised where they deliver comparable environmental integrity, rather than requiring partners to reproduce the EU system. Since MRV convergence precedes almost every other instrument discussed in this brief, it deserves to be treated as a priority for international cooperation in its own right rather than as a by-product of CBAM implementation.
- **Develop common methodologies across different policy architectures.** Cooperation should accommodate emissions trading, carbon taxation and credible regulatory approaches while maintaining robust standards. Methodological harmonisation would also pre-empt the fragmentation costs of a world of multiple CBAMs.[50]
- **Reduce unnecessary transaction costs.** Cooperative default values, simplified procedures and technical assistance can facilitate compliance, particularly for smaller exporters. [51]

4.3 INVEST: MAKE DECARBONISATION ECONOMICALLY VIABLE

Partnerships will only deliver if they change the economics of low-carbon investment. In many partner countries, the binding constraint is not the absence of technically viable solutions, but high capital costs, investment risks and a lack of bankable projects.

Make industrial decarbonisation bankable

Carbon pricing can change relative prices, but it cannot by itself provide the financing required to turn low-carbon opportunities into investment decisions. The test of a successful climate partnership should be whether it mobilises low-carbon investment that would otherwise not take place.

The EU should therefore:

- **Put bankability at the centre of climate partnerships.** Guarantees, risk-sharing and blended finance should be used to reduce financing costs and investment risks.
- **Create credible demand for low-carbon production.** Long-term offtake arrangements and lead markets can provide the revenue certainty needed to bring projects to final investment decision. The proposed Industrial Accelerator Act (IAA) is the near-term legislative landing point for this, as the EU aims to ramp up green lead markets.
- **Move from technology transfer towards co-investment and co-development.** European

48 Pietras, 2026.

49 Pietras, 2022.

50 See also Pietras, 2026.

51 Pietras, 2026.

finance, technology and industrial demand should be combined with partner countries' resources, renewable-energy potential and industrial capabilities.

- **Start with scalable projects.** A limited number of projects in sectors such as renewables-linked storage, ammonia or green steel inputs hydrogen derivatives, critical raw materials or cement can demonstrate viable business models before broader replication.[52]

Build critical mass for international carbon pricing and Article 6 cooperation

A single global carbon price is neither politically realistic nor necessary as a starting point. Cooperation can develop incrementally among countries with a shared economic interest in industrial decarbonisation.

The EU should therefore:

- **Start with willing partners and tangible mutual benefits.** Initial cooperation should focus on areas such as interoperable MRV, common product definitions, green public procurement, technical assistance and access to lead markets.
- **Deepen carbon-pricing cooperation progressively.** Recognition and linkage can develop as trust, institutional capacity and methodological convergence increase.
- **Use Article 6 as a complement, not a precondition.** Industrial partnerships and co-investment should proceed where economically viable without waiting for carbon-crediting arrangements. Article 6 offers two distinct routes for this: Article 6.2 enables decentralised bilateral or plurilateral cooperation through internationally transferred mitigation outcomes (ITMOs), while Article 6.4 establishes a centralised, UN-supervised crediting mechanism as the successor to the Clean Development Mechanism (CDM).[53] Neither route needs to be resolved before pilot projects and partnerships can begin.
- **Safeguard environmental integrity where Article 6 is used.** Cooperation should require robust accounting, public oversight and safeguards against additionality and integrity risks. Project-based crediting has a poor track record here: additionality is hard to verify, and even conservative estimates suggest that at least half of accepted CDM projects would have been commercially viable without credit revenues.[54] Recent contributions to the Article 6 debate favour centralised EU procurement and jurisdiction-level, rather than project-level, accountability [55] — a direction the EU's own ETS reform debate is already pointing towards, and one worth welcoming as a good first step.
- **Focus on convergence of incentives, not replication of the EU ETS.** The objective should be to increase progressively the share of global industrial production facing credible incentives to decarbonise.

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52 The steel sector could show how this can be practically applied: Strategically identifying mutually beneficial areas of coop eration between the Global North and the Global South along the steel value chain, flanked by incentives such as access to markets, strategic partners, finance and technology cooperation. This can entail upstream partnerships for green iron ore, green hydrogen and scrap, as well as downstream measures, such as the creation of lead markets for green-steel products. The same logic applies beyond steel, for instance to green hydrogen and its derivatives, to battery and critical raw material supply chains and to cement, wherever a limited number of economically viable projects can demonstrate a business model before it is scaled. (See also Kumar et al. 2023.)

53 Edenhofer et al., 2026.

54 Edenhofer et al., 2026.

55 Edenhofer et al., 2026.

5. CONCLUSION

From Climate Policy to Climate Partnerships

Europe's climate and industrial policy is entering a new phase. The challenge is no longer only to set ambitious targets, but to create the conditions under which investment in decarbonisation takes place—both in Europe and with its international partners. In a more fragmented geopolitical and economic environment, climate, industrial and trade policy therefore need to reinforce rather than undermine each other.

A credible European carbon price remains an essential foundation. Effective carbon leakage protection makes it possible to sustain that price in an internationally competitive economy. Weakening the ETS or CBAM would not solve Europe's structural competitiveness challenges and would risk undermining the investment certainty on which industrial transformation depends. At the same time, carbon pricing and border protection cannot deliver investment and international cooperation on their own.

Europe therefore needs to move from climate policy to climate partnerships. This means keeping CBAM focused on its core function, addressing genuine gaps in carbon leakage protection and avoiding unnecessary complexity. But it also means offering partners more than compliance with European rules: interoperable methodologies, differentiated cooperation, access to finance and a credible economic proposition for investing in low-carbon production.

Investment must be at the centre of this proposition. Carbon pricing can create incentives, but it cannot by itself lower the cost of capital, provide long-term demand or turn promising technologies into bankable projects. Guarantees, risk-sharing, offtake arrangements and co-investment should therefore become central elements of Europe's external climate and industrial policy. International carbon-pricing cooperation and Article 6 can complement this architecture by progressively extending credible incentives to decarbonise beyond Europe.

Europe does not need to build this architecture globally in one step. Starting with willing partners, differentiating by their capabilities, focussing on economically viable projects and areas of clear mutual benefit can demonstrate that decarbonisation is not only a regulatory obligation, but an investment and growth opportunity. Successful partnerships can then provide the foundation for deeper cooperation and broader convergence over time.

Europe should protect the credibility of carbon pricing, partner where interests can be aligned and invest where markets alone cannot deliver. Europe's climate leadership will ultimately be measured not only by the rules it sets, but by the investment and cooperation it mobilises.

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