

Giulia Cretti \* - 17 April 2026

## Why European Industry needs Carbon Diplomacy in the Age of CBAM

### Introduction

Carbon diplomacy, while not formally defined in EU policy, generally refers to the use of political, trade, financial and technical engagement with third countries to promote the adoption of carbon pricing, carbon markets, emissions reporting and equivalent emissions standards. While this is normally considered part of EU efforts to support global decarbonisation, it can also be leveraged as a tool to operationalise the Clean Industrial Deal (CID). The EU is already supporting the uptake of carbon pricing in partner countries with initiatives like the Task Force for International Carbon Pricing and Markets Diplomacy. But what benefits does it bring to European industry, and can it help ease the operational challenges of implementing the EU Carbon Border Adjustment Mechanism (CBAM)?

This policy paper examines why supporting carbon pricing in partner countries is increasingly central to the EU's industrial competitiveness agenda. It also recommends how the EU's existing carbon diplomacy toolkit can be aligned with the Clean Industrial Deal to reduce trade frictions, secure access to affordable low-carbon inputs, and safeguard Europe's long-term competitiveness.

### CBAM's implications for EU Industry

The entry into force of the EU CBAM in January 2026 has important economic and security implications for European industry. By setting a carbon levy at the border equivalent to the price paid under the EU Emissions Trading System (ETS) – currently around €70 per tonne of CO<sub>2</sub> – CBAM seeks to prevent carbon leakage in carbon-intensive sectors including steel, aluminium, fertilisers, cement, electricity and hydrogen. Its core objective is to ensure that European industries do not relocate production to jurisdictions with lower carbon costs, while maintaining a level playing field between domestic and foreign producers.<sup>1</sup> Although adopted under the Fit-for-55 climate

package, CBAM has become a central instrument of EU industrial policy.

When imported high-emission products face a levy, the relative competitiveness of cleaner EU production improves. This incentivises investments in domestic low-carbon technologies, a core pillar of the CID. However, European industry will continue, at least in the medium term, to rely on imported primary materials. The EU steel supply chain, for instance, is highly import-dependent. According to the European Steel Association, more than 25 million tonnes of steel (around 20% of EU production) are imported annually from third countries.<sup>2</sup> As a result, CBAM can increase costs for downstream sectors that remain structurally reliant on imported inputs.

EU importers ultimately bear the CBAM cost, as they must purchase certificates for the emissions embedded in imported goods. However, when foreign companies pay a credible carbon price at home, the amount is deductible from the CBAM obligations. For example, a carbon price of around €30 per tonne of CO<sub>2</sub> in a partner country can reduce compliance costs for EU importers, who would face an effective carbon price of around €40 per tonne of CO<sub>2</sub> instead of €70, even if part of the cost is reflected in higher export prices. Beyond this direct effect, carbon pricing also incentivises cleaner production, lowering the embedded emissions of traded goods and therefore the number of CBAM certificates required.

In partner countries, CBAM has encouraged the introduction of domestic carbon pricing systems to reduce exposure to the levy and retain carbon revenues at home. However, many remain unprepared. Some lack an operational carbon pricing framework; others apply carbon prices well below EU levels. In addition, numerous companies in exporting countries still lack adequate monitoring, reporting and verification (MRV) systems, which are now mandatory for exports to the EU. When emission data cannot be provided, European importers must rely on default

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values set by the Commission, resulting in higher compliance costs.

These dynamics must also be understood in the broader context of rising energy costs in Europe, as geopolitical tensions in the Middle East have disrupted global energy markets and driven up prices. Compared to key trading partners, EU industry continues to face higher electricity and gas costs, which remain a major constraint on competitiveness in energy-intensive sectors such as steel, aluminium and chemicals. In this context, CBAM adds further cost pressure, reinforcing the need to reduce the carbon cost of imports while accelerating the shift to renewable energy.

Carbon diplomacy therefore offers a strategic avenue to mitigate both industrial and energy-related pressures. By supporting carbon pricing and robust MRV systems in partner countries, the EU can reduce the carbon intensity of imports and lower long-term import costs for its industry. In the age of CBAM, carbon diplomacy moves beyond climate policy to become a tool to operationalise the Clean Industrial Deal.

### **EU's carbon diplomacy toolbox**

The EU is already an established and influential actor in the field of carbon diplomacy. Its toolbox combines bilateral and multilateral cooperation as well as financial support to international initiatives.

The Task Force on International Carbon Pricing and Markets Diplomacy, launched by the latest Commission in 2024 and housed within the European Commission's Directorate-General for Climate Action (DG CLIMA), plays a central role. It promotes the establishment of compliance carbon pricing instruments – carbon taxes and ETS – as well as the implementation of Article 6 of the Paris Agreement and voluntary carbon markets (VCM). In response to growing requests from partner countries on how to adapt to CBAM, the Task Force provides bilateral technical assistance and shares EU expertise to support the design and implementation of carbon pricing mechanisms.<sup>3</sup> However, it remains primarily focused on climate cooperation, without specifically prioritising countries most exposed to CBAM.

The EU also engages in structured policy dialogue through the Florence Process, launched in 2017 and hosted by the European University Institute in coordination with DG CLIMA. Unlike the Task Force, the

Florence Process focuses specifically on emissions trading systems and brings together jurisdictions that already operate an ETS.<sup>4</sup> While it facilitates convergence and trust among advanced carbon markets, its membership is restricted to existing ETS jurisdictions, limiting its relevance for countries newly considering carbon pricing in light of CBAM.

Bilateral cooperation with China on emissions trading represents another key pillar of EU carbon diplomacy. Since 2018, DG CLIMA has provided technical assistance to support the development of China's national ETS, including core components such as MRV systems.<sup>5</sup> This cooperation has become increasingly significant in the context of CBAM. China is one of the EU's largest trading partners, but the two ETS frameworks differ in terms of price levels, sectoral coverage and regulatory design. Greater alignment and transparency between the two largest carbon markets in the world are therefore essential to reduce uncertainty for businesses and mitigate potential trade frictions under CBAM.

Beyond its own initiatives, the EU also finances and participates in international cooperation efforts like the International Carbon Action Partnership (ICAP) and the World Bank's Partnership for Market Implementation (PMI). Most recently, the EU joined the Open Coalition on Compliance Carbon Markets, launched by Brazil at COP30, which aims to develop common standards and foster greater interoperability between ETS systems. While these platforms are beneficial to maintain dialogue, coordination among initiatives remains limited, resulting in overlapping engagement and duplication of efforts that risk diluting the strategic impact of EU carbon diplomacy.<sup>6</sup>

Despite this broad engagement, the EU's carbon diplomacy efforts remain dispersed and strictly focused on climate cooperation. Membership, funding priorities and geographic focus are not always aligned with industrial priorities and trade exposure under CBAM. Moreover, there is no systematic linkage between carbon pricing cooperation initiatives and CBAM implementation. If carbon diplomacy is to support industrial competitiveness under the Clean Industrial Deal, a clearer integration with trade and industrial policy will be necessary.

## Leveraging carbon diplomacy to boost industrial competitiveness

To meet the objectives of the Clean Industrial Deal, EU carbon diplomacy needs to evolve from a largely technical, climate-focused engagement into a more strategic instrument. This requires a clearer prioritisation of partner countries and a stronger alignment with the EU's trade and industrial cooperation tools.

A first step is to prioritise engagement with countries most exposed to CBAM and central to EU industrial value chains, particularly major exporters of steel, aluminium and fertilisers. In this context, G20 countries represent key partners, given their growing role in global value chains and ongoing efforts to develop carbon pricing systems. Engagement with these countries could be more closely linked to CBAM implementation, notably by promoting interoperability of MRV systems and exploring mutual recognition between emissions trading systems.

Second, carbon diplomacy could be better integrated into the EU's external policy instruments to pursue climate and industrial objectives simultaneously. Clean Trade and Investment Partnerships (CTIPs), for instance, offer a key opportunity to embed carbon pricing cooperation within strategic industrial partnerships. However, the CTIP with South Africa, agreed in November 2025, focuses on clean supply chains without explicitly addressing carbon pricing.<sup>7</sup> This represents a missed opportunity to directly link carbon pricing with industrial cooperation. Nevertheless, the EU Task Force is already working with South Africa on carbon pricing, even if not explicitly linked to the CTIP.

By contrast, the EU-India Free Trade Agreement (FTA) negotiated in January 2026 includes more concrete provisions on carbon pricing cooperation, such as technical assistance, verifier accreditation and the potential integration of future Indian carbon pricing into the EU mechanism.<sup>8</sup> These elements could serve as a model for embedding carbon diplomacy more systematically in future trade and industrial agreements.

Similarly, carbon diplomacy could be mainstreamed into the Global Gateway and Team Europe Initiatives, where partner countries show interest. This would ensure that investments and infrastructure projects are accompanied by support from the Task Force for regulatory frameworks such as carbon pricing and

MRV systems. Linking these efforts to the deployment of renewable energy would strengthen the long-term viability of low-carbon supply chains, reduce exposure to fossil fuel price volatility, and lower compliance costs for EU importers.

Finally, the potential role of carbon credits under Article 6 of the Paris Agreement is still limited but worth exploring. The EU is considering conditions for their use under the proposed CBAM amendment.<sup>9</sup> However, integrating such mechanisms into the EU climate framework requires robust governance and strong environmental safeguards, which are still under development. Article 6 cooperation, already part of the Task Force's activities, remains valuable in supporting decarbonisation by financing emissions reductions in partner countries. This can lower the carbon intensity of imports and reduce CBAM obligations over time. Moreover, engagement with carbon credit markets can strengthen MRV capacity in partner countries and pave the way for the introduction of an ETS, as illustrated by the Chinese experience.<sup>10</sup>

Overall, aligning carbon diplomacy with CBAM and the CID requires a shift from fragmented engagement to a more strategic, partner-focused approach that directly supports the competitiveness of EU industry.

## Conclusion

CBAM has turned carbon diplomacy into a core component of EU industrial competitiveness. By supporting carbon pricing and emissions reporting in partner countries, the EU can reduce trade frictions, lower costs for its own industry, and incentivise cleaner production. At the same time, a more strategic approach to carbon diplomacy can help address growing concerns among EU partners regarding CBAM. By combining regulatory engagement with targeted technical and financial support, the EU can reframe CBAM from a unilateral trade measure into a catalyst for cooperative decarbonisation. This, in turn, would enhance the EU's credibility as a reliable economic partner and reduce the risk of trade tensions. Aligning carbon diplomacy with the Clean Industrial Deal is therefore essential to strengthen economic resilience and industrial competitiveness, but also to accelerate global decarbonisation and the shift towards renewable energy in industrial value chains.

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