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Trading Green: How the EU Can Align Climate and Trade in a Fractured World

by **Margherita Bianchi and Pier Paolo Raimondi**

The tension between climate ambition and trade openness poses one of the most consequential policy challenges facing the European Union. As global trade has expanded, so too have the embedded emissions carried across borders. For the EU, imported emissions constituted nearly 40 per cent of its total carbon footprint in 2021. Against a backdrop of rising protectionism, US-China rivalry, Chinese industrial overcapacity, and soaring European energy costs, the EU faces mounting trade-offs between competitiveness, decarbonisation and economic security. Tools such as the Carbon Border Adjustment Mechanism represent meaningful steps, but have generated friction with trading partners and introduced regulatory uncertainty. A credible EU strategy requires domestic regulatory stability – particularly around the Emissions Trading System – alongside an internationally coherent framework integrating trade, climate and development objectives, including shared consumption-based emissions accounting and targeted green finance for partner countries.

Margherita Bianchi *is Head of the 'Energy, climate and resources' programme at the Istituto Affari Internazionali (IAI).*

Pier Paolo Raimondi *is Research Fellow at the EUI School of Transnational Governance and former Senior Research Fellow in the 'Energy, climate and resources' programme at IAI.*

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The international rules-based order has come under increasing strain in light of growing trade imbalances, protectionism and economic security concerns. Trade remains a key feature of the global economy and global prosperity as the value of global trade has grown from 6,388 billion US dollars in 2000 to 25,779 billion in 2025.[1] However, it is also becoming an increasingly contested issue.

A key driver of growing confrontation is climate change. Most countries have set ambitious climate targets, and they are increasingly considering the implications of trade on their targets and global climate action. Trade policy can serve as both a solution to and a source of emissions. Indeed, trade can be a powerful tool for decarbonisation thanks to the free flows of technology, financial resources and human capital. At the same time, trade flows can lead to net emission increases if the country of origin has limited or lower emissions mitigation measures. As some countries have considered unilateral actions to prevent carbon leakage and regain competitiveness, confrontation and fragmentation are emerging in the international arena. For decades, international organisations have largely failed to address the issue in a comprehensive manner

[1] World Trade Organization (WTO) website: *Evolution of Trade under the WTO: Handy Statistics*, https://www.wto.org/english/res_e/statis_e/trade_evolution_e/evolution_trade_wto_e.htm.

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due to their institutional mandates. To partially address these challenges and overcome a siloed approach to governance, Brazil has worked on the establishment of the Integrated Forum on Climate Change and Trade (IFCCT), officially launched at COP30 in late 2025.[2]

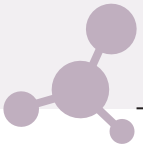
Against this backdrop, the EU needs to reconsider its trade policy[3] to achieve its multiple objectives (competitiveness, security and decarbonisation) given the new challenging international context. This imperative reflects both the EU's central role in the international trade system as the world's largest trade bloc (15.8 per cent of world trade in 2024)[4] and its climate ambitions (net-zero by 2050 enshrined in the EU law). Given the gaps in the international system, the EU has taken the lead with multiple initiatives, such as the Carbon Border Adjustment Mechanisms (CBAM) and the Deforestation Regulation (EUDR), to leverage market and regulatory power with a view to incentivising climate ambition abroad. It is critical to ensure policy and regulatory stability at home while pursuing international dialogue with key partners.

1. Trade openness: Rising trade-offs?

Traditionally, trade openness has been a key feature and value for the EU, whose prosperity depends on open markets, high-value exports and regulatory credibility. The EU has indeed embraced the core principles of the world's trade order, including the most-favoured-nation (MFN) treatment, a key non-discriminatory provision, since its early days. In 2024, around 80 per cent of extra-EU imports were subject to MFN, underscoring its continued centrality in EU trade.[5] As a result, the international trade share of GDP rose from 30 to 46 per cent in the EU between 2000 and 2025. To put it into perspective, the United States recorded an increase from 25 to 26 per cent over the same period.[6]

Trade openness has also been closely fuelled by other key EU economic principles, such as comparative advantage, which welcomes free imports of goods and services the EU lacks while exporting products to third countries in which it specialises. The EU has expanded its trade relations through the world's largest network of free trade agreements (FTAs), covering 76 countries and 44 per

[2] See the official website: https://ifcct.org.
[3] Based on the EU treaties, trade policy is an exclusive competence of EU institutions.
[4] Council of the EU, "The EU's Role in Global Trade", in *Explainers*, last review 16 March 2026, https://www.consilium.europa.eu/en/infographics/the-eu-s-role-in-global-trade.
[5] Stoll, Peter-Tobias et al., "The Role of the WTO in EU Trade: State of Play ahead of MC14", in *European Parliament Studies*, March 2026, https://www.europarl.europa.eu/thinktank/en/document/EXAS_STU(2026)775287.
[6] Draghi, Mario, *The Future of European Competitiveness*, September 2024, https://commission.europa.eu/node/32880_en; European Commission DG for Trade, *DG Trade Statistical Guide*, August 2025, September 2025, https://doi.org/10.2781/0201883.



Since 2021, the international trade environment has deteriorated further, with rising trade tensions related also to climate policies

cent of all EU trade in goods in 2024. Moreover, the EU has recently managed to conclude landmark FTAs with such large economies as Mercosur, India and Australia, in part in response to unprecedented trade tensions with the US Administration of Donald Trump. Notwithstanding the EU's commitment to trade openness, European policymakers have sought to design a new approach fit for a more competitive international context. A first step was the release of the new EU trade policy in 2021, whose underlying concept was "open strategic autonomy".

Since then, the international trade environment has deteriorated further,[7] with rising trade tensions related also to climate policies and underpinned by political, economic and environmental factors.

Politically, policymakers have increasingly prioritised economic security and resilience over economic efficiency in response to supply disruptions caused by natural (e.g., Covid-19) and political (e.g., US-China rivalry) developments. The return of Trump to the White House has elevated pressure on the stability of the international trade regime. Since the so-called Liberation Day (2 April 2025), the United States has used tariffs to reduce trade imbalances, increase revenues and induce companies to relocate production on its soil. On top of this, the United States has challenged international organisations, accused of being unable to address these issues and of favouring other economies, mainly China. In January 2026, the EU followed a similar approach, demanding the reform of the World Trade Organization (WTO) through the linkage of MFN treatment to reciprocity and fair competition – marking a historic shift in EU trade policy in stark contrast with its support for the multilateral system.[8]

The EU – and the world more broadly – has been experiencing an economic shock caused by the industrial transformation underway in China. Since joining the WTO, China has increased its role in global trade, becoming a key supplier of several products – including high-value goods – thanks to a variety of policy tools and macroeconomic conditions. China's emergence in key sectors previously considered areas of European industrial strength has led to the erosion of market share for European producers.[9] Chinese goods have flooded global markets as constrained domestic demand has intensified export pressure, weighing on the competitiveness of other countries' industries. The energy price spikes sparked by Russia's war on Ukraine in 2022 and the US-Israeli aggression of Iran in 2026 have

[7] Tensions are primarily linked to the rise of Chinese industry; the new US trade policy, which has led to the imposition of tariff increases; and two conflicts, in Ukraine and in the Middle East.

[8] Šefčovič, Maroš, "The WTO Needs an Overhaul", in *Financial Times*, 21 January 2026, https://www.ft.com/content/2ff1d4ce-4d63-4776-8e8c-ace6b3509f24.

[9] Tordoir, Sander and Brad Setser, "How German Industry Can Survive the Second China Shock", in *CER Policy Briefs*, January 2025, https://www.cer.eu/node/11268.

Imports of carbon-intensive goods frequently involve embedded environmental costs

placed additional strain on European industrial competitiveness, with average energy prices being three times higher than in other major economies like the United States and China.[10]

Last, but not least, trade carries potential negative climate effects at the global level. Imports of carbon-intensive goods frequently involve embedded environmental costs, as many countries still lack a robust climate framework – including carbon pricing – comparable to the EU's. Despite an expansion of carbon pricing around the world (with eighty schemes in 2025), both emissions coverage (28 per cent of global greenhouse gas emissions) and price levels remain generally limited (19 US dollars/tCO_2[11]).[12] Such an international mismatch in scope and price levels has become a pressing economic and political issue in Europe, particularly in light of the recent rise in European carbon prices. After having surpassed 100 euros/tCO_2 in February 2023, European CO_2 prices floated between 60 and 80 euros/tonnes CO_2 in 2025,[13] but prices are expected to increase even further.

On the one hand, this market dynamic will push European industries to accelerate decarbonisation. On the other, European producers are set to face higher competition in the international markets, like the ones of the energy-intensive industries, vis-à-vis extra-EU producers who generally benefit from lower energy and carbon prices. If not properly addressed, this could ultimately lead to higher import volumes and related emissions at the global level, alongside economic losses and increased dependence. A key example is the steel industry, which is squeezed by a global overcapacity driven by more carbon-intensive Asian producers and higher energy costs at home.[14] To partially shield domestic producers, the EU has expanded its defensive trade tools to prevent Chinese imports from flooding European markets. Moreover, in early 2026, industry and some member states have increasingly moved against the Emissions Trading System (ETS), calling for its revision or suspension, in an attempt to regain competitiveness as pressures mount.[15]

[10] European Commission DG for Energy, *State of the Energy Union Report 2025* (COM/2025/667), 6 November 2025, https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52025DC0667.

[11] In 2017, the High-Level Commission on Carbon Prices estimated that direct carbon prices (in 2017 US dollars) of at least 40-80 dollars/tCO_2 equivalent by 2020 and 50-100 dollars/tCO_2 equivalent by 2030 were consistent with limiting temperature rises to well below 2ºC.

[12] World Bank, *State and Trends of Carbon Pricing 2025*, Washington, World Bank, June 2025, https://hdl.handle.net/10986/43277.

[13] European Commission DG for Economic and Financial Affairs, "Trends in Carbon Intensity and the Macroeconomic Role of the EU Emissions Trading System", in *Economic Forecast Special Issues*, 17 November 2025, https://economy-finance.ec.europa.eu/node/3329_en.

[14] Sangiorgio, Alessio and Pier Paolo Raimondi, *Steel Decarbonisation and Competitiveness: The Case for an Italian-German Dialogue*, Rome, IAI, November 2025, https://www.iai.it/en/node/21101.

[15] Gupte, Eklavya and Irina Breilean, "EU Carbon Prices Tumble as Major States Add to ETS Reform Calls", in *S&P Global Commodity Insights*, 26 February 2026, https://www.spglobal.com/energy/en/news-research/latest-news/energy-transition/022626-eu-

2. The case for a trade-climate nexus

Globally, trade and climate have largely been addressed as separate issues in their respective institutions: the WTO and the United Nations Framework Convention on Climate Change (UNFCCC). Trade can serve decarbonisation in multiple ways, enabling exchanges of clean technologies and green finance, allocating resources more efficiently, and driving down costs through economies of scale. At the same time, the rise in global trade volume has been coupled with an increase in emissions. According to some estimates, greenhouse gas (GHG) emissions from the production of goods and commodities traded internationally now account for a quarter of global emissions.[16] Acknowledging this impact is indispensable to achieving global climate targets. Traditionally, governments and institutions have used a 'production-based' approach to accounting for emissions, partly for practical reasons. However, the expansion of international trade and the diverging levels of climate ambition among countries require a shift in the way emissions are counted – favouring a 'consumption-based' approach. To do so, shared and collaborative frameworks to build monitoring, reporting and verification (MRV) and overcome data gaps – especially for developing-country exporters – are vital.

China plays a significant role in EU imported emissions, accounting for 20 per cent of the total

For example, imported emissions accounted for almost 40 per cent of the EU's carbon footprint in 2021.[17] Unsurprisingly, China plays a significant role in EU imported emissions, accounting for 20 per cent of the total (Figure 1), mainly from energy production and manufacturing (chiefly metals and mining). This exposure to imports from countries without equivalent environmental standards risks undermining the very rationale of the green transition at home.

It is therefore essential for EU climate objectives to address imported emissions properly. While there are strategic benefits for developed, importing economies, this shift would also be beneficial for some developing economies. Indeed, the rise in embedded emissions is not confined to developed economies. For example, China is not only the largest emissions exporter, but also the largest emissions importer.[18] Moreover, China's imported emissions more than doubled between 2010 and 2021 (compared to 42 per cent growth in domestic emissions). Meanwhile, China established its own national ETS in 2021 while massively scaling up renewable capacity in line with its climate ambitions.

carbon-prices-tumble-as-major-states-add-to-ets-reform-calls.

16 Maquet, Pierre et al., *Imported Emissions: From Co-Dependence to Co-Operative Action*, Paris, Carbone 4/European Climate Foundation, November 2024, https://www.carbone4.com/en/publication-imported-emissions-en.

17 Tubiana, Laurence, "Trade Policy Is Central to the Green Transition", in *Financial Times*, 19 November 2025, https://www.ft.com/content/d846f8b7-04dc-459f-8ab0-d2fc354d6467.

18 Maquet, Pierre et al., *Imported Emissions*, cit.

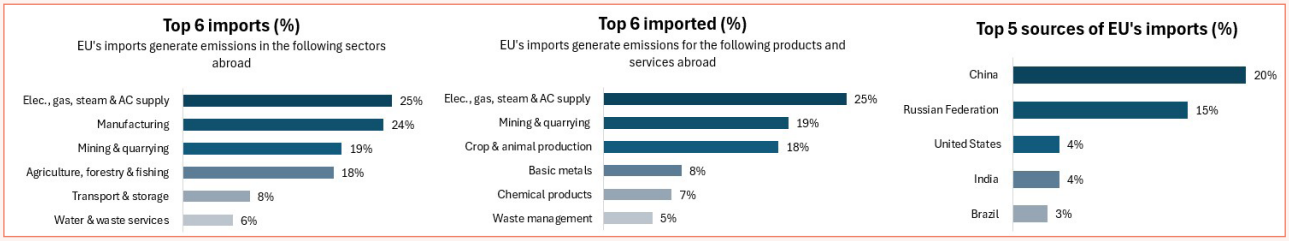


Figure 1 Sectors and sources of EU imported emissions in 2021

Source: Maquet, Pierre et al., Imported Emissions, cit.

3. Between unilateral and coordinated measures: Objectives, concerns and challenges

Historically, the EU has sought to align its trade agreements and relations with environmental ambitions through the incorporation of Trade and Sustainable Development (TSD) chapters in its FTAs, beginning with the EU-South Korea FTA in 2009.[19] Under TSD chapters, the parties are required to apply international labour and environmental standards and related laws or regulations. However, the actual effectiveness of this instrument has been questioned by multiple stakeholders due to weak enforcement and accountability concerns.[20] Furthermore, TSD chapters have a limited mandate to drive emissions mitigation.

Amid rising pressure from high carbon prices, the EU is called upon to design a holistic sustainable trade strategy that would also help the EU achieve its multiple objectives. To address imported emissions, the EU can consider two avenues: unilateral and coordinated measures.

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3.1 Unilateral measures

Over the past five years, the EU has taken several steps to adopt relevant, innovative measures (in particular CBAM and the postponed EUDR) by leveraging its market and regulatory power. The EU CBAM in particular responds to the current needs of European stakeholders and the reality of international climate politics. Given differences in climate ambition and carbon prices, the EU risks suffering from carbon leakage – especially in some sectors.[21] To reduce this risk, the EU decided to apply a carbon tax on imports of the most exposed sectors based on carbon content. Although the measure covers

[19] Jütten, Marc, "Trade and Sustainable Development in EU Free Trade Agreements", in *EPRS Briefings*, November 2023, https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2023)754613.
[20] Fina, Davide, "Partnerships for a Climate-Neutral World: EU Free Trade Agreements, the Global Gateway and Clean Trade and Investment Partnerships", in *ODI Europe Briefing Papers*, December 2025, https://media.odi.org/documents/ECF_third_Dialogue_Briefing_paper.pdf.
[21] Iron and steel, cement, aluminium, fertilisers, hydrogen, electricity.

around 5 per cent of the bloc's imports,[22] its application may be extended to additional products in the future. The EU CBAM became fully operational in January 2026.

CBAM has faced widespread criticism, particularly from emerging economies and especially the least developed economies. A key source of concern is the potential for economic exclusion and excessive burden, running counter to the UNFCCC's key principle of common but differentiated responsibilities and respective capabilities.[23] Nonetheless, CBAM has triggered some adjustments in the diffusion of carbon pricing rather than direct leakage prevention in key economies, such as Türkiye, Brazil and China, which have either already established or are in the process of establishing compliance carbon markets to offset their CBAM exposure. Logically, those that export a large share of their products to the EU are more eager to adopt carbon pricing to retain revenues at home and reduce their CBAM liability. However, recent research shows that the spillover effects are uneven, with lower-income countries – which tend to have weaker administrative and fiscal capacity – benefiting less than higher-income ones.[24]

Beyond CBAM, the EU disposes of a broader set of unilateral policy tools that can complement carbon pricing

Beyond CBAM, the EU disposes of a broader set of unilateral policy tools that can complement carbon pricing in sectors where border carbon adjustments are neither the most effective nor the most appropriate instrument. In this regard, the ongoing reform of the EU customs framework – including the modernisation of the Union Customs Code – offers an opportunity to better integrate environmental criteria into import controls and streamline compliance requirements for green goods. Ecodesign standards and energy labelling, directly address product-level emissions and resource efficiency, influencing both domestic production and import quality in sectors such as electronics, textiles and construction materials where border carbon adjustments are difficult to apply. Similarly, the reform of public procurement rules to systematically mainstream life-cycle emissions and green criteria into public contracting can act as a powerful demand-side decarbonisation lever. In agriculture and food systems, mirror measures requiring imported products to meet equivalent sustainability and emissions standards to those imposed on EU producers address both competitive distortions and embedded emissions in agri-food supply chains, an

[22] Bonnet, Antoine and Ieva Baršauskaitė, "The State of BCAs 2025", in *IISD Reports*, February 2025, https://www.iisd.org/node/18689.
[23] WTO, *Perspectives on LDC Environment-Friendly Trade and Trade-Related Climate Challenges* (WT/CTE/W/266), 6 February 2025, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=Q:/WT/CTE/W266.pdf&Open=True.
[24] Bahí, Anna et al., "Carbon Pricing beyond Borders: Assessing Climate Policy Spillovers from the EU Carbon Border Adjustment Mechanism", in *Bruegel Working Papers*, No. 05/2026 (26 March 2026), https://doi.org/10.64153/QIJX8741.

area where carbon pricing alone is structurally ill-suited. Crucially, however, unilateral measures have inherent limits when applied to goods that the EU imports but does not itself produce in significant volumes. In such cases – where no domestic industry stands to benefit from equivalent standards – imposing requirements without prior engagement risks being perceived as arbitrary market access barriers rather than legitimate climate policy. For these product categories, the EU's regulatory ambitions must be pursued through dialogue with trading partners, whether through bilateral green partnerships, FTA sustainability chapters, or multilateral forums. Taken together, these instruments reflect a more sophisticated and sector-sensitive approach to unilateral climate-trade policy – one that moves beyond the singular logic of carbon pricing and engages with the full complexity of the EU's embedded emissions footprint.

3.2 Coordinated measures

The EU should also work towards coordinated measures. A few existing initiatives focus on specific sectors or issues, such as the Climate Club, the Leadership Group for Industry Transition (LeadIT) and the Inclusive Forum on Carbon Mitigation Approaches (IFCMA). These initiatives may prove useful in developing shared methodologies to foster a consumption-based approach to imported emissions from specific goods, as well as providing a platform for policy dialogue. It is crucial that the EU remains engaged with international efforts, particularly given the ongoing US-China competition, which could culminate in a deal reached outside the rules-based framework.[25]

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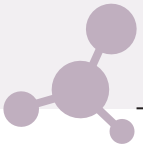
More recently, two relevant initiatives were launched during COP30: the IFCCT and the Open Coalition on Compliance Market.[26] The former seeks to reconcile trade and climate objectives through a dialogue platform that facilitates discussion and helps avoid unilateral trade measures. By engaging with the IFCCT, the EU would address some of the concerns of its trade partners. The Open Coalition focuses on compliance with carbon markets, bringing together major players such as the EU, China, the United Kingdom, Singapore, Brazil and Norway. The Open Coalition is expected to collaborate on MRV and accounting methodologies, support developing countries in building relevant capacity, and promote the long-term interoperability of compliance carbon markets.

[25] García Bercero, Ignacio, "Defining the New Strategic Direction for European Union Trade Policy", in *Bruegel First Glance*, 2 February 2026, https://www.bruegel.org/node/11738.

[26] Brazil Ministry of Foreign Affairs, *Declaration on the Open Coalition on Compliance Carbon Markets*, Belém, 7 November 2025, https://www.gov.br/mre/pt-br/canais_atendimento/imprensa/notas-a-imprensa/declaracao-sobre-a-coalizao-aberta-de-mercados-regulados-de-carbono/OpenCoalitiononComplianceCarbonMarkets.pdf.



Alongside these avenues, the EU has continued to expand its FTA network with significant deals, notably with India and Mercosur. It is worth noting, however, that both have voiced strong criticism of the EU CBAM. Although the EU-India FTA includes weaker climate-related provisions than those traditionally found in other EU FTAs, the deal does not provide any special CBAM flexibility or exemption.[27] The relative weakness of climate provisions in these agreements is largely a reflection of the current geopolitical context and the EU's need to adapt to growing transatlantic divergence.

3.3 Challenges and concerns

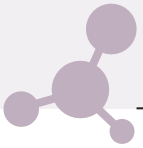
The EU faces growing trade-offs and dilemmas in its trade and climate policies

Although a coordinated approach is needed, the current geopolitical uncertainty is undermining the prospects for a robust multilateral regime. This uncertainty also weighs on the EU itself, which is reconsidering its role within the global trade system and the measures needed to address structural challenges. The EU faces growing trade-offs and dilemmas in its trade and climate policies, starting from its commitment to rules-based order while pushing for MFN-reciprocity push. On the one hand, it needs to shield its producers from being driven out of the market by global overcapacity. On the other, full-scale protectionism is neither affordable nor desirable: it would impose significant cost premiums on consumers, affecting affordability, without guaranteeing the long-term competitiveness of EU industries.

Cooperation is of paramount importance. Any cooperative initiative must acknowledge the different starting points and objectives of partner countries. Developing economies face pressing needs to address poverty through industrialisation, including through the use of fossil fuels. Developed economies, meanwhile, seek to protect their industries from competition with producers subject to less stringent climate regulations. In this context, promoting a shared accounting framework for imported emissions, linked to investment and trade initiatives, could be instrumental in advancing multiple objectives simultaneously. The role of revenue recycling is a debated topic especially related to developed economies' green finance commitments and the respect of the common but differentiated responsibilities principle.

Each avenue faces implementation challenges. Shifts in political priorities may push policymakers towards short-term solutions. In attempts to shield industries, governments and industry associations have sought to revise key EU climate regulations, such as the ETS

[27] van der Ven, Colette, "The EU-India FTA: A New Model Linking Trade, Climate and Industrial Policy?", in *Borderlex Commentaries*, 30 January 2026, https://wp.me/pdACML-dNR.



Despite member states' pressure, the EU preserved the centrality of the ETS and announced a review for July 2026

and CBAM. In December 2025, the EU presented a revision of the CBAM regulation, which simplified certain aspects and introduced new provisions, including a safeguard clause in Article 27a. The clause allows the Commission to temporarily remove goods from the list of sectors covered by the CBAM. This was particularly relevant for the fertilizer industry, which is currently under price pressure due to the closure of the Strait of Hormuz and exposure to carbon leakage. However, the clause has generated market uncertainty, deterring investment even before entering into force.[28] The European Parliament has called for the removal of this clause in the interest of market clarity.[29] It is equally important to close the remaining loopholes that could undermine the effective implementation of the Regulation.

At the domestic level, some member states called for the suspension of the EU ETS in early 2026 in order to artificially reduce energy prices. Despite this pressure, the EU preserved the centrality of the ETS and announced a review for July 2026. Addressing carbon price levels is essential for both domestic and international reasons: excessively high prices would slow the transition at home and widen the price gap with other countries, potentially discouraging them from adopting comparable carbon pricing mechanisms.[30] In the first quarter of 2026, the price of CBAM certificates stood at 75.36 euros/tonnes CO_2.[31] This dynamic illustrates the structural interdependence of the ETS and CBAM, and suggests caution about dismantling either instrument. CBAM is designed to create a level playing field vis-à-vis imported goods and to incentivise lower-carbon production, not to stabilise prices.

4. Way ahead

The EU needs to design a new trade policy agenda suited to the current geopolitical realities. Since the release of its trade policy in 2021, the world has changed dramatically. A range of EU instruments and tools have been announced – including Global Gateway, Green Alliances and Partnerships, and Clean Trade and Investment Partnerships (CTIPs) – but these have so far lacked a coherent overarching

[28] McDonald, Jeffrey, "CBAM Emergency Brake Throws Fertilizer Market into Paralysis", in *S&P Global Commodity Insights*, 8 January 2026, https://www.spglobal.com/energy/en/news-research/latest-news/fertilizers/010826-cbam-emergency-brake-throws-fertilizer-market-into-paralysis.

[29] Gualandi, Rebecca, "EU Lawmaker Pushes to Delete Suspension Mechanism, Article 6 Recognition from CBAM", in *Carbon Pulse*, 14 April 2026, https://carbon-pulse.com/502720.

[30] Delbeke, Jos, "Preparing the 2026 EU ETS/MSR Review", in *EUI STG Policy Briefs*, No. 2026/05 (February 2026), https://doi.org/10.2870/4771323.

[31] European Commission DG for Taxation and Customs Union website: *Price of CBAM Certificates*, https://taxation-customs.ec.europa.eu/node/2204_en.

European action must therefore be anchored to a strategy operating at two levels: domestic and international

framework.[32] Integrating the trade-climate nexus is indispensable for navigating the current geopolitical arena. At the same time, the EU cannot afford to drift away from the multilateral trade system on which it depends and from which it continues to derive significant value. European action must therefore be anchored to a strategy operating at two levels: domestic and international.

This struggle is particularly visible in the latest EU policy development on green industrial policy: the Industrial Accelerator Act (IAA). The document seeks to support domestic production through the prioritization of manufacturing within Europe. Supports and schemes would then favour "Made in Europe" products. This sparked a debate about the need of a more open approach ("Made with Europe"). As Europe needs to remain open and engage with partner countries, many details need to be sorted out. Yet, they become crucial in addressing: how embedded emissions are attributed, how carbon leakage is defined, and where EU climate-industrial policy should draw the line between protecting domestic capacity and accepting comparative advantage. The EU's answer will shape the scope and legitimacy of tools like CBAM and the public procurement reform.

Domestically, it is essential that the EU remains committed to the green transition. Regulatory certainty and sustained political will are key ingredients for success. Otherwise, it will undermine investment and sends mixed signals – both at home and abroad. The full implementation of the CBAM Regulation, along with the timely publication of technical guidance, is therefore essential. CBAM should serve as a central pillar of EU diplomacy, with the potential to advance multiple objectives simultaneously: competitiveness, global decarbonisation, co-development and security.

Regulatory stability is also a key ingredient for the EU's external strategy. Weakening EU climate policies would represent a missed opportunity to shape international discourse and negotiations – and would ultimately undermine European climate diplomacy. Despite opposition, a number of countries have already invested human and financial resources to adapt to EU climate regulations and standards. An abrupt reversal would risk eroding both investment and trust. In its diplomatic efforts, the EU should work with partners to develop shared methodologies and provide financial support for capacity building. Priority partners should be those that are exposed to CBAM. The new support could also encourage to design clear strategy towards establishing compliance carbon markets – including through the Open Coalition. A strong effort should be made to find common ground with China, given that both economies

[32] Raimondi, Pier Paolo, *European and Italian Just Transition Policies amid Industrial Decarbonisation and External Policies*, Rome, IAI, April 2025, https://www.iai.it/en/node/19900.

are committed to clean energy and carbon pricing and are significant trading partners. China is simultaneously the EU's largest source of imported emissions, its most significant competitor in key industrial sectors, and a partner in carbon market development. The EU should pursue a dedicated bilateral climate-trade dialogue with China – one that addresses not only carbon pricing interoperability but also the trade distortions arising from China's state-driven industrial policy and subsidised overcapacity. The EU should also proactively engage with initiatives such as the IFCCT to sustain dialogue with a broader range of partners. It will be critical to link projects and partnerships to direct green finance for local projects, which would allow the EU to address the issue of CBAM revenue recycling.

Developing a shared consumption-based approach to emissions accounting would also help enhance the competitive edge of EU exports. As a large exporter, the EU's economic activity depends significantly on market conditions in third countries. When major partners advance more slowly on climate action, EU industries may face market constraints that undermine the green transition. This is the case, for example, for some EU steel producers – such as those in Italy – whose output benefits from some of the lowest carbon-intensity rates in the sector.[33] More granular, sector-by-sector and value-chain analysis is needed to identify where this approach could most effectively strengthen competitiveness. To do so, the EU should develop joint economic and climate intelligence units and support partners in building MRV and improving data availability. By doing so, partners will be able to provide actual data and avoid the use of more conservative default values for products.

Beyond energy-intensive industries, embedded emissions accounting could also be a powerful tool for shaping EU mineral diplomacy

Beyond energy-intensive industries, embedded emissions accounting could also be a powerful tool for shaping EU mineral diplomacy. Mining activities carry significant emissions and broader environmental impacts. The EU could engage with mineral-rich countries to support decarbonisation in the mining sector, including through market mechanisms designed to ensure sustainable mineral supply chains, in alignment with the G7 Mineral Security Partnership.

To this end, it would be beneficial for the EU to streamline and rationalise its many external strategies and initiatives, which currently risk creating fragmentation and conflicting objectives. Otherwise, the fragmentation of EU initiatives will exacerbate the international trade fragmentation causing additional regulatory burden imposed to partner countries. CTIPs, for example, are expected to address the trade-climate nexus alongside competitiveness and decarbonisation goals. This nexus should drive initiatives to foster green industrialisation in renewable-rich countries, which stand to benefit

[33] Sangiorgio, Alessio and Pier Paolo Raimondi, *Steel Decarbonisation and Competitiveness*, cit.

in terms of economic growth and sustainability while also reducing their CBAM exposure. In doing so, the EU would help address the embedded emissions associated with key industrial products whose production is at risk of relocating away from Europe due to high energy costs.

In conclusion, it is crucial for both the European and global green transition to recognise that embedded emissions represent a shared challenge with trade partners. Developing and strengthening common strategies to address this challenge would yield positive results across climate, security and industrialisation objectives. To achieve this, the EU must preserve the core of its climate regulatory framework.

Abbreviations

CBAM	Carbon Border Adjustment Mechanisms
CTIP	Clean Trade and Investment Partnership
EUDR	EU Deforestation Regulation
ETS	Emissions Trading System
FTA	Free trade agreement
GHG	greenhouse gas
IFCCT	Integrated Forum on Climate Change and Trade
IFCMA	Inclusive Forum on Carbon Mitigation Approaches
LeadIT	Group for Industry Transition
MFN	Most-favoured-nation
MRV	Monitoring, Reporting and Verification
tCO_2	Tonne of CO_2
TSD	Trade and Sustainable Development
UNFCCC	UN Framework Convention on Climate Change
WTO	World Trade Organization

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T +39 06 6976831
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