MAY 2026 – OPTIONS PAPER

BUYING THE 5%: FUNDING, GOVERNANCE AND MARKET DESIGN FOR THE EU'S INTERNATIONAL CREDIT PURCHASES

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Contents

Key messages

- High-quality credits will not be cheap. The average credit price in Switzerland's Article 6 credit portfolio is €32, not including administration costs. If we add inflation and the costs of sharing benefits with host countries, we can expect credits to cost at least €50.
- The upper bound to credit prices will be around ETS allowance prices. Above this price, credits will be difficult to present as cost-containing, especially if we take into account that this money is (mostly) not spent within the EU. ETS allowance prices after 2030 are highly contingent upon future policy decisions, so we will use €100 as a working assumption for the upper bound.
- The EU needs to decide whether credits are a "*nice to have*" or a "*must have,"* or a bit of both. Credits can be built into the climate target or can be just one compliance tool among many. This also depends on whether credits are to be used in the ETS or outside of it or both. These choices have major implications for funding, governance and market development.
- The EU's total credit bill could be anywhere between 12 and 70 billion EUR, with a middle estimate around 35 billion EUR. This is to be paid either by governments or ETS installations depending on who will use them.
- 2036 is very close: as credit development has a lead time of several years, credit quality requirements and funding commitments need to be set up as soon as possible in order to provide certainty to developers.
- The key government funding options are: i) ETS1 auction revenues; ii) ETS2 auction revenues; iii) CBAM revenues; iv) EU budget; and v) Member State contributions. None of them are ideal; they all come with tradeoffs.
- A key funding opportunity is to use the purchasing power of the private sector either directly or indirectly. However, using the private sector has its own risks and tradeoffs.

Background

Until 2020, the EU allowed the use of international carbon credits generated under the Kyoto Protocol's Clean Development Mechanism (CDM) and Joint Implementation (JI) mechanism in the EU ETS. However, due to concerns about additionality and environmental integrity, the EU phased out their use after 2011.

This policy was reversed with the March 2026 amendment of the EU Climate Law[1] (the "Climate Law"). The amendment determines that the EU's climate target for 2040 will be 90% of 1990 net emissions, of which 85% will be achieved through domestic action and "*up to 5% of 1990 EU net emissions*" will be contributed by international credits after 2036. Such credits could either be used to offset emissions covered by ETS1, ETS2, and/or in the agricultural and LULUCF sectors.

The Climate Law does not regulate the importing of credits in detail; the detailed conditions for importing credits will only emerge from the implementing legislation. The key proposals for such legislation will emerge throughout 2026, as the Commission is to propose a review of the EU ETS in Q3 of 2026 and a review of the entire EU climate governance system in Q4.[2]

The Climate Law does not expressly state the reason for introduction of international credits into the EU's mitigation strategy. One reason appears to be that many Member States are concerned that reaching the 90% target domestically would be very costly and hurt European competitiveness.[3] However, if credits purchased internationally were to be cheaper than domestic abatement, then the EU could achieve its climate goals with a smaller financial effort. Another reason for buying credits appears to be that the EU should give more support to mitigation in developing countries, and credits are one way to do that. Finally, the EU's re-entry into the international carbon market can be very impactful for global climate governance: it can foster strategic partnerships, potentially be used for further climate diplomacy ends, and will help cementing higher standards in the market.

The Climate Law attaches a range of review clauses to its headline target. Thus, there will be a biennial assessment of the target by the Commission (Art 4(8)). Furthermore, as part of the Climate Law's regular reviews in 2029, 2034, and 2039, Member States can: i) adjust the 2040 target if removals by LULUCF sinks is "*significantly diverging*" from what was estimated. (Art 11 (e)); and ii) re-consider their use of international credits. The multiple review opportunities result in a fair bit of uncertainty around the final impact on actual mitigation and cost containment. (In the following analysis, we will assume that there will be no interim review to the 2040 target, and no change in the size of the credit import window.)

One key review clause is missing: there is no express reference to the possibility of an upward revision of the 85% domestic target if the EU somehow proves unable to procure the full quantity of international credits needed to cover the remaining 5%. Thus, if the credit purchase is set up as a mandatory pillar of the EU climate policy framework, there is a risk that if the purchase process fails or comes short of the required amount, the EU would have to revise its target downward.

This paper is one of a series of policy papers that to explore and discuss the possible details of how international credits should be purchased by the EU. This paper covers the matter of **funding**: i.e., who will pay for the credits, when, and how? The other papers, covering credit quality criteria, and climate diplomacy-related issues can be found on the https://www.edf.org/international-credits-eu webpage.

Preliminary Policy Choices

Before being able to decide on the funding of credit purchases, Member States will need to make certain policy choices regarding the entire EU climate policy framework. As the time of this writing (April 2026) there is no clear direction on how negotiations will go, so we will lay out the key options with their respective pros and cons.

How big is the credit purchase window?

The Climate Law states that the credits will contribute "*up to 5%*" of 1990 emissions in 2040 to the achievement of the 90% target, but it is silent on how many credits could be purchased in the preceding years, i.e., between 2036 and 2039. The Commission proposal's explanatory memorandum did say that "*These international credits should be accounted on the basis of a linear trajectory,"*[4] but it is not clear what this means in terms of purchasing, and in any case, it is not part of the legal text. Experts have offered various interpretations for the purchase window from 235 million tons to 700 million tons.[5] For our budget estimates, we will use the figure of 700 million tons, assuming a gradual ramp-up of purchases to the full 5%, (i.e., 235 million tons), starting in 2036. We should keep in mind that the final amount is yet to be determined. We should note that under the accounting rules of the Paris Agreement, an ITMO does not need to be used in the year it was transferred, it only has to be used in the same NDC commitment period.[6] Thus, the EU is free to distribute the credits in any way it likes for the years between 2036 and 2040.

Is credit purchase a "*must-have*" or a "*nice-to-have*"?

The meaning of the term "*up to 5%*" also needs to be specified; the exact volume will be determined in advance or kept open. There are three options:

1) Must-have: the credit purchase target is mandatory: i.e., it is determined by law and is baked into the 2040 target, e.g., all the EU targets are set to achieve only 85% reduction, and the EU must buy 5% credits to reach 90%. In this scenario, if credit purchases fail, the reduction obligation will not fall back to the Member States or to the ETS sector.

2) Nice-to-have: Purchasing credits will remain optional, i.e., 2040 targets are set to achieve 90% reduction, and buying credits is just one way of meeting the target. If no credits are purchased, this just means that Member States will need to achieve their targets by other means, or — if credits are used in the ETS directly — installations can decide whether to buy credits or not.
3) A combination of the above two options, where e.g., 2.5% is mandatory and 2.5% is optional.

Making credit purchases mandatory relieves Member States and ETS participants of the burden of achieving these reductions, but it also means that the EU cannot later choose domestic abatement if that proves to be cheaper. This is a crucial point because we don't know whether the EU will eventually be able to procure credits in the desired volume and quality at an acceptable price. If credit purchase is a mandatory element and it fails, the EU would need to adjust its target either by weakening its ambition or reassigning reduction obligations to Member States (at a time when it might be already too late to put additional policies into effect). On the plus side, mandatory purchasing sends a much stronger market signal than an optional system where we do not know how many credits will be purchased. Funding is also easier to arrange if we know well in advance that credits will be needed, and the EU's diplomatic and credit-quality leverage is much stronger.

By contrast, an optional purchase mechanism avoids impacting the target, and in theory allows Member States to choose the more cost-effective abatement option between domestic abatement and credit purchasing (assuming that the system of binding Member State-level targets of the current non-ETS system remains). There is a serious timing flaw in an optional purchase mechanism, however: if Member States would want to resort to the use of credits, they cannot decide this in the last minute, because generating credits requires years of development work. Member States cannot purchase credits off the shelf when they feel like it. (Thus, such a mechanism would probably need to be combined with annual Member State targets, where Member States are allowed to borrow against future credit purchases.) An optional mechanism is also very weak forward signal to the market, as it gives no certainty to project developers. Finally, it also offers very limited leverage for the EU's climate diplomacy.

In summary, a combination of mandatory and optional purchases is probably the most suitable solution. The mandatory part provides a firm basis for the market signal, the policy framework, the funding and the diplomatic outreach, while the optional part ensures that most credits are only purchased when they are really needed.

Who shall use the credits: ETS 1 installations or Member States?

The choice of mandatory vs. optional is strongly connected to the question of where credits will be used. Here, the basic question is whether credits should be used in the ETS1 or in the non-ETS part, currently under the authority of the Member States. This key variable translates to a variety of options:

- Member States use the credits to cover their 2040 obligations under the Effort Sharing Regulation and LULUCF. This assumes that the current system with Member State–level targets for emissions under the ETS2 plus agriculture, waste, and their LULUCF targets will continue after 2030. (This would be an "optional" use.)
- The EU uses it centrally to cover a 5% share of the EU's target which is not attributed to any Member State target. (This would be a "mandatory" use.)
- The credits are used in the EU ETS1 indirectly. Purchases are done centrally and credits are either auctioned off or placed into the Market Stability Reserve. (This would be a "mandatory" use.)
- Credits are purchased by EU ETS installations directly and used for compliance. (This would be an "optional" use.)
- Any combination of the above options.

In theory, it would also be possible to direct credits toward use by the ETS2 system, but this is very unlikely as the ETS2 has a soft price cap of €45 and there is strong political pressure to keep prices low.[7] (in November 2025, the Commission has proposed an overhaul of the ETS2 Market Stability Reserve, which is intended to ensure that prices do stay low, although it is not clear how effective this will be. Various analysts expect 2035 ETS2 prices to be between €55 and 214.[8]) Also, we expect that ETS2 sectors will continue to be part of Member States' targets

under the Effort Sharing Regulation after 2030, so if Member States are allowed to use credits, they will be able to use these to cover any eventual shortfalls in reductions under the ETS2.

The choice has a major impact on funding: if Member States used the credits (option i), then Member States should pay for them. If the EU buys the credits centrally (option ii), then purchases will need to be funded through the EU budget. If credits are used in the ETS1 (options iii and iv), then they will be ultimately paid for by the installations and not the Member States. There is already a lot of debate on where to use the credits, a lot of Member States are advocating for using credits in the ETS (DE, PL), while others (FR[9]) seem to be against it.

Finally, we should note that it is not unavoidable to decide the ETS vs. non-ETS use question in advance. The EU could also choose to set up International Credits Fund or Flexibility Fund which collects financing, turns them into credits and makes decisions on how to allocate credits (e.g., use in ETS, use by Member States, keep them or cancel them) on the basis of the prevailing conditions and needs of the time. Such a mechanism is outlined in a recent article by Agora Energiewende.[10]

Credit supply and credit demand: 2036 is very close

2036 may feel far off in the future, but it is actually very close. The EU's primary legislation will not be agreed before 2027 and even after that it could take years until the detailed rules and institutional arrangements are in place. Also, the current credit supply of project-based credits is not very reassuring. The international carbon market currently is like a Soviet supermarket: it stocks few products, not the ones you need, and what it does stock is often of poor quality. It usually takes several years after the initial investment decision for a project to be able to actually deliver credits to a buyer. In addition, if the EU wants to purchase credits through bilateral agreements with other governments, negotiating these could also take several years.

It is highly speculative to say anything about the total expected credit demand in 2036, but if the EU does end up requiring 700 million credits (i.e., an annual average amount of 140 million), it would probably become a major buyer after 2036. We can look at the other potential buyers to get a rough idea of the demand that could emerge:

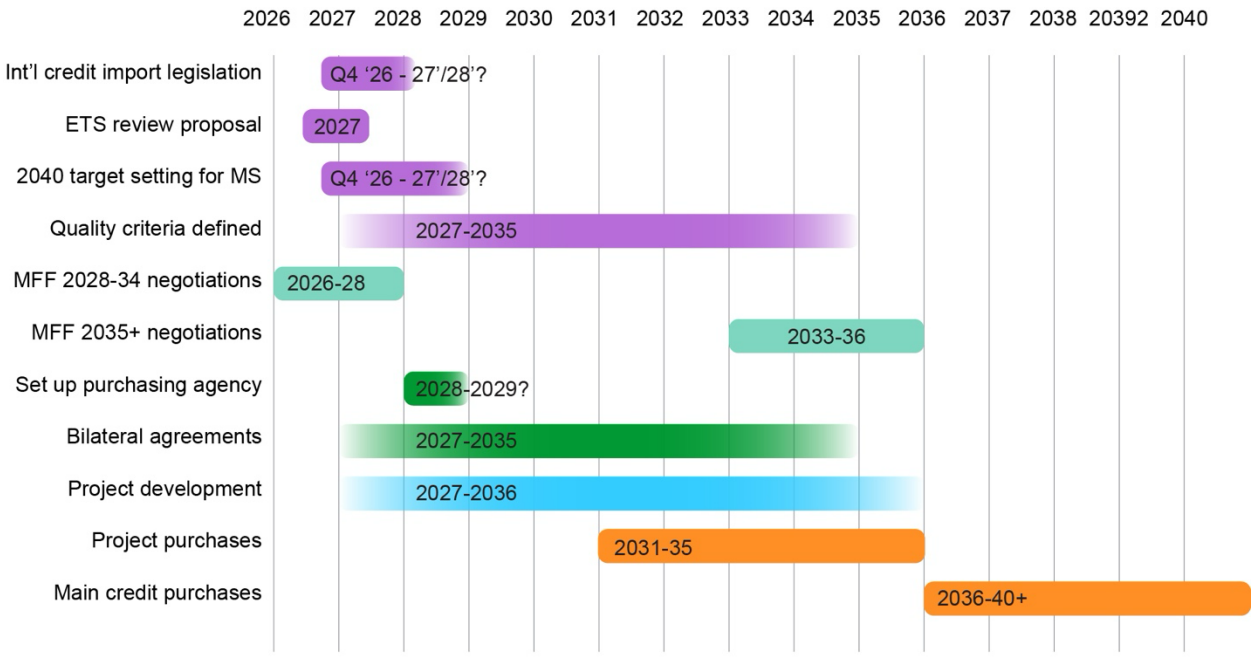
- CORSIA is forecasting an annual demand of 150 to 220 million tons for the year 2035[11].
- Japan is considering buying about 10 million credits per year between 2030 and 2040[12]
- There are many other countries that have indicated their intention to buy credits although without an indication of specific volumes: e.g., Korea, Switzerland, Singapore, and Norway.[13]
- Finally, several countries have not declared any intention, but their emissions forecasts show a gap that would presumably need to be filled with international credits. For example, New Zealand, at an annual 8 to 10 million[14], and Australia at an annual 10 to 20 million.[15]
- Looking even further out, if the USA rejoined the Paris Agreement with an intention to buy credits, they would need hundreds of millions of credits every year.

In any case, 250 to 700 million credits is an amount of demand that will probably be large enough to make its own weather in the global carbon project ecosystem. Even though such a significant amount of new demand can reasonably be expected to generate some supply by itself, the EU will also probably need to make an effort to secure a pipeline of high-quality credit supply well in advance of 2036.

All this means that if the EU does want to be able to purchase credits in 2036, it needs to provide a reasonable amount of legal certainty to potential credit suppliers by 2030 at the latest, but the earlier, the better. (To compare, CORSIA was adopted in late 2016 and the first credits were purchased in late 2024, i.e., about 8 years later.16) Legal certainty needs to cover two main areas: i) quality requirements (i.e., what constitutes a "high-quality credit"?); ii) funding (i.e., where is the money to pay for the credits coming from?) The focus of the present paper is on the second question.

2036 is very close: overlapping lead times for EU credit purchases

Each row shows when key workstreams must run. Shaded zones market pilot and purchasing periods



How much does it cost to buy hundreds of millions of carbon credits?

Before we start looking for money, we need to know how much money we need. At this stage, we don't know how the EU will define "high quality" credits, so it is very hard to tell how much such credits will cost a decade from now. Predicting prices ten years into the future is a fool's errand, but if we want to build a budget for buying credits, we do need to come up with a working estimate, however imperfect.

Credit prices today

At present, carbon credits are not homogeneous, commoditized products yet — although there is progress in this direction through labels and ratings. At the moment, there is a huge variety in the method of mitigation, the timeline, the certainty, and thus, the cost. The price of a carbon credit today depends on several factors:

- The project's type (e.g., nature-based or permanent removal, etc.) Most credits issued to date are from nature-based projects, while technological removal credits are much more expensive. In 2025, Sylvera suggested a price benchmark of $7 for REDD+ projects and one of $500 for DAC projects.[17]
- Another key factor in pricing is the rating that carbon credit agencies give to a particular credit[18] (from A to D in the case of Bezero and Sylvera and Tier 1 to Tier 3 in the case of Calyx.) At the end of 2025, a BBB-rated ARR-credit had an average price of over $40, while a C-rated ARR-credit was priced at $8[19].
- The price is also influenced by the various quality qualifications that a credit can obtain, such as the CCP-label, or eligibility for CORSIA, or conformity with PACM requirements. For example, a CCP-label can translate to a price premium of "up to 25%".[20]
- Finally, as the carbon market is really a "market," prices are also impacted by the level of total credit supply and demand, by inflation, the cost of capital, geopolitical risks, and so on.

Figure 2provides a good illustration of the diversity in credit prices that emerges on account of project type and project quality.

Liquidity-weighted average off price ($/t)

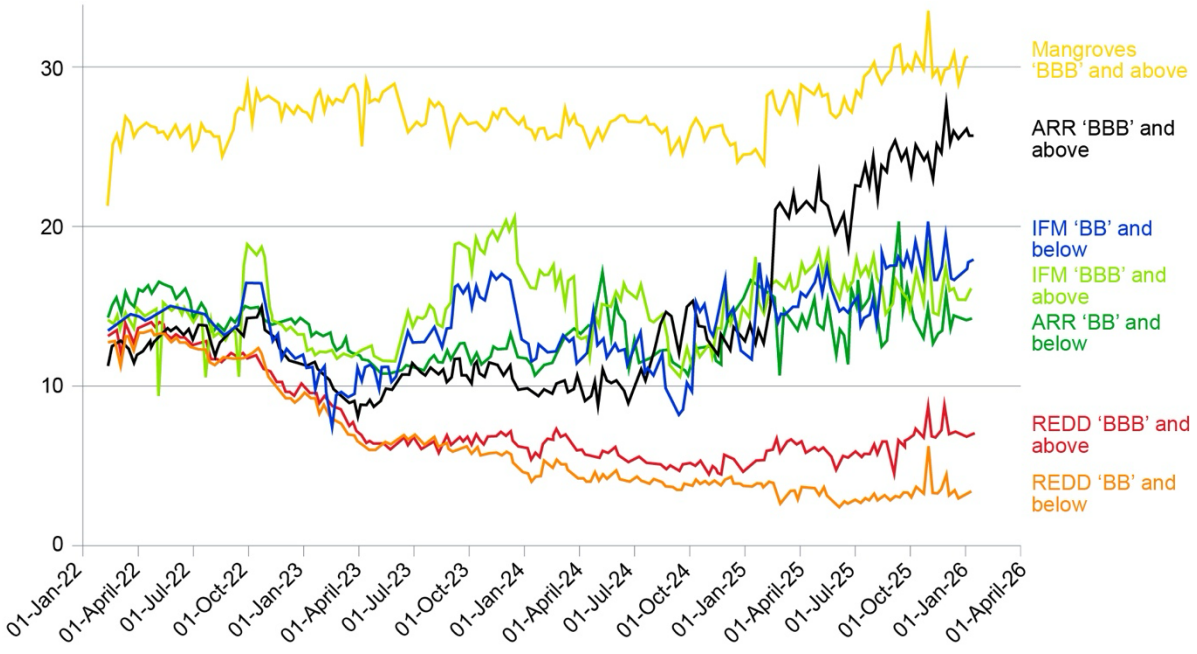


Figure 2: Quality-weighted price indexes

In this context, forecasting credit prices a decade into the future is almost impossible — it is thus not surprising that such forecasts are rare. Given that the evolution of CORSIA is planned out into the 2030s, there exist forecasts on the expected price of CORSIA-eligible carbon credits, but they are so vague that they are practically meaningless. (MSCI forecasts that these credits would cost "up to $124 in 2033/35.)[21].

Estimating a future price range

The lower bound

Instead of attempting to forecast future credit prices, we can try to find a range for the prices that would work for the EU. The lower bound is determined by credit quality, the various deductibles, and of course inflation.

High-quality credits today cost about €30 on average. We know this from the Swiss government's international credit purchasing scheme, where the current portfolio of Art 6 credits has an average cost of CHF29 or €32 per ton of CO222. Also, in early 2025, Singapore had a carbon credit tender for nature-based Article 6.2 credits which attracted almost 20 offers, with prices ranging from USD18 to over USD40.23

The next element contributing to the price are the "deductibles." The Climate Law requires that the credits "*high ambition for the share of proceeds for adaptation and the sharing of mitigation benefits with countries concerned*". While there are no rules on the exact level of the share of proceeds for adaptation, a 5% share of proceeds (SOP) and a 2% share for overall mitigation in global emissions (OMGE) is generally considered the minimum under the Paris Agreement, but some experts are calling for higher shares.

We don't know what the EU will consider "high ambition" in the sharing of benefits with the host country. For example, Japan's Joint Crediting Mechanism typically allocates a third of the credits to host countries, although there is a large variation by host country.24 It is also possible to withhold the issuance of credits for a portion of the reductions or require additional investments. The exact form and level of host country share will probably evolve through the bilateral agreements the EU makes and could even be differentiated by project type.

Finally, in the case of nature-based credits, there will be additional costs related to insurance against the potential loss of permanence, either through buffer pools, or other insurance methods.

Taken together, these deductibles can potentially add up to 30-50% of the total crediting in a project, further increasing the unit cost. (A silver lining is that the host country share could be counted against the EU's climate finance goals.)

We should also mention that procuring credits comes with some transaction costs, i.e., the cost of administration. For example, the Swiss government spent an estimated €4 million on staff and overhead in 2023 for its procurement program.[25] These are to some extent fixed costs, so as purchased volumes grow, they should proportionally diminish. If we apportion the annual estimated administration costs in Switzerland to the total amount of credits we intend to purchase, this would add €1-2 per ton.[26]

In sum, it is unlikely that the EU would be able to get the kind of "high-quality" credits it wants for less than €50 after 2036.

This is to be expected: if a credit is too cheap, the EU probably would not want to buy it as it raises the suspicion of overcrediting – i.e., that the host country is selling credits that it cannot really afford to sell because they are representing the low-hanging fruits of mitigation that it should rather reserve for meeting its own targets under its NDC. There is evidence that such overcrediting is already happening today.[27]

The upper bound

The upper bound, i.e., the maximum price that will be determined by the EU's willingness to pay. In theory, imported credits should on average cost less than domestic abatement, otherwise they do not result in cost containment. However, domestic abatement costs are uncertain, subject to debate, and not well understood outside academic circles. Thus, most people will probably use ETS allowance prices as a proxy for domestic abatement costs, even if this is not an entirely appropriate comparison. Also, there could be valid political reasons for buying credits instead of implementing an otherwise cheaper domestic measure. That said, it will be difficult to argue that a credit purchase was cost-effective if it costs more than allowances in the ETS. Thus, international credits *on average* will need to be discernibly cheaper than both ETS1 and ETS2 allowances. (Admittedly, there is some circularity in this argument, as the price of credit purchases might impact allowance prices.)

Of course, we also don't know how much ETS allowances will cost in 2036. The legislative process for setting the ETS 1 cap for the period after 2030 will take place in 2026, and it is becoming clear that the 2040 cap will be larger than it was previously expected, already putting a downward pressure on prices today. There is also very little clarity on expected ETS2 allowance prices — as we have indicated earlier, various analysts expect 2035 ETS2 prices to be between €55 and 214.[28] **As a working assumption, we conclude that credits on average should not cost more than €100 after 2036. (**This upper bound should be revisited as soon as there is more clarity on the EU's post-2030 climate policy framework.)

All these considerations mean that although price forecasting is not possible, we can at least make an educated guess about the EU's total credit bill. Depending on how many credits are bought and where the price lands within the above range, the total bill could be between 12 and 70 billion EUR, with a middle estimate around 35 billion EUR. For simplicity, we will refer to this number in our analysis.

Where to find billions of euros for credit purchases?

The Climate Law itself is silent on the matter of funding. As noted earlier, funding choices are fundamentally determined by who is using the credits, (i.e., Member States or ETS installations), and whether it is a mandatory or an optional purchase. Although the bulk of payments would be due in 2036–2040, the pilot program, capacity building, and project development would need some earlier funding as well. In the following, we will look at the funding options for the cases where the credits would be used by governments.

EU ETS1 auction revenues

The most straightforward funding source is the auction revenue from ETS1. Just in 2024, the EU collected almost €40 billion in ETS1 auction revenues.[29] Although the annual quantity of allowances auctioned is gradually decreasing, this is to some extent compensated by the increase in the unit cost of allowances. €35 billion is still only about 20% of all estimated ETS1 auction revenues between 2030 and 2040, or about 65% of revenues between 2036 and 2040.[30] The EU ETS Innovation Fund, also funded through auctions, is quite comparable to the funding needs of international credits as it will receive approximately €40 billion (depending on carbon prices).[31] In sum, there is ample financial space in ETS1 to cover the purchase of international credits. The great advantage of using auction revenues is that it can create dedicated financing well in advance that provides sufficient certainty for project developers to start developing projects for the EU's purchase.

Of course, there is also a lot of competition for these funds. Member States normally use these funds for their domestic decarbonization investments.[32] There are also EU-level objectives vying for this financing such as innovation, solidarity, or European energy security. What is more, as part of the EU's new 2028-34 Multi-Annual Financial Framework (MFF) the European Commission is proposing that the EU ETS should pay about €9 billion annually into to the EU's budget.[33] More recently, the Commission and several Member States have suggested that auction revenues should be spent on strategic investments in industrial decarbonization instead of the current objectives.[34]

This mechanism is ideal if credits are to be used indirectly by ETS installations, because in this case, the auctioning revenues only need to pre-finance credit purchasing, but the expense will be repaid (potentially with some profit) when the credits are auctioned. If credits are to be used by Member States, using auction revenues means that the EU will have to set up a redistribution mechanism, as Member States' individual credit demand will most likely be different from their share of the auction revenue.

ETS2 auction revenues

Auctions in ETS2 will also probably bring at least about €30 billion a year in revenues for Member States between 2028 and 2032.[35] An advantage of using ETS2 auction revenues is that there is not so much competition for them yet: apart from the roughly 20-25% of the revenues that would flow to the Social Climate Fund, all revenues belong to the Member States. Member States are obliged to spend all the revenues on climate policy-related objectives, but as of yet, there are no vested beneficiaries of these revenues.

At the same time, the ETS2 is not yet operational, and it may face further political challenges in the future, potentially eroding the forecasted revenues. The launch of ETS2 was already postponed by one year by the Climate Law, and yet there are still Member States who would like to see it cancelled altogether.[36]

Using the ETS2 auction revenues for international credit purchases is also difficult politically. These revenues are mainly coming from the heating and transport expenditure of households, including the most vulnerable, and there is a strong political expectation to reinvest them into these sectors to support a just transition. It would be politically difficult to justify a system whereby households are made to pay more "*only to send the money abroad*".

CBAM revenues

Another potential revenue source for buying international carbon credits would be the payments received under the EU Carbon Border Tax Mechanism. There is a definitive political and communications appeal to the idea that the EU is spending the CBAM money it receives from abroad on reducing emissions internationally, instead of enriching itself. This could make CBAM more acceptable both within the EU (where people might see CBAM as a "windfall" revenue) and among countries exporting to the EU, where the CBAM is frequently seen as a tax on competitive imports, rather than a bona fide climate policy measure. The use of CBAM revenues for buying credits would also help the CBAM's acceptance in the WTO by strengthening the argument that the CBAM is an environmental measure.[37]

There are also difficulties with CBAM revenue, however. First, we don't really know how much money will come from CBAM. The European Commission estimates €1.4 billion annually from 2028 onwards,[38] but no public information is available on how this estimate was reached. CBAM revenues are highly uncertain, as they depend strongly on how importers respond to CBAM and how exporting countries' domestic climate policy measures are taken into account. As no payments are yet due under CBAM so far, we have no track record to rely upon. The level of uncertainty can be illustrated with the modeling done by CAKE, which estimated an annual CBAM revenue of € 5 to 20 billion for 2030.[39]

The second problem is that if the €1.4 billion/yr figure proves to be correct, it would not be enough. All the CBAM revenues from 2030 to 2040 (€14 billion) would cover less than half of an international credits bill of €35 billion. So, even if CBAM is earmarked for international credits, other sources of funding would also need to be found.

Finally — as with ETS auction revenues — there are other contenders for this pot of money. Most notably, the Commission is proposing to use the majority of CBAM revenues as a contribution to its own resources under the 2028–34 MFF. Another Commission proposal suggests using the CBAM revenues to provide support to EU exporters exposed to carbon leakage.[40]

EU budget

Another potential source of funding is the EU's budget, most of which is also coming from the Member States. The purchase of international credits could have a dedicated funding line. The EU institutions will disburse about €200 billion in 2026. Of this amount, about €55 billion will be spent on nature and environment and about €15 billion on international development aid, to mention similar areas.[41] This should be compared to a €7 billion/year credit purchase bill. Blending the purchase of international credits with development aid could also help build an appealing political narrative around the idea of mutual benefits for Europe and the developing world —although this usually comes with the risk of the EU being accused of diverting development funding for other purposes.

A key advantage of using EU funds is that it does not depend on changes in allowance prices, unlike ETS auction or CBAM revenues. Using the EU budget would also mean an increase in total EU-level climate-related spending and not redirect revenues that are earmarked for domestic climate action.

The difficulty with relying on the EU budget is that it cannot secure funds far enough in the future. The EU is currently negotiating its 2028–34 MFF, which is legally prevented from making any commitments beyond 2036.[42] The MFF for after 2036 will probably not be decided until 2035. Even if funds for the pilot period and the initial commitments for building the project pipeline are added to the 2028–34 MFF, this does not guarantee that there will be money for credit purchases after 2036.

There are also procedural difficulties with relying on the 2028–34 MFF. One is that the process is well underway: the Commission presented its complete proposal in September 2025[43] and it is difficult to add new elements at this stage. In addition, changes to the EU budget would require consultations that go well beyond climate policy officials — this is not something that they can decide among themselves. Purchasing credits would need to compete with defense, energy crises, competitiveness issues, and the many other problems threatening the EU.

Member State contributions

Member State representatives have often hinted that they would prefer a centralized, Commission-led process for the purchases. This makes a lot of sense, as it is more efficient and more effective than each Member State purchasing on its own.[44] A centralized purchase process does not by definition imply a centralized source of funding, however. One could imagine a system where the centralized system acts as a purchasing agent: Member States give orders to the central system to buy a certain amount of credits and commit to paying for it or pool their funds in advance. There is precedent to the EU spending funds committed by Member States: the ETS Modernization Fund allows Member States to contribute voluntarily.[45]

There are some advantages to such a solution: it is flexible, as Member States could set their credit import needs based on their own mitigation strategy, so the EU would only buy the exact amount of credits that are actually needed by Member States. This structure would also allow a gradual, phased launch where more committed Member States move first. Also, there would be no need to negotiate the distribution of centrally purchased credits to Member States because each purchase would take place on behalf of a particular Member State.

There are also significant drawbacks, however. Receiving money from 27 Member States in 27 national procedures according to 27 timetables would make the work of a central purchaser very difficult. The market needs strong signals well in advance to start producing credits — it is unlikely that contributions by Member States would provide that.

The length and strength of funding commitments would vary by Member State, so a central purchaser would never quite know how much funding they can plan for. Such a system would be weak on guarantees and would take longer to set up than a central source of funding. In addition, Member States would probably want to attach their own purchasing conditions to the deals, (e.g., supporting businesses from that Member State) leading to fragmented procurements.

In broader terms, if funding is left with Member States, there is a huge risk that some Member States will never get around to finding money for something that is just a "nice-to-have," especially if there are no serious penalties for not meeting the 2040 Member State–level climate targets. This would weaken the EU's ability to use its purchasing power as a leverage in climate diplomacy. It would also weaken the incentive of project developers to start developing projects, thereby undermining supply.

A more predictable variation on Member State funding would be a "managed optional purchase" system, whereby the freedom of Member States to buy credits is somewhat bounded, by central EU rules. If we assume that Member States will have binding annual targets for their non-ETS1 sectors, this implies that there will be provisions for "borrowing," i.e., booking shortfalls over to subsequent years. The EU could allow Member States to opt for covering some of their shortfall through international credits by a deadline, e.g., five years.[46] This could build some long-term certainty of demand, while retaining Member State funding and autonomy.

TABLE 1:

Pros and Cons of various funding sources

Funding Source	PRO	CON
ETS1 auction revenue	• Can provide long-term guarantee • Already earmarked for climate spending by MS • Strong precedents (Innovation, Modernization Fund)	• Competing demands (other funds, European Commission own resources) • Difficult to share burden among MS
ETS2 auction revenue	• Can provide long-term guarantee • To be used for climate • Would go to MS anyway • No additional demands yet	• Politically difficult: • impacts the cost of living, • ETS2 revenues are expected to be recycled to the paying public, (not sent abroad) • Not yet established, not sure how much money will come
CBAM revenue	• Can provide long-term guarantee • Politically appealing (“spend abroad what was collected abroad”) • Could be seen as windfall money	• Competing demands • We have no idea how much it will be, but most likely not enough
EU budget	• Very secure commitment • Not impacted by EUA prices • Could be framed as part of development and climate diplomacy • Does not cannibalize other climate funding	• The 2028-34 MFF can only commit money until 2036 • 2028-34 MFF discussions are very advanced • Requires broad political consent (i.e., beyond climate officials) while competing with other political priorities
MS contributions	• Tailored to actual MS needs • Allows phased approach with willing MS • No need for redistribution of purchased credits	• Has weak guarantees for project developers • Funding would come in increments, probably with delays — difficult to manage and implement

Mixed approaches

One could also envisage a mixed approach similar to what exists for the Social Climate Fund, or to a lesser extent for the Modernization Fund. In this option, funding is cobbled together from a variety of sources, e.g., some core funding from both ETS1 and ETS2 auction revenues, with additional funds provided on a voluntary basis by some Member States. This way, the steady funding for the administration of the mechanism is ensured, but there would also be flexibility in the funding. The Member States who provide funds would have the opportunity to decide on the direction of their funds, i.e., which countries they are directed toward, what types of projects, they are used in. These Member States would also have ownership of the credits that they have financed.

The role of the private sector in funding credits

Another funding opportunity is to use the money of the private sector. Many EU governments are struggling with their public finances and thus would be happy to find a way to have credit purchases financed to some extent by the private sector. In this section, we will explore the opportunities for arranging this.

Credit use in the ETS1

Earlier, we have discussed that a key policy choice for Member States is to decide whether credits should be used within the ETS1 or outside it. The unbeatable advantage of allocating credit use to the ETS is that if credits are used by the EU ETS installations, then ultimately it is they who will have to pay for them, and thus no public funds are needed. Of course, if credit use is allocated for the ETS, it will not be available for the non-ETS sector. Thus, Member States will need to decide whether they would rather reduce compliance costs in the ETS or in the non-ETS part of their economy.

If we do decide to allow credit use in the EU ETS, it can be set up in a number of ways. The key alternatives are *direct use* vs. *indirect use* — both have pros and cons, as explained below:

- Indirect use means that a central agent buys the credits, converts them into allowances, and auctions them off to installations. There are two ways for implementing indirect use: the credit-backed allowances could i) be auctioned off directly and immediately, or ii) used to replenish the Market Stability Reserve and auctioned off only if and when this is necessary.

PROs:

- The EU can have strong control over credit quality as the gatekeeper who decides which credits are allowed in
- The EU can organize credit development and plan the purchasing — thus having a strong impact on the global credit market
- The EU can capture the price difference between credit price and allowance price — thus credit sales can even make money for Member States

- The cost savings from credits are distributed evenly among all ETS1 installations.

CONs:

- It does not reduce installations' compliance costs as much as direct use because the price gap between allowance and credit accrues to the Member States.
- It requires setting up a purchasing agency that organizes credit development and procurement. (This is only an extra task if such an agency is not already required for government purchases.)

- Direct use means that ETS installations buy credits on the market and use them after their conversion into allowances. This is very similar to how credits were allowed into the ETS in the past, with the main difference being that instead of allowing all credits within a mechanism, there is a screening process that identifies eligible credits. There two ways to implement direct use: i) a "shop window" where pre-screened eligible credits are made offered for purchase by installations, or ii) installations present their credits to the EU for conversion into allowances after an eligibility screening.

PROs:

- The EU would have a light administrative burden as it only needs to evaluate credits, but not procure them.
- It pushes allowance costs down more than indirect use because the price difference between allowances and credits stays with the purchasing installation.

CONs:

- The total volume to be purchased is uncertain and outside the control of the Member States – it would depend on the choices of the ETS installations. This is a much weaker global market signal than a central govt purchase.
- If the EU allows installations to seek out the credits themselves (instead of creating a shop window), credit quality would be harder to maintain as private sector buyers would generally try to seek out the cheapest credits. The EU would also be unable to influence the makeup of its credit purchase portfolio as this would be the result of the collective choices of installations.

- The price difference between credits and allowances would be captured by installations. (Note that this is not purely windfall; buying credits does have transactions costs. Also, purchasing should come with some financial benefit for the buyer, otherwise it is not attractive)

A key variable of direct use is how the right to import credits is distributed among installations. There are several options for this:

- *Equal access to all:* when the EU last allowed direct use of credits in the ETS, every installation was allowed to import credits equal to a certain share of its allocation. (The exact share was set by each Member State.) In theory, this could be replicated by distributing the import window pro rata among installations.[47]
- *Preferential access for industry exposed to carbon leakage*: the right to use credits and thus have lower compliance costs could be to some extent reserved to those most exposed to international competition.
- *Bidding for importing:* the EU could auction off the right to import credits. This would minimize the windfall problem, but like the previous solution, it would benefit larger players with more capital. It would also probably intensify the race toward finding the cheapest possible credit.
- *Technology transfer support:* the EU could use the right to import credits as a mechanism to support the EU's technology export. ETS installations that are exporting European technology through a credited project could import these credits to the ETS. This solution is akin to Japan's CDM and Korea' ETS. The difficulty with this solution is that there is only a limited overlap between technology providers and ETS installations.
- *A combination of the above*: the above options are not mutually exclusive. The right policy choice is strongly dependent on the amount of credits intended for the ETS. The right solution is not the same if credit import constitutes 10% or 50% of the total supply of units in the ETS.

Finally, we should mention one interesting variation on direct credit use, the one where private entities are turned into "purchasing agents" of Member States. When credits are purchased by

installations, it is normally assumed that the purchased credits would be used to cover emissions in the ETS, thus increasing the total supply of units in the ETS. This is not the only way, however. The credits surrendered by installations could also be used to cover non-ETS emissions. In this solution, when an installation surrenders a credit, a corresponding amount of allowances is moved from the auctioning put to a Member State's non-ETS (AEA) account. This is convenient for the Member State, but has some drawbacks: i) the total supply of allowances in the ETS does not grow, and thus there is no downward pressure on the price; ii) there is (potentially large) cost for the Member State, as it is in effect means buying credit for the price of an allowance, with the price difference accruing to the private sector.

Such a "purchasing agent" solution is not only feasible with ETS installations but could also work any business that buys international carbon credits, provided that there is a corresponding adjustment. Such purchases could happen as a result of voluntary commitments under the CSRD, or as a result of some other policy that requires companies to purchase credits. (For example, if — as proposed by some experts — the EU were to allow importers to meet their CBAM obligations through the purchase of carbon credits, these credits could be accounted in the climate targets through the 5% window.)

Getting the private sector to pre-finance credit development

Financing by the private sector has a role to play in the non-ETS sector as well and that is in pre-financing. Carbon projects need several years of upfront investments as they have a typical lead time of about 2 to 5 years before they can start delivering credits.

We do not expect that the EU would create its own project development and implementation agency and start running fully government-owned and funded projects abroad. Thus, projects would be developed by private sector entities (potentially with some aid or project development support from the EU), who should also bear the initial investment costs. In order to convince them to do that, the EU needs to provide certainty both on the quality requirements and on future demand. However, the general existence of paying demand is not enough in itself. Specific commitments on purchase would need to be provided as part of the purchase process. There are several ways the EU could structure its credit purchasing:

- Spot transactions: "The EU wants to buy eligible credits EU right now?" This is a very flexible solution that requires zero advance investment. But it is also very risky because there might not be enough credits on the market that meet the requirements. Higher risks during development would also probably translate into higher prices.
- Future options: "the EU may buy your EU-eligible credits at a future date." In principle, options are a great way to ensure supply without taking on too much commitment. This works well if sellers have other outlets for their products. In the case of international credits, the EU's projected market share is so large, and the quality requirements are expected to be so specific that it is not obvious that an option would be sufficiently appealing for project developers.
- Offtake agreements: "EU will buy your credit if it does meet the agreed requirements and is delivered at the agreed time." This is probably the most appropriate purchasing mechanism for most of the credits because it provides certainty to the project developer well in advance. Recently, offtake agreements have become more and more popular on the international carbon market: in 2025, offtake agreements covered 158 million tonnes, which is equal to three quarters of that year's total retirements.[48] Offtake agreements can also be made through exchanges, in the form of forward contracts.

Most government credit purchasing programs use agreements similar to offtakes to secure long-term supply. Singapore announced a request for proposals to buy credits in 2024 and selected the winning suppliers that it will contract with in 2025.[49] KLIK, the agency charged by the Swiss government to procure credits, is signing Mitigation Outcome Purchase Agreements (MOPAs)[50], which are primarily results-based (i.e., pay-on-delivery) although limited pre-financing is possible in some cases. The UNDP is following a similar approach in its High-Integrity Carbon Markets Initiative where selected project developers will eventually sign Performance-Based Payment Agreements (PBPAs)[51]

Offtake agreements are mutually beneficial, because the developer has certainty of demand, and the buyer has a clear pipeline of credit supply. Of course, this pipeline will not be entirely reliable, and therefore the EU would need to plan to use other, complementary credit purchasing mechanisms.

A key question in negotiating offtake agreements is the setting of the price. A fixed price gives the most certainty for both sides, but it could prove embarrassingly high or low compared to prevailing market prices a few years later.[52] Another option is to index to some market benchmark. For example, the EU could agree to a floor price that covers development costs and beyond that follow the price of allowances in ETS2 with a 25% discount. Thus, the purchased credits would be clearly cheaper than alternative domestic abatement opportunities. Tying prices to the ETS may not be ideal as this is unrelated to price developments in the credit market. Another option is to tie prices to carbon price indices that are available for the public, e.g. from MSCI or Abatable.

We should note that even, if the EU offers maximum certainty on demand through offtake agreements, this still leaves the developer with a lot of overall uncertainty Under the current rules, the EU is only planning to buy in the five years between 2036 and 2040. The EU might buy more credits after 2040, but this will probably not be decided for a decade. Most projects have a crediting period of at least 10 years, with nature-based credits often crediting for decades. It is difficult to make projects financially viable and not prohibitively expensive if they have revenues only in five years.

The EU can mitigate the uncertainty due to the short, five-year purchasing window by "globalising" its credit criteria. I.e., projects could be cheaper and more viable if they would be developed to meet credit criteria that apply not only in the EU, but in many other buying countries. With more buyers for the same credit type, there is a better chance of selling credits issued before 2036 and after 2040. The EU could use the Open Coalition or the Coalition to Grow Carbon Markets to develop such global criteria.

The pilot period: what is its role and how big should it be?

The Climate Law states that "a pilot period to initiate a high-quality and high-integrity international credit market may be considered for the period 2031-2035." There is no further guidance on what the pilot is for, how big it should be, how to fund it, and what to do with the credits purchased with the pilot. In the following, we shall attempt to answer these questions.

What is the pilot good for?

The pilot process is very useful as a "learning-by-doing" exercise. The EU can achieve a number of objectives with the pilot. These are:

- Developing, testing, and refining the policy framework: In the course of the pilot period, the EU can draft, adopt, test and refine the detailed implementing rules which are necessary for such a large-scale procurement process. Contracts need to be developed, credit quality assessment procedures established, and so on. The EU can experiment with solutions and find the one that works best.
- Testing global institutional infrastructure: the pilot can also be used to test the institutions of the host countries. Are MRV systems reliable, do corresponding adjustments work?
- Building human and institutional capacity: During the pilot period, the EU can build up its staff and collect enough experience for the main purchasing period.
- Signaling a serious purchasing intent: The rest of the world in general and potential project developers in particular need to know that the EU really intends to buy credits. The best way to signal this is to run a pilot project which can give credibility to the EU's plans to buy quite large quantities of credits starting in 2036.
- Discovering prices: A few rounds of procurement on the basis of the EU's quality criteria will give a much clearer picture on the prices that can be expected during the main period — allowing the EU to adjust its budgets in time, if needed.
- Negotiating bilateral agreements: Not so much as part of the pilot, but building on the experiences and market signals of the pilot, the EU can also be more effective in the signing of bilateral agreements with host countries.

The advantage of a pilot is that it can start gradually, without all the detailed rules in place, without the full staff, and so on. If there is one country to work with and one type of credit that the EU knows it likes, it can already start. As the amounts in question are small, the EU can afford some failures, mistakes or delays during the pilot.

How big should the pilot be?

Pilot credit purchase programs usually do not have targets for purchased credit volume; their purpose is to test the workability of complex international procedures. However, considering that the EU will have a long pilot period and one that should also serve as a market signal, it should consider setting a quantitative target.

This target should take into consideration the quantities that the market could reasonably supply without overwhelming it, resulting in very high prices. In 2025, only about 20 million credits were retired that were approved under ICVCM's Core Carbon Principles (CCP) label and thus could be considered high-quality credits.[53] On the other hand the pilot has to be large enough to attract serious engagement from host countries and developers. However, the pilot should also not so large that it becomes too big to fail (i.e., that it becomes politically impossible to acknowledge quality problems or write off losses).

While there are no obvious answers to these considerations, we consider that the pilot should by around 5–10% of the total window, i.e., somewhere between 12 and 70 million credits, equal to an annual 2,5 to 14 million. This would imply an estimated total cost of about €120 million to €1.5 billion.

What to do with credits purchased in the pilot?

A key issue regarding the pilot is how to use the credits purchased in the pilot? Should they be accounted against the EU's climate target, or should they be considered climate finance?

UNFCCC rules prohibit the transfer of ITMOs between NDC periods.[54] Thus, credits purchased before 2035 need to be used before 2035. Some understand this as meaning that credits purchased in the pilot cannot be used toward the EU's target because the EU's 2035 NDC55 contains a domestic-only target. However, a close reading of the NDC reveals that there is in fact no express prohibition of the use of credits before the 2035 period.[56] (Of course, even if the NDC does not expressly preclude this, the use of such credits towards the target would need to be accommodated in EU legislation as the current text of the Climate Law expressly sets the starting year of credit use to 2036.)

Another option for the pilot period credits would be to purchase them and not use them for the EU target – thus essentially becoming a form of pure climate finance or development aid. This solution raises a number of new issues, however. Development aid and climate policy are funded from different sources and have different objectives, which would need to be harmonized.

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[54] https://unfccc.int/sites/default/files/resource/cma3_auv_12a_PA_6.2.pdf. Article 1(d) on page 5 states that ITMOs are to be authorized for a specific NDC. This is understood by experts to mean that there can be no ITMO transfer between NDCs. (see e.g., here: https://www.tcafwb.org/sites/default/files/2023-09/6_ITMO%20no-banking%20note.Final_.%20June%2015.pdf)

[55] Danish Presidency of the Council of the EU and European Commission, *Nationally Determined Contribution of the European Union and Its Member States*, submitted to the UNFCCC, 5 November 2025. Available at: https://unfccc.int/sites/default/files/2025-11/DK-2025-11-05%20EU%20NDC.pdf

[56] See e.g., this section on page 43 of the NDC: *The target is an economy-wide net emissions reduction target by 2040 compared to 1990, including an adequate contribution of high-quality international credits under Article 6 of the Paris Agreement in a way that is both ambitious and cost-efficient, leading to an indicative contribution of an economy wide net reduction of between 66.25-72.5% in GHG emissions by 2035 compared to 1990.*