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Legal Framework for the Carbon Credit Market in Vietnam - Lessons From the Eu Emissions Trading System

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Abstract

The overall goal of a carbon credit market is to reduce emissions cost-effectively through the creation of permits and their commercialization. However, for a carbon market to function effectively, its elements must be regulated by a suitable and compatible legal regime. As with any asset or legal instrument, understanding the legal nature of carbon credits is crucial for assessing and controlling their trading and the potential risks for trading parties. This article analyzes the carbon credit market and the EU-ETS regulations governing its operation. It also examines Vietnam's legal system regarding the carbon credit market, identifying existing loopholes. Based on EU-ETS regulations, the article offers recommendations to improve the legal framework for Vietnam's carbon credit market.

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Introduction

The Emissions Trading System (ETS) is a system in which emissions are recorded and verified by a third party to ensure reliability. Facilities are permitted to emit only within their allocated quotas and may exchange quotas with other emitting facilities to match actual emissions. Allowing quota exchange provides short-term economic flexibility, thereby reducing the economic cost of emission reduction. The total emission quota across the entire ETS system will gradually decrease in the long term, ensuring a gradual reduction in greenhouse gas emissions. ETS is currently a major policy trend emerging in many parts of the world, with countries contributing 58% of global GDP using it (ICAP and the World Bank (2022). Vietnam is not outside this trend; accordingly, ETS will be piloted between 2025 and 2028 and fully operational by 2029.

The establishment and development of ETS in Vietnam are crucial steps in the process of international integration regarding climate change. However, Vietnam still faces legal gaps in establishing specific bilateral or multilateral linkage mechanisms, as well as a lack of regulations to resolve international disputes over emissions. Therefore, referencing EU-ETS regulations is important to complete the legal framework for Vietnam's carbon market.

Overview of the carbon credit market

In the late 1960s, Ronald Coase began promoting the idea of buying and selling pollution. He argued that pollution should be considered part of the cost of production. If pollution were

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priced into the production process and added to product costs, end consumers would discourage polluting businesses because higher pollution would raise product costs, making the business less efficient. Other economists later developed Ronald Coase's theory. Economists J.H. Dales and Thomas Crocker proposed that, while the market should largely control prices and pollution levels, overall pollution limits should be set by the government. Therefore, "pollution trading" is the most cost-effective way to ensure businesses comply with government-set emission targets (Lohmann, 2026).

Environmental economics theory has used the concept of "negative externalities". To explain the necessity of internalizing environmental costs into product prices through carbon pricing (Pigou, 1920/2017). The carbon credit market is a specialized market used for the exchange and trading of carbon credits. Carbon credits. Owning carbon credit gives the buyer the right to release them into the environment. Atmospheric carbon dioxide (CO2) or other greenhouse gases correspond to the number of credits currently in ownership. National governments regulate these carbon credit markets. Alternatively, international institutions where many governments are unable to do so. They can participate on their own to save costs (Nguyen Duy Thanh, Nguyen Ngoc Khanh Linh, 2024).

The essence of a carbon market is the "commodification" of greenhouse gases. The units of trade, including emission quotas and carbon credits, are quantified (typically in tons o f CO_2equivalent) and function as tradable assets (Daya Shankar Tiwari, 2022).

The carbon credit market is an important tool in the economy. The emissions trading system (cap-and-trade) not only limits the amount of greenhouse gas emissions but also allows for trading of allowances. Furthermore, it provides financial support for other environmental protection activities, an area that consistently faces funding shortages, with many countries managing only 10% to 20% of the required capital. The amount of capital needed (UNDP, 2022). It can be asserted that the carbon market is the most effective tool for reducing emissions at the lowest cost to society, and that the EU ETS is the benchmark for transparency and price stability (Yan & Lin, 2026).

The primary purpose of carbon credit trading is to reduce emissions cost-effectively by creating greenhouse gas emission permits and facilitating trade within them. This is the overall goal of international carbon markets established under the Kyoto Protocol and of all emerging national-level carbon trading systems. However, for carbon markets to achieve these goals, they must be supported by an appropriate and compatible legal framework.

The international legal basis of the carbon credit market.

United Nations Framework Convention on Climate Change (UNFCCC)

In June 1992, the United Nations states joined the UNFCCC. This Convention formed the basis for all subsequent climate negotiations. While acknowledging that human activities are increasing the concentration of greenhouse gases in the atmosphere and that this will lead to increasing global warming and climate change, the UNFCCC's stated goal is to stabilize atmospheric greenhouse gas concentrations at a level that would prevent dangerous human interference with the climate system. Such a level must be achieved within a timeframe sufficient to allow ecosystems to naturally adapt to climate change, to ensure that food production is not threatened, and to allow sustainable economic development. Article 4 of the Convention sets out what the United States must accomplish. One of the most important things is that developed countries must adopt policies and implement measures to mitigate climate change by limiting

greenhouse gas emissions and protecting greenhouse gas sinks. The UNFCCC established the Conference of the Parties to the Convention to carry out the work and make the necessary decisions to promote the effective implementation of the Convention.

Kyoto Protocol and Marrakesh Treaty

The Kyoto Protocol was adopted on December 11, 1997, in Kyoto, Japan, and entered into force on February 16, 2005, after the required number of countries ratified it. These provisions led to the emergence of an international "carbon market," named after the trading of carbon credits measured in carbon dioxide equivalents. From then on, the term "carbon credits" became part of international law. The Kyoto Protocol paved the way for the creation of emissions trading programs, establishing a new commodity market that allowed the buying and selling of carbon credits to comply with emission limits (Julien Chevallier, 2012).

Paris Agreement

The Paris Agreement calls on both developed and developing countries to establish and meet emissions targets. The Paris Agreement reflects the growing urgency of the climate crisis and widely recognizes that, to be effective, measures to combat climate change are necessary. These measures must be adhered to by all sources of carbon emissions. Each country must submit its plans to the National Climate Action Plan (NDC) every five years. Article 6 of the Paris Agreement provides for market mechanisms for creating and trading carbon offsets, namely the SDM and ITMO mechanisms. The market-based approach in Article 6 has enabled countries to meet their obligations by buying and selling carbon credits generated by eligible projects that reduce greenhouse gas emissions.

The EU Emissions Trading System (EU ETS) and lessons learned

The legal basis for the EU carbon market is EU Directive 2003/87, as amended by EU Directive 2023/959, establishing a system for trading greenhouse gas emissions quotas within the EU. The main instruments traded on the emissions trading system are emissions quotas and carbon credits. Previously, the EU was "closed" to external credits to force businesses to reduce emissions through technology rather than buy cheaper credits from abroad to minimize carbon leakage. Therefore, carbon credits eligible for trading on the emissions trading system are those generated by internal mechanisms, approved by the European Parliament and the European Council based on proposals from the European Commission for use in domestic operations (Article 30, paragraph 3 of EU Directive 2003/87, as amended by EU Directive 2023/959).

In Directive 2014/65/EU on markets for financial instruments (MiFID), the EU broadly defines the legal nature of two types of transactions in the carbon market. Both carbon credits and emission quotas are considered financial instruments (in the same category as securities). Furthermore, quotas are considered an administrative instrument because they are linked to the state's right to emit and are managed by a competent authority. This means that transactions in the EU are subject to supervision by financial market regulators such as the European Securities and Markets Authority (ESMA).

Carbon credits eligible for trading under the EU ETS are emissions credits issued by internal mechanisms adopted by the European Parliament and the Council, based on proposals from the Commission, for use in internal operations. Auctions are the primary method for allocating emissions rights within the EU ETS. This accounts for 57% of the total quota. The

Auction Regulations set out rules to ensure that the auctions are conducted in an open, transparent, synchronized, and non-discriminatory manner. Treatment. Regulations include those concerning timing, management, and other aspects of the competition. Emission rights price (The Commission to the European Parliament and The Council, 2022).

The EU has set out guidelines for the development of phase 4 (from January 1, 2021, and ending on December 31, 2028), the main objectives of phase 4 being (1) Strengthening EU-ETS development by reducing 2.2% of free emissions credits by 2021; (2) Continuing the allocation of free credits; (3) Supporting the industrial and electricity sectors (high-emission sectors) to meet the challenges in the transition to low-emission industries (Nguyen Quang Hieu, 2024).

Overall, the EU ETS can be seen as the world's first and largest multinational carbon market, operating on the Cap-and-Trade principle. Operationally, the EU sets a ceiling on total emissions for heavy industries and aviation. This ceiling is gradually reduced each year to ensure long-term emission reduction targets are met. Regarding quota allocation, the EU initially allocated most quotas free of charge to prevent carbon leakage. However, in later stages, auctions became the dominant method, generating significant revenue for reinvestment in green technologies. In terms of monitoring mechanisms, the EU maintains an extremely transparent database and a rigorous MRV system, where every ton of CO2 is independently verified (Dang Van Sang, 2026).

Current state of carbon market legislation in Vietnam and recommendations for improvement

Current legal status of carbon markets in Vietnam

Vietnam has established the basic legal framework for international carbon credit exchange by setting out the conditions for credit exchange and the approval process for international transfers (as stipulated in Decree No. 06/2022/ND-CP). However, the market still lacks systemic integration. Specifically, the current process for transferring carbon credit internationally remains heavily administrative, based on approval and licensing mechanisms from state agencies. All international transfers of carbon credits or mitigation results must be approved by the Ministry of Agriculture and Environment (Clause 4, Article 20a of Decree No. 06/2022/ND-CP).

To create a legal basis for the implementation of the Clean Development Mechanism (CDM), Vietnam issued Directive No. 35/2005/CT-TTg, dated October 17, 2005, of the Prime Minister on organizing the implementation of the Kyoto Protocol; Decision No. 130/2007/QD-TTg, dated August 2, 2007, of the Prime Minister on some financial mechanisms and policies for investment projects under CDM and some circulars guiding the implementation of CDM. In 2015, the Ministry of Natural Resources and Environment chaired and oversaw the implementation of the Joint Crediting Mechanism (JCM) between Vietnam and Japan, issuing Circular No. 17/2015/TT-BTNMT, dated April 6, 2015, which regulates the construction and implementation of projects under the JCM. Subsequently, in NDC [(4)], in its submission to the UNFCCC Secretariat under the Paris Agreement, Vietnam also committed to reducing greenhouse gas emissions by 15.8% compared to the business-as-usual scenario by 2030, and potentially by up to 27.7% (equivalent to 257.4 MtCO2e) or a total reduction of 43.5% if it receives international support (according to the 2022 NDC). At COP26, Prime Minister Pham Minh Chinh declared that Vietnam aims to achieve net-zero emissions by 2050.

Regulations on the carbon market were officially codified in Article 41 of the 2014 Environmental Protection Law, which addresses "greenhouse gas emission management," and further detailed in the 2020 Environmental Protection Law (Article 139) and Government Decree No. 06/2022/ND-CP on greenhouse gas emission reduction and ozone layer protection. This also affirms Vietnam's efforts and ambitions to build a domestic carbon market, thereby creating a positive legal environment for long-term development. In addition, there are several other relevant documents, including Decision No. 01/2022/QD-TTg on the list of sectors and facilities emitting greenhouse gases that must conduct greenhouse gas inventories, and Circular No. 17/2022/TT-BTNMT stipulating the method for measuring, reporting, and evaluating greenhouse gas emission reductions and establishing greenhouse gas inventories in waste management.

Although the 2020 Environmental Protection Law initially acknowledged the existence of emission quotas and carbon credits (Article 3), the current legal system still lacks a clear definition of these tools under civil and financial law. Specifically, it has not been clearly defined which type of asset they belong to under the provisions of the Civil Code: whether they are property rights, securities, or a specific type of derivative financial instrument (Article 115).

Decision No. 232/QD-TTg dated January 24, 2025, of the Prime Minister approving the Project to establish and develop a carbon market in Vietnam stipulates the functions and tasks, clearly assigning responsibilities for management, inspection, and complaint resolution. This shows that there is currently no arbitration mechanism or a real-time, interconnected "one-stop" process to address discrepancies in data between ministries and agencies. Furthermore, the legal framework lacks strict penalties for violations.

Proposals for improving the legal framework on carbon markets in Vietnam

First, Vietnam needs to establish a clear framework defining the legal nature of emission quotas and carbon credits, designating them as a specific type of financial asset with characteristics like those of securities. From a financial perspective, asset identification provides commercial banks with a basis for integrating carbon credit into their portfolios of legally secured assets, enabling the application of collateral and debt resolution measures in accordance with standard procedures. In the event of business bankruptcy or dissolution, a transparent identification mechanism will protect creditors' legitimate rights by transforming carbon quotas and credits into assets with the potential for liquidation.

Secondly, to protect the carbon market from risks such as financial exploitation, Vietnam must increase administrative penalties for violations related to the carbon market and combine them with civil sanctions.

Third, Vietnam needs to strengthen its integration into the international carbon market. First, the country needs to shift from an administrative approval mechanism to an automated order-matching system, drawing on lessons from automated order-matching systems used by organized trading facilities in the EU.

Fourth, Vietnam also needs to proactively negotiate and sign recognition agreements on carbon quotas with major carbon markets or third countries, thereby helping banks and other credit institutions manage exchange rate risks and foreign exchange reserves while optimizing the liquidity value of carbon assets. In particular, the digitization of post-audit processes and the interoperability of national data are also essential. Accordingly, the government should establish

a mechanism for data interoperability between the National Registration System and the exchange.

Fifth, Vietnam needs to plan the allocation of quotas for compliant entities participating in the carbon market, including two issues: (1) The allocation ratio between free and auction; (2) How to use the revenue from quota allocation.

Sixth, the scope of the mandatory carbon market, or ETS, should be reduced by defining the regulated sectors and providing a specific list of compliant entities in sectors required to conduct greenhouse gas inventories. Specifically, Vietnam's ETS should initially select only a small number of sectors and businesses that have already conducted greenhouse gas inventories since 2023 to participate in the carbon market, to reduce the management burden on state agencies.

Conclusion

The current legal framework for the carbon market only provides definitions, principles, and general operating mechanisms, without going into detail. Fundamental regulations such as market limits, trading procedures, and the establishment of supporting trading platforms, including registration systems, are still lacking; meanwhile, the scope of the law is quite broad, allowing many "non-traditional" mechanisms without limitations. If only these regulations are used, establishing a pilot market in 2025 and a formal market in 2028, as outlined in the current roadmap, will not be effective and may even be impossible. Furthermore, considering the national target of net-zero emissions by 2050 – a commitment comparable to that of developed countries – the establishment of a carbon market must be effective, reflected in high carbon prices (ranging from $50 to $250 per ton of CO2e, averaging $120 per ton of CO2e – according to the World Bank). This will also place a burden on the process of building and perfecting the legal framework to ensure that not only is the carbon market properly established, but it also develops effectively and rapidly.

For the reasons mentioned above, building and perfecting the legal framework for the carbon market in Vietnam is in line with current requirements and a crucial task to ensure the timely implementation of measures for the pilot plan starting in 2025.

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