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Master's Thesis of International Studies

Resolving Conflicting Issues  
in the Creation of  
the Carbon Border Adjustment  
Mechanism (CBAM)

탄소국경조정제도 수립과정에서 상충하는  
이슈 해결 방안 연구

August 2022

Graduate School of International Studies  
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# Abstract

This paper examines how the European Union resolves conflicting issues in the creation of the Carbon Border Adjustment Mechanism (CBAM). In particular, it focuses on identifying whether conflicting issues discovered in the preparation period have been resolved in the CBAM regulation proposal. The analysis of conflicting issues related to context and structure policy complexity produces intriguing findings. First, the most conflicting issue is related to ensuring an international trade agreement and the proposal could not reach an agreement instantly. Second, the design of the CBAM was divided into two divisions in the initial period. The proposal provides guidelines for the creation of CBAM. Also, there is a strong agreement between European institutions on designing CBAM related to the EU ETS. Lastly, the proposal settles on a specific range of coverage compared to its wide range in the preparation period. These findings suggest that there are still conflicting issues that require its decision in the following legislative procedure. Also, countries potentially under the influence of CBAM should consider these conflicting issues for preparing their policies.

**Keywords: Carbon Border Adjustment Mechanism (CBAM), European Union, Policy Complexity, Ordinary Legislative Procedure, European Green Deal, Fit for 55**

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# Chapter I. Introduction

## 1. Research Question and Purpose

The European Union (EU) leads the global fight to tackle climate change. It has actively pursued policies and legislation to reduce greenhouse gas (GHG) emissions. Likewise, climate change is a challenging issue asking for collective action. The rapid increase in greenhouse gasses such as CO<sub>2</sub> emitted by human activities immediately impacts human life by causing consequences. For instance, infectious diseases like covid-19, extreme weather, and rising sea levels threaten human well-being.

The world needs to work on reducing GHG emissions collectively to hold global warming. Regarding the issue of avoiding climate change, the Paris Agreement, an international treaty on climate change, set the long-term temperature goal under the global framework in December 2015.<sup>1</sup> In response, the EU set a new growth strategy to achieve climate neutrality by 2050. Through European Green Deal communication for the first time globally in 2019.<sup>2</sup> As an intermediate step to

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<sup>1</sup> United Nations / Framework Convention on Climate Change. 2015. "ADOPTION OF THE PARIS AGREEMENT". <https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf>. [Accessed 6 July 2022].

<sup>2</sup> European Commission. 2019. "The European Green Deal". [https://ec.europa.eu/info/sites/default/files/european-green-deal-communication\\_en.pdf](https://ec.europa.eu/info/sites/default/files/european-green-deal-communication_en.pdf). [Accessed 6 July 2022].

reach this goal, the 'Fit for 55' package was introduced as the EU dedicated to reducing at least 55% GHG emissions.

Carbon Border Adjustment Mechanism (CBAM) is one of this 'Fit for 55' package's most critical legislative proposals. The European Commission introduced a package of proposals named 'the Fit for 55' that aims to achieve the EU's climate objectives by revising and updating EU legislation in July 2021. The goal of the CBAM is to reduce global GHG emissions cost-effectively. This objective aligns with the world's goal of limiting global warming. In particular, CBAM targets to impose a carbon price on imported goods to the EU. The EU is trying to encourage non-EU countries to reduce GHG emissions. Just like the EU is reducing their GHG emissions with the EU Emission Trading System (EU ETS).

CBAM is not the first attempt of the EU seeking to control GHG emissions. The EU has been working on reducing GHG emissions by implementing the EU ETS since 2005. As a result, "The EU ETS remains the world's biggest emissions trading market, accounting for over threequarters of international carbon trading."<sup>3</sup> However, the risk of carbon leakage increased due to the EU's high carbon emission standards. Therefore, when the EU implements CBAM, it not only aims to reduce global GHG emissions but also considers levelling the playing field and reducing the risk of carbon leakage caused by unequal carbon prices.

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<sup>3</sup> European Commission. 2018. "European Commission Climate Action\_The EU Emissions Trading System (EU ETS)".[https://climatechange.lta.org/wp-content/uploads/cct/2018/03/factsheet\\_ets\\_en.pdf](https://climatechange.lta.org/wp-content/uploads/cct/2018/03/factsheet_ets_en.pdf). [Accessed 6 July 2022].

The primary goal of the EU is to resolve the carbon leakage risk by imposing a carbon price on imported goods with the CBAM. The feature that it is an environmental policy related to trade issues causes global controversy in CBAM. The EU stresses that CBAM is a policy with environmental ambition that reduces global carbon emission levels. However, on the international level, CBAM is critical because it encourages non-EU member states to reduce carbon emissions when they export their goods with carbon emissions to the EU. Considering technological improvement and the industrial structure related to their economy is necessary to reduce GHG emissions embedded in products. Therefore, implementing CBAM affects non-EU member states' economies within their industries and even at the border.

As a result, the trading system for countries that export to the EU will change significantly. Mainly, CBAM aims to reduce global GHG emissions so that the country that exports goods with high carbon emissions will be affected considerably. For instance, South Korea is an export-oriented country. Once CBAM enters into force, it will notably impact the Korean economy and export enterprises. It is because of South Korea's high dependence on trade and its reliance on energy-intensive industrial structures.<sup>4</sup> Nevertheless, it is not easy to take measures and the Korean government and exporting companies do not have a specific response strategy

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<sup>4</sup> Kamal-Chaoui, Lamia, Fabio Grazi, Jongwan Joo, and Marissa Plouin. 2011. "The Implementation Of The Korean Green Growth Strategy In Urban Areas". OECD Regional Development Working Papers, OECD Publishing. <http://dx.doi.org/10.1787/5kg8bf414lvg-en>. [Accessed 4 July 2022].

for CBAM. Transforming the structure of industry and trade to secure carbon reduction is a complex issue that is hard to solve in a short period. Countries like SouthKorea are trying to cooperate and agree with the international need for carbon neutrality based on the negative impact caused by intensive carbon emissions. However, it is not easy for them to rapidly change their industry structure related to the trading economy.

The EU is taking the implementation of CBAM at a very fast speed to push other states in a rush. The ordinary legislative procedure began in July 2021. The European Commission introduced the regulation proposal of CBAM under the ‘fit for 55’ package. In the proposal, the EU aims to enter CBAM into force starting from 2026 after a transitional period from January 2023 until December 2025.<sup>5</sup> Accordingly, when CBAM is implemented on full-scale, non-european companies exporting to the EU market will have to compensate for the carbon price corresponding to the amount of carbon emission embedded in their goods. Therefore, it is necessary to devise an export strategy while continuously updating the current status of the CBAM legislative procedure.

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<sup>5</sup> European Commission. 2021. "Proposal For A REGULATION" COM/2021/564 Final. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52021PC0564>. [Accessed 7 July 2022].

Further, the European Parliament and the Council of the EU proceed with the ordinary legislative procedure based on the European Commission's proposal. In progress, European institutions will adjust the interests of each member state and industry within the EU. Also, bilateral CBAM consultations with other trading partners will be processed. To implement CBAM, European institutions should resolve the critical issues discovered creating CBAM. Various issues are founded during debates and communications to introduce the CBAM proposal. These conflicting issues will affect the next step of the legislative procedure.

Therefore, the paper examines how the European institutions resolved conflicting problems in creating CBAM. Analysing the literature presented by European institutions during the proposal preparation period illustrates conflicting issues. As an intermediate step toward its implementation, the paper analyses the contents and structures of the proposal to demonstrate whether European institutions resolved conflicting issues in the proposal.

## **1.2 Previous Studies**

The European Union's policy-making process is implemented through mutual competition under 'Multi-Level Governance'.<sup>6</sup> In other words, the system of the EU is not simply limited to state actions. The authority for policy-making is

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<sup>6</sup> Hooghe, Liesbet, and Gary Marks. 2001. *Multi-Level Governance And European Integration*. Rowman & Littlefield.

distributed in various areas and levels of action. In particular, the European Union has Multi-Level environmental governance.<sup>7</sup> It excludes centralised authority and has a polycentric decision-making structure.

Also, the power of policy-making is gradually distributed across various domains and various levels of action.<sup>8</sup> European actors at several different levels share policy decisions in the negotiation process. At the same time, there is no apparent authority that takes responsibility for the outcome of a specific policy decision. Neunreither (1998) points out that it is a ‘governance without opposition’. In other words, there is no formal opposition to a particular policy decision during negotiations.<sup>9</sup> In particular, the ‘Cooperation procedure’ was abolished and incorporated into the ‘Codecision procedure after the Treaty of Lisbon. Furthermore, it was generalised as an Ordinary Legislative Procedure.<sup>10</sup>

The CBAM follows the ordinary legislative procedure, which begins with the European Commission submitting the legislative proposal to the European Parliament and the Council. The most common legislative process in the European

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<sup>7</sup> 박용성. 2007, "다층적 환경거버넌스의 유형에 대한 연구", 국정관리연구, 2, 1 103-121.

<sup>8</sup> 이수형. 2004, "다층 거버넌스로서의 유럽연합체제", 세계지역연구논총, 22, 1 29-48.

<sup>9</sup> Neunreither, Karlheinz. 1998. "Governance Without Opposition: The Case Of The European Union". *Government And Opposition* 33 (4): 419-441. doi:10.1111/j.1477-7053.1998.tb00460.x.

<sup>10</sup> VOERMANS, WIM J.M. 2011. "The Birth Of A Legislature: The EU Parliament After The Lisbon Treaty". *Brown Journal Of World Affairs* 17 (2): 163-180.

Union is the Ordinary Legislative Procedure. It is a modified and renamed version of the co-decision procedure introduced in 1992.<sup>11</sup> The European Parliament and the Council have 'co-equal' legislative power from this 'co-decision procedure'. Accordingly, the co-decision procedure was the most common legislative process in the European Union in the past.<sup>12</sup> After adopting the Lisbon Treaty in 2009, 'the ordinary legislative procedure' became the standard for adopting EU legislation and is currently exercised as the practical legislative power in about 85% of policy decisions in the European Union.<sup>13</sup>

As the European Parliament's power expanded in this procedure, it strengthened the binding force of the deliberation result. In other words, the European Parliament has the status of a legislative position equal to the Council.<sup>14</sup> At the same time, the European Parliament checks the European Commission that leads the European Union's policy-making process and agenda-setting. As a result, the European Parliament's legislative authority which was relatively weak compared

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<sup>11</sup> The Council of the EU and the European Council. 2022. "The Ordinary Legislative Procedure". Consilium. <https://www.consilium.europa.eu/en/council-eu/decision-making/ordinary-legislative-procedure/>. [Accessed 5 July 2022].

<sup>12</sup> Huber, Katrin, and Michael Shackleton. 2013. "Codecision: A Practitioner's View From Inside The Parliament". *Journal Of European Public Policy* 20 (7): 1040-1055. doi:10.1080/13501763.2013.795396.

<sup>13</sup> Brandsma, Gijs Jan. 2015. "Co-Decision After Lisbon: The Politics Of Informal Trilogues In European Union Lawmaking". *European Union Politics* 16 (2): 300-319. doi:10.1177/1465116515584497.

<sup>14</sup> Tsebelis, George, and Geoffrey Garrett. 2000. "Legislative Politics In The European Union". *European Union Politics* 1 (1): 9-36. doi:10.1177/146511650001001002.

to the Council was embodied. This equal status between the European Parliament and the Council ensures better working procedures than in the previous system.

In Ordinary Legislative Procedure, each organisation expresses its interest and coordinates through a balance of power between the European Commission, the European Parliament and the Council. Subsequently, the consensus of all three organisations is required for the proposal to pass. While having independent authority, all three institutions must form an interdependent relationship. Moreover, the decision-making deadline is stipulated as the first and second readings progress.<sup>15</sup> In this respect, the European Parliament and the Council must focus on drawing an agreement by considering each other's positions as much as possible.

As such, the legislative process of the European Union proceeds through the collaborative policy-making process of institutions.<sup>16</sup> Existing literature on conflicts occurring in the legislative process of the European Union argues that there is a possibility of disputes between member states within the European Union and conflicts at the supranational level. Also, intergovernmentalism can interpret

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<sup>15</sup> European Parliament.” Legislative powers”

<https://www.europarl.europa.eu/about-parliament/en/powers-and-procedures/legislative-powers>

[Accessed 7 July 2022].

<sup>16</sup> 한정훈. 2021. "유럽연합의 탄소국경조정제도 도입 논의와 유럽의회 내 정치적 갈등". 유럽연구 39 (4): 347-380.

conflicts between EU member states.<sup>17</sup> It is even more evident when the Council representing member states' preferences leads the process. In particular, these opinion differences between member states manifest in EU citizens and foreign policy fields.

On the other hand, the regulation or redistribution policy mainly showed transnational practices. It is believed that an imbalance of powers among European institutions causes conflict at the supranational level.<sup>18</sup> After the Treaty of Lisbon, the powers between these institutions became equivalent. As a result, the European Parliament is involved in selecting the European Commission's policy agenda and making decisions on an equal level with the Council under the Ordinary Legislative Procedure. Thus, strengthening the European Parliament's power controls conflicts arising from the asymmetric administrative power.

Furthermore, the 'Trilogues' is the EU's informal consensus process that deals with conflicts within European institutions during the legislative procedure. The ordinary legislative procedure must start with the first reading, and it can further the second and third readings between the European Parliament and the Council.

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<sup>17</sup> Howorth, Jolyon. 2012. "Decision-Making In Security And Defense Policy: Towards Supranational Inter-Governmentalism?". *Cooperation And Conflict* 47 (4): 433-453. doi:10.1177/0010836712462770.

<sup>18</sup> 김미경. 2005. "초국가적 수준에서의 다원주의적 민주주의와 유럽연합의 민주적 결핍", *한국정치학회보*, 39 (2): 65-84.

However, if it is an urgent issue proposal can be drawn up through an informal Trilogue the European Commission, the European Parliament and the EU council. It is surprising that “the informal ‘trilogues’ that play a pivotal role in almost 90 per cent of European Union legislation.”<sup>19</sup> The Trilogues in the EU generally take 3-6 months. It takes a short period compared to Ordinary Legislative Procedure, which takes an average of 18 months. Moreover, the EU conducts trilogues during the ordinary legislative procedure, especially once the policy is complex. It is because trilogues cover intra-institutional relations between the three European policy-making institutions and inter-institutional relations.<sup>20</sup>

### **1.3 CBAM Background**

The Paris Agreement is an international treaty on climate change adopted in December 2015. Following the Paris Agreement adoption, European Union established the European Green Deal. After the European Commission nominated new leader Ursula von der Leyen in December 2019. She pledged the European Green Deal as an opportunity that helps to cut GHG emissions, expecting it to improve industrial competitiveness and achieve a Just Transition of workers.<sup>21</sup>

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<sup>19</sup> Roederer-Rynning, Christilla, and Justin Greenwood. 2015. "The Culture Of Trilogues". *Journal Of European Public Policy* 22 (8): 1148-1165. doi:10.1080/13501763.2014.992934.

<sup>20</sup> Delreux, Tom, and Thomas Laloux. 2018. "Concluding Early Agreements In The EU: A Double Principal-Agent Analysis Of Trilogue Negotiations". *JCMS: Journal Of Common Market Studies* 56 (2): 300-317. doi:10.1111/jcms.12633.

<sup>21</sup> European Commission. 2019. "Turning Challenge Into Opportunity On The Course To Becoming The First Climate-Neutral Continent".

In this context, the EU expects to continue the European Green Deal as a key EU policy since 2019.

The European Union is strengthening its target of reducing GHG emissions by implementing related policies. The principal objective of the European Green Deal is “to be climate-neutral by 2050- an economy with net-zero greenhouse gas emissions”.<sup>22</sup> It suggests the necessity of achieving the next-zero CO2 emission at the global level in 2050 to suppress the average global temperature to 1.5°C as lowering compared to the pre-industrial period. The EU intends to prepare it in advance because the burden of response costs will increase once it delays climate change response. Therefore, the European Green Deal is a roadmap that ultimately makes the EU economy more sustainable. It contains policy directions and action plans to transform the EU's climate and environmental crisis into opportunities in all policy areas.

As part of the European Green Deal, the EU enacted the European Climate Law to legislate its goal of achieving climate neutrality by 2050. The European Commission proposed a legislative proposal for this European Climate Law

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[https://ec.europa.eu/commission/presscorner/detail/en/AC\\_19\\_6778](https://ec.europa.eu/commission/presscorner/detail/en/AC_19_6778). [Accessed 2 July 2022].

<sup>22</sup> European Commission. 2022. "2050 Long-Term Strategy". Climate Action.

[https://ec.europa.eu/clima/eu-action/climate-strategies-targets/2050-long-term-strategy\\_en](https://ec.europa.eu/clima/eu-action/climate-strategies-targets/2050-long-term-strategy_en). [Accessed 7 July 2022].

in March 2020 and formally adopted it in July 2021.<sup>23</sup> During the European Climate Law amendment period, the EU must execute the goal of reducing GHG emissions by 2030 to achieve net-zero greenhouse gas (GHG) emissions by 2050. The European Union's target stated in the European Climate law is designed to reach a minimum of 40% GHG emission reductions by 2030, compared with 1990 levels.<sup>24</sup>

However, in September 2020, the European Commission announced that it would propose the EU's new 2030 greenhouse gas reduction target of at least 55% reduction compared to 1990. It is communication for 'Stepping up Europe's 2030 climate ambition' for investment in achieving climate neutrality that benefits European citizens.<sup>25</sup> The 2030 Climate target plan illustrates, "Raising the EU's ambition of greenhouse gas emissions reductions to 55% by 2030 is feasible and beneficial for the health, prosperity, and well-being of our citizens....an opportunity for durable investments that can kick-start the EU economy."<sup>26</sup>

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<sup>23</sup> European Commission. 2022. "European Climate Law". Climate Action. [https://ec.europa.eu/clima/eu-action/european-green-deal/european-climate-law\\_en](https://ec.europa.eu/clima/eu-action/european-green-deal/european-climate-law_en). [Accessed 1 July 2022].

<sup>24</sup> European Parliament. 2021. "BRIEFING EU Legislation In Progress European Climate Law". European Parliamentary Research Service. [https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/649385/EPRS\\_BRI\(2020\)6493](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/649385/EPRS_BRI(2020)6493) [Accessed 4 July 2022].

<sup>25</sup> European Commission. 2020. "Stepping Up Europe's 2030 Climate Ambition [COM(2020) 562 Final]". <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0562&from=EN>. [Accessed 7 July 2022].

<sup>26</sup> Ibid., p.24 (5. CONCLUSIONS AND NEXT STEPS)

Based on this, the European Commission considered revising relevant laws and proposed the Fit for 55% Package in July 2021.

The CBAM was first introduced as part of the European Green Deal, and the 'Fit for 55' package elaborated the detail by presenting the European Commission's proposal on 14 July 2021. The EU intends to promote carbon neutrality by introducing CBAM, which imposes costs according to carbon emissions on items imported by the EU while maintaining European production and supply chains. The EU has been regulating the carbon emissions using the EU ETS which is the carbon pricing instrument since 2005. The EU-ETS is one of the most well-known methods that deal with the problem of carbon leakage in the EU. It prevented the risk of carbon leakage through free allowances within the EU-ETS until today.

The EU expects CBAM to complement the EU ETS and reduce the risk of carbon leakage. Regarding the application of CBAM, the European Commission selected sectors with high carbon leakage risk. Particularly, it is because countries outside the EU have relatively loose regulations compared to products within the EU. So, the EU tries to manage GHG emissions of their imported goods related to trade. Therefore, CBAM is not just a simple policy that deals with the environmental issue of reducing GHG emissions. Regarding the trade issue, CBAM is opening an era of the global carbon price system with economic implications. Also, CBAM shares its objective of avoiding carbon leakage by reducing imported carbon emissions with the EU ETS.

## Chapter 2. CBAM Procedure

Period	Institution	Purpose
11 December 2019	European Commission	Presented 'The European Green deal.'
04 March 2020 - 01 April 2020	European Commission	Open Feedback period - Inception impact assessment
22 July 2020 - 28 October 2020	European Commission	Public consultation: Collect various stakeholders' opinions
16 September 2020	European Commission	2021 Work Programme -President Ursula von der Leyen: The CBAM implementation will help ensure others follow Europe's lead.
07 October 2020	European Parliament	(ENVI) draft presented: a WTO-compatible EU carbon border adjustment mechanism
19 October 2020	European Commission	2021 work program: a plan to introduce the CBAM in the second quarter of 2021
05 February 2021	European Parliament	Adopted the report: the introduction of a CBAM as part of a broader EU industrial strategy
10 March 2021	European Parliament	Adopted the Resolution on a WTO-compatible EU carbon border adjustment mechanism
14 July 2021	European Commission	Proposed a Regulation for the carbon border adjustment mechanism (CBAM)

<Table 1. Timeline of CBAM developments>

The European Union (EU) leads the global fight to tackle climate change. According to the interest, European institutions have been working to implement the CBAM as part of the European Green Deal. The implementation is based on the idea that the CBAM will be able to reduce the risk of carbon leakage by promoting non-EU countries to produce and export goods with low carbon emissions. To reach this goal, European institutions had a preparation period before the European Commission's legislative proposal.

This paper determines that the preparation period of CBAM proposal is debate and communication between European institutions before the European Commission introduces it. Thus, three documents presented by European Commission and European Parliament will be considered documents from the initial period to prepare the creation CBAM proposal. First, the European Commission conducted the inception impact assessment from March 2020 to April 2020, right after the communication of the European Green Deal in December 2019.<sup>27</sup> Second, Public Consultation offered by European Commission collected opinions from major countries in trade relations with the EU from 22 July to 28 October 2020.<sup>28</sup> Third, the European Parliament adopted a resolution and urged the

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<sup>27</sup> European Commission. 2020. "Inception Impact Assessment - Ares(2020)1350037". <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-EU-Green-Deal-carbon-border-adjustment-mechanism-en>. [Accessed 7 July 2022].

<sup>28</sup> European Commission. 2021. "Public Consultation Summary Report - Ares(2021)70541". <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-CarbonBorder-Adjustment-Mechanism/public-consultation-en>. [Accessed 5 July 2022].

introduction of CBAM on 10 March 2021.<sup>29</sup> Responding to this request, on 14 July 2021, the European Commission proposed a Regulation for the carbon border adjustment mechanism (CBAM) through the climate change policy package "Fit for 55" to achieve the European Green Deal vision.<sup>30</sup> The document of the CBAM regulation proposal represents the proposal period in this paper.

Although implementing CBAM is still in progress, the primary phase from the regulation proposal in July 2021 to the first reading in March 2022 only took eight months. CBAM presents an interesting phenomenon of a regulation proposal, including various issues going through the legislative procedure at a fast speed. MEP Mohammed Chahim, the rapporteur of the CBAM, presented the "Draft Report on the proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism" in December 2021.<sup>31</sup> It was the European Parliament's response, including amendments to the regulation proposed

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<sup>29</sup> European Parliament. 2021. "A WTO-Compatible EU Carbon Border Adjustment Mechanism. European Parliament Resolution Of 10 March 2021 Towards A WTO-Compatible EU Carbon Border Adjustment Mechanism (2020/2043(INI)).". [https://www.europarl.europa.eu/doceo/document/TA-9-2021-0071\\_EN.html](https://www.europarl.europa.eu/doceo/document/TA-9-2021-0071_EN.html). [Accessed 4 July 2022].

<sup>30</sup> European Commission. 2021. "Proposal For A REGULATION"

<sup>31</sup> European Parliament, Committee on the Environment, Public Health and Food Safety. 2021. "DRAFT REPORT On The Proposal For A Regulation Of The European Parliament And Of The Council Establishing A Carbon Border Adjustment Mechanism (COM(2021)0564 – C9-0328/2021 – 2021/0214(COD))". [https://www.europarl.europa.eu/doceo/document/ENVI-PR-697670\\_EN.pdf](https://www.europarl.europa.eu/doceo/document/ENVI-PR-697670_EN.pdf). [Accessed 7 July 2022].

by the European Commission. In March 2022, the Council recently agreed on the general approach to regulating CBAM.<sup>32</sup>

## **2.1 Inception Impact Assessment**

As a first step, the European Commission published 'Inception Impact Assessment' to provide relevant information to stakeholders and citizens. The European Commission received relevant stakeholders' feedback from 04 March 2020 to 01 April 2020. A total of 224 valid feedback were given by respondents such as business associations, companies, non-governmental organisations (NGOs), and EU citizens. The European Union offers the initial impact assessment when the legislative proposal is expected to have enormous economic and social impacts like CBAM.

The document provides four main contents of creating CBAM. First, the indicative planned year for CBAM legislative proposal is 2021. Second, revising the current EU ETS and the risk of carbon leakage is necessary. Third, a design that minimises administrative burdens by analysing the economic, social and environmental impacts within and outside the EU. Particularly, technical compliance with WTO rules and other international agreements is needed. Lastly, it emphasises

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<sup>32</sup> Council of the EU. 2022. "Council Agrees On The Carbon Border Adjustment Mechanism (CBAM)". Press Release.

<https://www.consilium.europa.eu/en/press/press-releases/2022/03/15/carbon-border-adjustment-mechanism-cbam-council-agrees-its-negotiating-mandate/>. [Accessed 7 July 2022].

the importance of 'public consultation' that receives stakeholders' and citizens' views on the aspects of CBAM.

## **2.2 Public Consultation**

For the second step, the European Commission collected opinions by publishing the CBAM questionnaire for 'public consultation' from 22 July to 28 October 2020. In the open consultation, all stakeholders could present opinions and suggestions through an online questionnaire and submit related materials. The European Commission received a total number of 617 valid feedback from various stakeholders. European Commission seeks to listen to different stakeholders' views because CBAM impacts both EU member states and non-EU countries. CBAM is expected to influence the EU member states by replacing free allowances in the EU ETS. At the same time, new carbon prices will be implemented for the imported goods to the EU from outside.

The summary report for the public consultation was published in January 2021 with three important contents. First, stakeholders responded to the "most appropriate options to design the CBAM" in the questionnaire. The outcome illustrates that they prefer CBAM to be a tax on imported goods at the EU border. The listed goods will be in the sector with the risk of carbon leakage, which aligns with the primary objective of the CBAM.

Second, the summary report examines the “product coverage” of the CBAM. The result shows that CBAM should be implemented on products included in the current EU ETS with a high risk of carbon leakage. The summary significantly related value chains primarily related to the product. "The following five sectors are selected more than 50 times by the 609 respondents: i) Electric power generation, transmission and distribution; ii) Manufacture of cement, lime and plaster; iii) Manufacture of iron and steel and of ferro-alloys; iv) Manufacture of basic chemicals, fertilisers and nitrogen compounds, plastics and synthetic rubber; and v) Extraction of crude petroleum.”<sup>33</sup>

Lastly, respondents did not have a consensus on the CBAM implementation issues, such as calculating the carbon content of imported products. There are three primarily supported ideas in Figure 7: 1) allow importers to demonstrate how the product was manufactured. 2) considering all emissions throughout the value chain. 3) calculate both direct and indirect emissions from the product's installation.

## **2.3 European Parliament’s Resolution**

The last document in the initial period is the resolution proposed by the European Parliament. The European Parliament’s Committee on the Environment, Public Health and Food Safety (ENVI) collected opinions from four relevant standing committees for two months from November 2020. The ENVI proposed its

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<sup>33</sup> European Commission. 2021. "Public Consultation Summary Report"

own-initiative report in February 2021. The European Parliament revised the report and discussed it as a parliamentary agenda.

As a result, the final resolution was based on adopting the “A WTO-Compatible EU CBAM” proposed by the ENVI.<sup>34</sup> The European Parliament adopted a resolution supporting the implementation of CBAM and urged its introduction on 10 March 2021. The European Parliament members' votes on the resolution submitted were 444 in favour, 70 against, and 181 abstaining, with an approval rate of 63.8%. This high rate illustrates that implementing CBAM is an outstanding issue in Europe. The parliament resolution is not legally binding in itself. However, it significantly impacts the contents and adoption of the CBAM proposal proposed by the European Commission on 14 July 2021.

## **2.4 European Commission’s Proposal**

The proposal period begins on 14 July 2021 as the European Commission introduced the regulation proposal of the carbon border adjustment mechanism (CBAM). It was introduced as one of the most critical elements of the "Fit for 55" policy package to achieve the European Green Deal vision. Also, the CBAM proposal accompanies the European Commission’s impact assessment.

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<sup>34</sup> European Parliament, Committee on the Environment, Public Health and Food Safety. 2021. "REPORT Towards A WTO-Compatible EU Carbon Border Adjustment Mechanism". [https://www.europarl.europa.eu/doceo/document/A-9-2021-0019\\_EN.html](https://www.europarl.europa.eu/doceo/document/A-9-2021-0019_EN.html). [Accessed 3 July 2022].

The first reading for the CBAM ordinary legislative procedure started after introducing the regulation proposal. MEP Mohammed Chahim, the rapporteur of the CBAM, presented the Draft Report “on the proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism” in December 2021. It was the European Parliament’s response with amendments to the regulation proposed by the European Commission. In March 2022, “the Council reached agreement (general approach) on the Carbon Border Adjustment Mechanism (CBAM) regulation.”<sup>35</sup> However, this paper does not include documents presented after the proposal. It is because the European Parliament and the Council are still awaiting the first reading’s position in June 2022.<sup>36</sup>

CBAM is following the ordinary legislative procedure that is the most democratic decision-making method, unlike other policy processes. However, the possibility exists of developing regulation informally through trilogues, which is a method of resolving conflicts between European legislative institutions. Especially trilogues and conciliation committees for coordinating preferences have been established as consensus-based mediation systems for the ordinary legislative procedure. The procedure is a policy process that satisfies functional efficiency and

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<sup>35</sup> Council of the EU. 2022. "Council Agrees On The Carbon Border Adjustment Mechanism (CBAM)".

<sup>36</sup> European Parliament. 2022. "Procedure File: 2021/0214(COD) | Legislative Observatory | Carbon Border Adjustment Mechanism".  
[https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2021/0214\(COD\)&I=en](https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2021/0214(COD)&I=en). [Accessed 6 July 2022].

democratic legitimacy.<sup>37</sup> Trilogues is a policy process that leads to output optimisation through the principle of institutionalised majority voting even in the formalised preference competition between supranational organisations.

## **Chapter 3 Conflicting Issues in the Initial Period**

### **3.1 WTO Compatibility**

The initial period before the introduction of the CBAM regulation proposal includes a debate on the CBAM design that complies with the World Trade Organization (WTO) rules and other international agreements. The discussion is based on the fact that CBAM is not only an environmental policy but also an international trade policy that has the potential to act as a trade barrier. In this regard, CBAM corresponding WTO compatibility is essential for both EU member states and non-EU member states. To ensure WTO compatibility, the CBAM should meet GATT's general agreement, which is the principle of 'non-discrimination'. In detail, many previous studies paid closer attention to CBAM violating GATT Article I (Most Favoured Nation (MFN) and Article III (National Treatment)).<sup>38</sup>

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<sup>37</sup> Lindseth, Peter L. 1999. "Democratic Legitimacy And The Administrative Character Of Supranationalism: The Example Of The European Community". *Columbia Law Review* 99 (3): 628-738. doi:10.2307/1123519.

<sup>38</sup> MARCU, ANDREI, MICHAEL MEHLING, and AARON COSBEY. 2020. "Border Carbon Adjustments In The EU: Issues And Options – ERCST". *Ercst*. <https://ercst.org/border-carbon-adjustments-in-the-eu-issues-and-options/>.

On the other hand, scholars argue that GATT Article XX(b) and (g) may justify it even though the CBAM fail to comply with these WTO rules. Ultimately, the consistency of WTO rules while creating CBAM is still an ongoing issue with legal clashes during the preparation period and legislative procedure.

Concerns regarding CBAM complying with WTO rules started from the preparation period for the creation of CBAM. Notably, the design of CBAM was on a debate between the carbon border tax and the EU ETS linkage. Both options are related to trade, and it must ensure compatibility with WTO no matter which design the EU will implement as CBAM. Accordingly, CBAM should not violate GATT Articles I and III to guarantee WTO rules. Also, once it is violated, GATT Article XX must be thoroughly measured as a waiver.

The European institutions argue that they are creating CBAM that complies with WTO rules. The European Commission's Inception Impact Assessment emphasises the legal and technical feasibility of respecting international trade agreements such as the rules of the WTO.<sup>39</sup> It shows that the EU is aware of accomplishing WTO-compatible CBAM.

Furthermore, the European Parliament's resolution reveals that WTO compatibility is the EU's most significant concern in preparation for CBAM. Article 7 of the resolution stated that it supports the introduction of CBAM on the premise

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<sup>39</sup> European Commission. 2020. "Inception Impact Assessment"

that it is not discriminatory or disguised as a restriction on international trade and it complies with WTO rules and EU FTAs.<sup>40</sup> Also, article 23 expressed deep concern about the erosion of the multilateral trading system by introducing CBAM and emphasised that CBAM should instead contribute to global carbon emission reduction.<sup>41</sup>

In particular, the European Parliament's resolution specifically indicates that GATT Articles have been consistently controversial. It is stated in article 27: "to be compatible with WTO rules, GATT provisions such as Article I (the principle of most-favoured-nation treatment), Article III (the national treatment principle) and, if necessary, Article XX (general exceptions) could be the basis for any CBAM design".<sup>42</sup>

Also, Recital (P) in the resolution mentions that the CBAM aligns with Article XX of GATT, allowing an exception to "the necessary to protect human, animal or plant life or health (b), or natural resources (g)".<sup>43</sup> The GATT Article XX (b) and (g) are environmental exceptions.<sup>44</sup> Moreover, Article 28 emphasised the principle of non-discrimination under Article III of GATT.<sup>45</sup> This article supports that Article III is a

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<sup>40</sup> European Parliament. 2021. "Resolution of 10 March 2021", Article 7

<sup>41</sup> Ibid., article 23

<sup>42</sup> Ibid., Article 27

<sup>43</sup> Ibid., Recital (p)

<sup>44</sup> The World Trade Organization (WTO). 2022. "WTO Rules And Environmental Policies: GATT Exceptions". [https://www.wto.org/english/tratop\\_e/envir\\_e/envt\\_rules\\_exceptions\\_e.htm](https://www.wto.org/english/tratop_e/envir_e/envt_rules_exceptions_e.htm). [Accessed 7 July 2022].

<sup>45</sup> European Parliament. 2021. "Resolution of 10 March 2021", Article 28

critical criterion for ensuring CBAM's WTO compliance as CBAM should imply the same treatment on imported and domestically produced goods.

However, the European Parliament also urged the EU Commission to change the WTO. Article 24 stated that there is an urgent need to promote comprehensive reform of the WTO to ensure fair trade and simultaneously respond to global warming. In other words, CBAM should meet the current rules of WTO. Still, it is also necessary to revise GATT and WTO rules to prioritise adopting CBAM because the global response to the climate crisis is urgently needed. Regarding the European Parliament's desire to reform the WTO rules, WTO accepts that "The WTO has no specific agreement dealing with the environment."<sup>46</sup> Also, GATT Article XX is one of the most representative potential relevance between WTO and climate change.<sup>47</sup>

Also, Environmental experts point out that under the current WTO rules, any trade-related climate policy introduced will violate it. Experts argue that this situation may act as a factor hindering climate response policies such as CBAM.<sup>48</sup>

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<sup>46</sup> The World Trade Organization (WTO). 2022. "LEGAL TEXTS: GATT 1947 The General Agreement On Tariffs And Trade (GATT 1947) Article I". [https://www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_01\\_e.htm#articleI](https://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm#articleI). [Accessed 4 July 2022].

<sup>47</sup> The World Trade Organization (WTO). 2022. "The Multilateral Trading System And Climate Change: Introduction". [https://www.wto.org/english/tratop\\_e/envir\\_e/multilateral\\_trading\\_e.htm](https://www.wto.org/english/tratop_e/envir_e/multilateral_trading_e.htm). [Accessed 7 July 2022].

<sup>48</sup> 한국무역협회. 2022. "환경전문가들 “기후변화에 대처하는 길은 무역정책 개혁뿐”". <https://kita.net/cmmrcInfo/cmmrcNews/cmercNews/cmercNewsDetail.do?pageIndex=1&nIndex=1809448&no=1&classification=&searchReqType=detail&searchCate=&searchStartDate=&searchEndDate=>

Thus, it is necessary to introduce a peace article in the WTO that supports countries adopting climate change policies.

In conclusion, the European Parliament agrees with the existing literature that conflicts with several WTO rules must be solved in creating CBAM. It underlines that the CBAM should not be double protection. Also, CBAM must be designed with clear global environmental goals of reducing GHG emissions and confirming the excessive environmental integrity stated in Article 25.<sup>49</sup>

This paper demonstrates GATT articles mentioned in the resolution in depth because implementing CBAM compatible with WTO rules has a deep relationship with other issues such as CBAM design, revenues and coverage.

First, CBAM violates the GATT Article I (General Most-Favoured-Nation Treatment) if the mechanism discriminates against imported products of the same kind. GATT Article I(MFN) prohibit discrimination between member countries. It emphasises that policies must treat all member states equally in trade under the WTO.<sup>50</sup> In other words, all advantages granted to imported goods of one WTO member are immediately and unconditionally assigned to the same product of all other WTO members. However, the possibility of violation exists once the EU gives

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[Accessed 7 July 2022].

<sup>49</sup> European Parliament. 2021. "Resolution of 10 March 2021", Article 25

<sup>50</sup> The World Trade Organization (WTO). 2022. "LEGAL TEXTS: GATT 1947"

exceptions. These exceptions may apply to countries that have already implemented climate policies such as carbon tax or ETS, just like the EU.<sup>51</sup> Therefore, GATT Article I is violated once the CBAM gives any exception to apply it.

Secondly, National Treatment (NT) prohibits discrimination between imported and domestic products. CBAM is against GATT Article III if it is used as a discriminatory measure to protect domestic industries. Differences in carbon emissions are not considered in determining the homogeneity between imported products with high carbon emissions and European products with low carbon emissions.<sup>52</sup> Imposing a discriminatory policy based on this is a violation of the national treatment because CBAM does not guarantee equal treatment between imported products and domestic products of the same kind. Hence, GATT Article III is dishonoured unless CBAM is the same as the EU ETS.

Applying GATT Article XX (general exception) as a waiver raised in the previous studies. Existing literature constantly argues that CBAM may violate the MFN or NF principles. So, the GATT Article XX accepts an exception to health and environmental measures which is possible for the CBAM. Notably, to comply with the Chapeau of GATT Article XX, the EU should not unilaterally demand its

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<sup>51</sup> 이로리. 2010. “탄소세의 국경세 조정에 대한 WTO 법적 검토”. 국제법학회논총, 55(1), p.161-185.

<sup>52</sup> 김호철. 2021. “탄소국경조정 도입의 WTO 합치성 쟁점: GATT 제 2 조, 제 3 조, 제 20 조.” 통상법률, (151), p.3-54.

standards on the other state so that the mechanism will not be judged arbitrary.<sup>53</sup> Furthermore, it is attempted to have serious negotiations with other states and efforts to form a consensus at the international level.

Existing literature OECD (2020) discussed possible systems for the effectiveness of CBAM to prevent carbon leakage with the application of WTO compatibility. This study argues that CBAM should set a standard for carbon reduction efforts even though it is justified under GATT Article XX.<sup>54</sup> Currently, the standard does not exist for calculating carbon emissions to impose carbon prices globally. Also, Nationally Determined Contributions (NDCs) have different goals, procedures and methodologies for mitigation and adaptation that each state sets for itself. States take their situation and capabilities into account under the Paris Agreement.<sup>55</sup> Therefore, a particular standard with the countries' consent will be required to apply CBAM under GATT Article XX.

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<sup>53</sup> 유형정·조현진. 2014. 국가의 일방적인 환경보호관련 조치의 정당화 요건-GATT 제 XX 조 두문 (Chapeau) 의 해석과 적용을 중심으로. 법학연구, 24(4), p.211-248.

<sup>54</sup> Organisation for Economic Co-operation and Development (OECD). 2020. "ROUND TABLE ON SUSTAINABLE DEVELOPMENT\_The Climate Challenge and Trade: Would border carbon adjustments accelerate or hinder climate action?" <https://www.oecd.org/sd-roundtable/papersandpublications/The%20Climate%20Challenge%20and%20Trade...%20background%20paper%20RTSD39.pdf> [Accessed 7 July 2022].

<sup>55</sup> United Nations Framework Convention on Climate Change (UNFCCC). 2022. "Nationally Determined Contributions (Ndc)". <https://unfccc.int/process-and-meetings/the-paris-agreement/nationally-determined-contributions-ndcs/nationally-determined-contributions-ndcs> [Accessed 7 July 2022].

Moreover, trading partner states such as Russia and China constantly dispute that CBAM is an inequitable trade barrier inconsistent with WTO rules. Russia brought up the CBAM as one of the trade concerns because of its incompatibility with WTO rules in June 2020. Also, Fouré et al. (2013) predict a decrease in states' exports due to the introduction of CBAM. It applied to states with a large proportion of exports of energy-intensive items to the EU, such as the US, Russia, and China. The paper points out that CBAM may lead to trade disputes under the multilateral trade system such as WTO.<sup>56</sup> Additionally, China and India criticise that green protectionism limits the competitiveness of trading partners rather than purely responding to climate change.<sup>57</sup> Developed countries such as the EU have responsibility for carbon emissions and unilaterally introduce carbon border adjustments to solve environmental problems. However, in reality, they consist of a solid protectionist feature.<sup>58</sup> Developed countries with historical responsibility for carbon emissions introducing CBAM to developing countries' goods is particularly unfair to trade. Thus, trading partners have conflicting views on the implementation of WTO-compatible CBAM.

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<sup>56</sup> Fouré, Jean, Houssein Guimbard, and Stéphanie Monjon. 2016. "Border Carbon Adjustment And Trade Retaliation: What Would Be The Cost For The European Union?". *Energy Economics* 54: 349-362. doi:10.1016/j.eneco.2015.11.021.

<sup>57</sup> Venzke, Ingo, and Geraldo Vidigal. 2022. "Are Trade Measures To Tackle The Climate Crisis The End Of Differentiated Responsibilities? The Case Of The EU Carbon Border Adjustment Mechanism (CBAM)". *SSRN Electronic Journal*. doi:10.2139/ssrn.4013767.

<sup>58</sup> HOLMES, PETER, TOM REILLY, and JIM ROLLO. 2011. "Border Carbon Adjustments And The Potential For Protectionism". *Climate Policy* 11 (2): 883-900. doi:10.3763/cpol.2009.0071.

Furthermore, a member state of the EU is concerned that CBAM may work as a trade dispute. Ireland is a member of the EU that concerns CBAM electricity sector coverage. It is because Ireland has its electricity connected to the UK. The UK is one of the CBAM target states as it is a non- EU state due to Brexit in 2020.<sup>59</sup> Even after Brexit, Ireland has not secured a physical power connection with other EU member states, and an undersea power connection with France is due to be completed in 2027. Ireland understands that the EU has no intention of setting up carbon borders in its member state, but it has a connection with the non-EU country, so it shows concern about CBAM.

Overall, the European institutions agree on creating the WTO-compatible CBAM. However, previous studies argue that GATT Articles I and III is violated under the current development of CBAM. Also, trading partner states such as Russia, China and India states that CBAM is a protectionist measure. The only exception that allows CBAM compliance with WTO is GATT Article XX. The EU still needs to manage its regulation to meet this rule of WTO. The CBAM in the preparation period does not have a particular feature agrees with the waiver.

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<sup>59</sup> Ainger, John. 2021. "EU'S Carbon Levy Throws Up Another Brexit Border Challenge". Bloomberg. <https://www.bloomberg.com/news/articles/2021-12-20/eu-s-carbon-levy-throws-up-another-brexit-border-challenge>. [Accessed 7 July 2022].

## 3.2 Revenues

The idea of using CBAM as a financial resource was raised while creating CBAM. For instance, the EU agree to use the revenues for the economic recovery of Europe after COVID-19. However, the use of CBAM revenues could occur incompatibility with WTO rules. As discussed above, avoiding conflicts against international trade law is essential for creating CBAM. One possible chance to meet WTO rules is applying a general exception (GATT Article XX) which illustrates that the CBAM must be imposed for welfare or environmental reasons. However, the plan to utilise CBAM revenues conflicts with the claim that the EU implements CBAM solely for environmental purposes, so it may be challenging to apply the WTO exception. Thus, existing literature argues that it is necessary to prove that CBAM is intended for environmental reasons for WTO-compatible CBAM.<sup>60</sup> Specifically, CBAM should demonstrate that CBAM is not created for collecting a financial budget such as economic recovery due to COVID-19.

The European Commission's Inception Impact Assessment does not particularly state the budgetary impact of CBAM. Nevertheless, it focuses economic impact on the European Union. CBAM could operate the EU economy to become a more resource-efficient and competitive economy with net-zero emissions by

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<sup>60</sup> Lee, Cheon Kee. 2022. "EU CBAM: Legal Issues And Implications For Korea". KIEP Research Paper, KIEP Opinions No. 222. doi:10.2139/ssrn.3940746.

2050.<sup>61</sup> Also, In the European Commission's public consultation summary report, respondents admitted that the CBAM would benefit investment in the EU.<sup>62</sup> It was also more of an economic impact related to EU businesses and promoting innovative clean technologies rather than using CBAM revenues as the EU budget.

The debate over utilising the new resources created by CBAM begins explicitly with a European Parliament resolution. In the resolution, the European Parliament supports the EU using revenues generated from CBAM for the EU budget. Especially in article 33, new sources should fund the EU budget with sufficient transparency in its use.<sup>63</sup> Also, Article 34 again emphasises that all three institutions (European Parliament, European Commission, and the Council) have agreed to create new funding sources.<sup>64</sup> Precisely, in article 35, various revenues "ranging from EUR 5 to 14 billion per year" are estimated depending on the scope and design of the new system.<sup>65</sup> In article 36, the European Parliaments argue for using revenues caused by CBAM as its resources. These articles confirm the European Parliament's intention to use new revenues as the EU's budget while considering the ultimate act of reaching an agreement with WTO rules.<sup>66</sup>

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<sup>61</sup> European Commission. 2020. "Inception Impact Assessment" p.2-3

<sup>62</sup> European Commission. 2021. "Public Consultation Summary Report", p.6

<sup>63</sup> European Parliament. 2021. "Resolution of 10 March 2021", Article 33

<sup>64</sup> Ibid., Article 34

<sup>65</sup> Ibid., Article 35

<sup>66</sup> Ibid., Article 36

Conclusively, European institutions expect CBAM to have positive impact on its economy. They have a consensus on using the revenues as the own resources. However, it contradicts the waiver of GATT Article XX that applies to environmental policy. The EU must provide a detailed plan to use the revenues and must allow CBAM compliance with WTO.

### **3.3 EU ETS**

The design of CBAM is still unclear in the initial period before the introduction of the CBAM proposal. Two different strategies have been discussed for the creation of CBAM. One method applies CBAM as a carbon border tax, and the other demand CBAM as an extension of the EU ETS to imported goods. European institutions considered these various options in the initial period of creating the CBAM. The linkage between the EU Emission Trading System (EU ETS) and CBAM is also conflicting.

The European Commission's Inception Impact Assessment determined that CBAM should be equivalent to the internal EU carbon price. Also, it illustrated that CBAM acting on imported goods could be done through various options such as a tax on imports or by expanding the EU ETS. Section B initiates three different policy instruments "a carbon tax on selected products – both on imported and domestic

products, a new carbon customs duty or tax on imports, or the extension of the EU ETS to imports.”<sup>67</sup>

Stakeholders who participated in the European Commission’s public consultation were given four similar options regarding CBAM design as a tax or the EU ETS. In Figure 5, stakeholders preferred imposing a tax on imported goods: “A tax applied on imported products associated with sectors at risk of carbon leakage appears to be the most relevant option according to the respondents followed by a carbon tax at consumption level applied to all products (both imported or produced in the EU) in sectors that are at risk of carbon leakage.”<sup>68</sup> However, implementing a carbon tax requires unanimous support from all EU member states.<sup>69</sup>

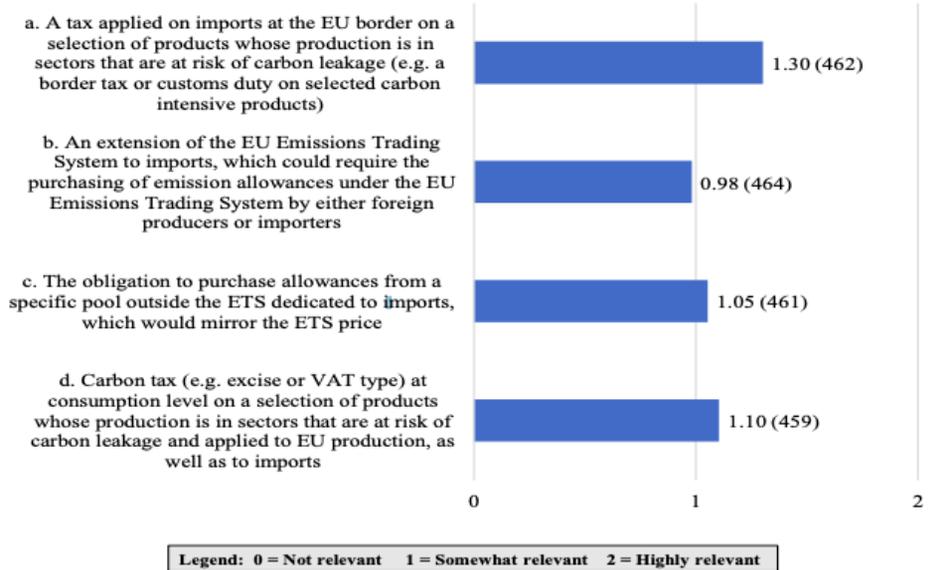
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<sup>67</sup> European Commission. 2020. "Inception Impact Assessment", p.2 section B

<sup>68</sup> European Commission. 2021. "Public Consultation Summary Report", p.3

<sup>69</sup> Weishaar, Stefan E. 2018. "Carbon Taxes At EU Level: Introduction Issues And Barriers". WIFO Working Papers, Austrian Institute Of Economic Research. 556.

**Figure 5: Most appropriate options to design the CBAM**



Source: Public consultation questionnaire responses

<Figure 1. Public Consultation Summary Report (Figure 5)> <sup>70</sup>

Also, the European Parliament acknowledges that the European Commission is currently evaluating various options such as taxes and using EU ETS to introduce CBAM. On this matter, Article 14 in the resolution highlighted that the EU should revise the EU ETS before presenting CBAM to prevent the double protectionism that might cause inconsistency with WTO rules.<sup>71</sup> The European Parliament admits that there are several options for CBAM design.

However, the European Parliament disagrees with implementing CBAM as a carbon border tax on imported goods. The European Parliament prefers the CBAM

<sup>70</sup> European Commission. 2021. "Public Consultation Summary Report", p.4 (Figure 5)

<sup>71</sup> European Parliament. 2021. "Resolution of 10 March 2021", Article 14

method to be purchased by importers from a separate pool linked to the EU ETS auction price rather than in the form of a tax. In Article 16, the European Parliament provides specific processes out of the various forms of the CBAM mirroring the EU ETS.<sup>72</sup> In this method, importers should purchase allowances from a separate pool of allowances linked to the EU ETS auction price. Mainly, importers must purchase allowances equivalent to the same-day price of the EU ETS.

The European Parliament suggests that for purchasing CBAM allowances, it should use carbon price from a separate pool of the EU ETS free allowances. In other words, carbon pricing of CBAM needs to be imposed on the carbon content of imports to reflect the carbon price paid by EU producers. In addition, the European Parliament acknowledges that a fixed duty or tax on imports could work as a simple tool providing a solid and stable environmental price signal for carbon-embedded imported goods in Article 17.<sup>73</sup> It would be a less flexible mechanism to reflect the evolving price of the EU ETS due to the fixed nature of the tax. In conclusion, in the preparation of the CBAM, the European Commission provided various options regarding the design of the CBAM, and the European Parliament prefers it to be related to the EU ETS.

Existing literature points out the remaining double compensation problem with implementing EU ETS-related CBAM. Maintaining the free allowance of EU

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<sup>72</sup> European Parliament. 2021. “Resolution of 10 March 2021”, Article 16

<sup>73</sup> European Parliament. 2021. “Resolution of 10 March 2021”, Article 17

ETS should be restricted because it might cause the double-protection issue related to WTO rules. Horn and Sapir (2013) argue that if the free allocation of the EU ETS is continuously maintained together with CBAM, it violates WTO rules and occurs double protection of domestic producers.<sup>74</sup> The research evaluates that CBAM must avoid the problem of double compensation. If not, CBAM will act as a disguised protectionist measure.

In particular, the national treatment ensures that offshore products are treated no less favourably than those accorded to products of the same type within the EU.<sup>75</sup> The EU ETS free allocation system is a system that allocates emission permits free of charge to companies. Therefore, it causes discrimination between international and domestic products. Domestic products have price competitiveness compared to international products of the same type as imported so it may violate GATT Article III national treatment. Based on this, some European industries that received free allowances are protesting against the abolition of the free allocation system due to job loss and carbon leakage. Even if CBAM is linked with the EU ETS, it still has remaining issues to be solved.

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<sup>74</sup> HORN, HENRIK, and ANDRÉ SAPIR. 2013. "Can Border Carbon Taxes Fit Into The Global Trade Regime?". Bruegel Policy Brief 2013/06. <https://www.bruegel.org/2013/12/can-border-carbon-taxes-fit-into-the-global-trade-regime/>. [Accessed 7 July 2022].

<sup>75</sup> 이천기, 박지현, 박혜리. 2021. "EU 탄소국경조정 메커니즘에 대한 통상법적 분석 및 우리 산업에의 시사" 대외경제정책연구원.

<http://lib.keei.re.kr/search/DetailView.ax?sid=11&cid=806790> [Accessed 7 July 2022].

### 3.4 Coverage

Broadening the list of goods and coverage might effectively respond to the objective of preventing carbon leakage. However, it can also increase transaction costs and impose additional methodological burdens. Thus, it is essential to set a proper CBAM coverage.

At the beginning of the initial period, the Inception Impact Assessment provided by the European Commission did not set up particular coverage scope. However, it illustrated that the sectoral scope should meet the objective of preventing the risk of carbon leakage.<sup>76</sup> Sectors exposed to the risk of carbon leakage, such as steel under free allowances, have been considered under the EU ETS since 2013. Therefore, products with the highest risk will be on the first list to measure the CBAM application.

The European Commission's public consultation provided an online questionnaire for product and sectoral coverage of the CBAM. Stakeholders agree with the European Commission by considering goods with the highest risk of carbon leakage as the prime sector. Especially, respondents believe that the CBAM should focus on products concerning what the EU ETS is covering for the product coverage.

Also, Figure 6 stated that they prefer considering the entire value chain rather than just focusing on products. Moreover, the summary of the public consultation determines specific sectors. The 609 respondents selected five sectors

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<sup>76</sup> European Commission. 2020. "Inception Impact Assessment"

more than 50 times: “i) Electric power generation, transmission and distribution; ii) Manufacture of cement, lime and plaster; iii) Manufacture of iron and steel and of ferroalloys; iv) Manufacture of basic chemicals, fertilisers and nitrogen compounds, plastics and synthetic rubber; and v) Extraction of crude petroleum.”<sup>77</sup>

The European Parliament considers the broad scope of CBAM coverage. The resolution of the European Parliament article 12 argues that the EU should apply it to imports of all goods covered by ETS so that it would not negatively affect European industries. In particular, it should include energy-intensive sectors that continue to receive free allocations under the EU ETS. Article 12: "the CBAM should cover the power sector and energy-intensive industrial sectors like cement, steel, aluminium, oil refinery, paper, glass, chemicals and fertilisers, which continue to receive substantial free allocations, and still represent 94 % of EU industrial emissions.”<sup>78</sup> Additionally, the resolution emphasises that CBAM coverage should include direct and indirect emissions. Article 13 supports that GHG emissions of imported products should be calculated transparently and accurately, including all types of emissions.<sup>79</sup>

A previous study also estimated that CBAM should first be applied to the energy-intensive sector with high GHG emissions. Mehling et al. (2019) presented guidelines for the scope of carbon border adjustment's emission coverage, applicable

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<sup>77</sup> European Commission. 2021. "Public Consultation Summary Report", p.4

<sup>78</sup> European Parliament. 2021. "Resolution of 10 March 2021", Article 12

<sup>79</sup> European Parliament. 2021. "Resolution of 10 March 2021", Article 13

products, countries, and emission calculations. Remarkably, the paper emphasises that CBAM will be more likely to meet GATT Article XX once it only covers sectors that are high carbon costs.<sup>80</sup> For example, "Such sectors include cement, steel, and aluminium" that contain intensive GHG emissions show high costs at risk due to climate regulations.<sup>81</sup>

In October 2020, Diederik Samsom (head of the European Commission's climate cabinet) said, "The core sectors are indeed steel, cement and electricity... This could be extended later to aluminium, fertilisers and chemicals." The EU considers structural construction industries such as steel, cement, and aluminum as a prime target of CBAM. These industries consume a lot of energy and emit greenhouse gases in the production process. At the same time, these industries receive free allocations for their GHG emissions within the EU under the EU ETS due to the risk of carbon leakage. However, the EU expects to include a wide range of coverage based on these documents from the initial period. Also, European institutions do not have particular agreements on implementation guidelines for the coverage during the preparation of the CBAM.

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<sup>80</sup> Mehling, Michael A., Harro van Asselt, Kasturi Das, Susanne Droege, and Cleo Verkuijl. 2019. "Designing Border Carbon Adjustments For Enhanced Climate Action". *American Journal Of International Law* 113 (3): 433-481. doi:10.1017/ajil.2019.22.

<sup>81</sup> Cosbey, Aaron, Susanne Droege, Carolyn Fischer, Julia Reinaud, John Stephenson, Lutz Weischer, and Peter Wooders. 2012. "A Guide For The Concerned: Guidance On The Elaboration And Implementation Of Border Carbon Adjustment".  
Entwined Policy Report No. 03. <http://dx.doi.org/10.2139/ssrn.2178312>.

## **Chapter 4 Conflicting Issues in the Proposal Period**

This chapter determines and analyses whether the proposal reached a consensus about four conflicting issues recognised in the initial period. On 14 July 2021, the European Commission introduced a proposal to regulate the Carbon Border Adjustment Mechanism (CBAM). For the structure, the CBAM proposal published by the European Commission is 291 pages. Specifically, the CBAM proposal includes an Explanatory Memorandum, proposal text, Legislative Financial Statement, Annexes I~V, Subsidiarity Grid, and Executive Summary of the Impact Assessment report and Impact Assessment report.

In the proposal for a regulation of CBAM, an Explanatory Memorandum is presented over 14 pages before the main proposal text. It works to help understand the basis and logic that led the EU to consider introducing CBAM. In detail, it includes 1) the context of the proposal, 2) legal basis, subsidiarity and proportionality, 3) ex-post evaluation, stakeholder consultation, and impact assessment results, 4) budgetary implications, and 5) other elements to propose the CBAM regulation.

It provides a total summary of the CBAM from the European Green Deal to the proposal of the regulation, including impact assessment. Consequently, the Explanatory Memorandum clearly explains the provision and goal of the proposal.

The CBAM proposal includes 61 recitals, while there are 19 recitals in the resolution of the European Parliament. The recital declares the background, purpose,

and basic principles of the enactment of CBAM in the European Commission's regulation. Thus, particular attention should be paid to the part beginning with 'whereas' in the recital. Klimas and Vaiciukait (2008) illustrate that clear recital can control the ambiguity with articles in the regulation.<sup>82</sup> It precisely examines the background and purpose of introducing CBAM and the basic principles for implementing it in the future. Accordingly, the increased number of recitals explains that there is more consensus made on the CBAM.

The main text of CBAM defines the scope of application and operation of the CBAM. It is composed of 11 chapters and 36 articles. The Explanatory Memorandum pages 11 to 13, provides particular provisions and details of the proposal. As existing issues that reached an agreement are covered with recitals, the articles of the proposal distribute a more specific guideline of the CBAM.

Detailed designs of CBAM presented in the proposal are organised in table 2.

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<sup>82</sup> Klimas, Tadas, and Jurate Vaiciukait. 2008. "The Law Of Recitals In European Community Legislation".

ILSA Journal Of International & Comparative Law 15. <https://ssrn.com/abstract=1159604>.

<b>Chapter I</b> Subject matter, scope and definitions	<b>Chapter VI</b> Enforcement
<b>Chapter II</b> Obligations and rights of authorised declarants of goods	<b>Chapter VII</b> Exercise of delegation and committee procedure
<b>Chapter III</b> Competent authorities	<b>Chapter VIII</b> Reporting and review
<b>Chapter IV</b> CBAM certificates	<b>Chapter IX</b> Coordination with free allocation of allowances under the EU ETS
<b>Chapter V</b> Border administration of goods	<b>Chapter X</b> Transitional provisions
	<b>Chapter XI</b> Final provisions

<Table 2. CBAM Proposal Chapters>

## 4.1 WTO Compatibility

The regulation proposal certainly supports designing CBAM within the framework of WTO rules. This argument follows the effort in the preparation period. The main reason for stressing WTO-compatible CBAM is to implement a fair mechanism that avoids trade diversion. The proposal advanced the importance of CBAM ensuring WTO rules in the Explanatory Memorandum and recital. The European Commission emphasised that CBAM is designed to be fully compatible with WTO rules. In detail, the context of preparing the CBAM proposal explained in the Explanatory Memorandum points out that the EU reached an agreement on establishing WTO-compatible CBAM starting from the Commission’s Communication about Green Deal in 2019.<sup>83</sup>

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<sup>83</sup> European Commission. 2021. "Proposal For A REGULATION", Explanatory Memorandum

Moreover, the proposal included WTO compatibility under ‘subsidiarity for non-exclusive competence’. CBAM is a cross-border dimension policy that addresses climate change that requires global coordination. In this context, it is stated in the proposal that “Due to its environmental nature and to avoid trade diversion, the CBAM should be more efficiently applied at Union level uniformly, mirroring EU ETS and designed in a compatible way with WTO rules.”<sup>84</sup>

In addition, the Proposal Explanatory Memorandum emphasises that all six options considered in the impact assessment were designed to respect WTO rules fully. "Six different options were assessed against this dynamic framework, all of which were designed to take account of WTO requirements and of the EU's international commitments such as free trade agreements concluded by the EU or the Energy Community Treaty."<sup>85</sup>

Except for the Explanatory Memorandum, the proposal Recital 13 determined the issue of WTO compatibility. In Recital 13, CBAM compliance with WTO must be ensured while achieving the European ambition on climate mitigation and preventing carbon leakage. It states that “As an instrument to prevent carbon leakage and reduce GHG emissions, the CBAM should ensure that imported products are subject to a regulatory system that applies carbon costs equivalent to

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<sup>84</sup> Ibid., ‘subsidiarity for non-exclusive competence’

<sup>85</sup> Ibid., p.7

the ones that otherwise would have been borne under the EU ETS. The CBAM is a climate measure which should prevent the risk of carbon leakage and support the Union's increased ambition on climate mitigation while ensuring WTO compatibility."<sup>86</sup>

As a result of analysing contents, the CBAM proposal does not cover WTO compatibility as much as the resolution. The resolution also had a sub-heading that emphasised WTO, but the proposal article did not deal with it. Also, the structure of the resolution included five Articles, while the proposal only has one related Recital to the issue of WTO-compatible CBAM. It is because European legislative institutions share the same view on the issue. Thus, the issue of WTO-compatible CBAM is only included in the part that explains the content based on consensus throughout the preparation process. In this regard, the structure of the proposal suggests that the European Commission still implies that the CBAM is compatible with the WTO.

The EU argues that the CBAM is consistent with the WTO from the preparation period. However, previous studies raised that the proposal did not completely resolve the issue of CBAM violating WTO rules. Lee (2021) argues that various trade risks are still inherent in the European Commission's proposal.<sup>87</sup>

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<sup>86</sup> Ibid., Recital 13

<sup>87</sup> Lee, Cheon Kee. 2022. "EU CBAM: Legal Issues And Implications For Korea".

Significantly, the inconsistency with the WTO rules that have been continuously raised during the CBAM preparation period is still not resolved in the legislation. There is continuing controversy over the violation of GATT Article I and III. It is about the imposition of CBAM on carbon generated in the production process of a product unrelated to the final product. Moreover, the CBAM revenues will be the own resources under the EU budget in the regulation proposal. Thus, it is still challenging to apply GATT Article XX, which covers violations of the other GATT Articles.

In short, the European Union should be aware that there are precedents for trade disputes in environmental measures taken by the EU in the past. The EU must accept the supranational opinion that the EU's CBAM is not yet in line with WTO rules. Furthermore, in the Ordinary Legislative Procedure, the European Parliament and the Council will have to conduct an additional review on this debate.

## **4.2 Revenues**

According to the EU, CBAM revenues incurred from the sale of CBAM certificates will be mostly returned to the EU budget. It is mentioned under Explanatory Memorandum: '4. BUDGETARY IMPLICATIONS' and not covered in the Articles of the proposal.

The structure illustrates that the EU has an agreement on its use as it deals with the topic of revenues only under the Explanatory Memorandum. In comparison, the

resolution of the European Parliament contained four articles treating the issue of revenues. In the end, European institutions clearly agreed on using CBAM revenues as their own resources. These contents are the same argument as the preparation period. Therefore, the proposal still contains the problem of avoiding waiver Article under WTO rules. If this budget continues to include content used for recovery rather than just environmental issues, it will be adversely affected to receive an exception (GATT Article XX) for WTO compatibility.

### **4.3 EU ETS**

According to the proposal, the CBAM will be implemented as an EU ETS extension rather than a carbon tax. During the CBAM preparation period, European institutions conflicted over whether the design should be a tax or a linkage with the EU ETS. The proposal emphasises a strong relationship with the EU ETS as a solution to this conflicting issue. CBAM's link with the EU ETS became more evident through the proposal as it is being addressed throughout the text. In the structure, the proposal illustrates a wide range covering the CBAM design issue related to the EU ETS. Most of the articles in Chapters two to eleven cover new guidelines that the European Commission proposes to implement the CBAM.

Recitals describe the European consensus on the interrelationship and differences in connection with the EU ETS. Furthermore, articles of the proposal present how CBAM should be related to the EU ETS, such as purchasing CBAM

certificates and phasing out free allocations during the transition period. Overall, the proposal suggests solutions to existing conflicts regarding the CBAM design by providing explicit implementation methods.

In-depth, the Explanatory Memorandum in the proposal insists that the ‘gradual reduction’ of free allocations under the EU ETS after the transition period: “to allow producers, importers and traders to adjust to the new regime, the reduction of free allocation should be implemented gradually while the CBAM is phased-in, in order to ensure that they are not cumulative.”<sup>88</sup> Furthermore, Recital 11 reveals that CBAM must ensure a gradual reduction to avoid deviating from WTO compatibility.<sup>89</sup>

Also, proposal Article 1 states that CBAM is a policy to replace the current EU ETS free allocation.<sup>90</sup> In particular, CBAM is a policy applied to goods imported into the EU. So, it differs from the EU ETS, which is used for European products.

Until the introduction of CBAM, the EU managed the issue of carbon leakage with EU ETS free allocations. However, the European Commission emphasises that the gradual imposition of CBAM on imported products will solve

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<sup>88</sup> European Commission. 2021. "Proposal For A REGULATION", Explanatory Memorandum p.3

<sup>89</sup> Ibid., Recital 11

<sup>90</sup> Ibid., Article 1

the carbon leakage problem. Additionally, regarding the CBAM dealing with the risk of carbon leakage, Recital 11 provides a guideline to meet WTO compatibility.<sup>91</sup>

As such, CBAM will be linked to the EU ETS. The European Commission proposes policy option (iv), namely the introduction of a ‘CBAM certificate’ for imported goods with a separate pool of allowances corresponding to the EU ETS. The impact assessment “supports option four as the preferred option for its positive impacts and coherence with the rest of the Fit for 55 Package”.<sup>92</sup> In addition, the proposal states that "The impact assessment concluded that ‘Option 4’ provides clear benefits relative to all other options considered."<sup>93</sup>

The European Commission intends to create a new pool without directly incorporating imported goods into the EU ETS. This choice considers the situation in which EU ETS phase 4 is already in progress from 2021. In sum, the EU is trying to establish a separate pool only applied to imported goods so that imported goods are not directly affected by EU ETS. As a result, importers have to purchase and submit CBAM Certificates.

In particular, Article 21 illustrates that the price of CBAM certificates calculated by the European Commission will be linked to the average closing price

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<sup>91</sup> Ibid., Recital 11

<sup>92</sup> Ibid., Impact Assessment, p.2

<sup>93</sup> Ibid., Explanatory Memorandum p.9

of EU ETS per week.<sup>94</sup> The auction and pricing of CBAM certificates are strongly connected to the EU ETS. However, EU ETS allowances and CBAM certificates are not interchangeable because they are not the same. Furthermore, the European Commission will adjust the level of CBAM imposed by Article 31 of the Proposal by taking the free allocation under the EU ETS into account.<sup>95</sup> The CBAM applied to importers is also reduced once the EU ETS free allocation is maintained. According to the proposal and impact assessment, the EU ETS free allocation will be gradually abolished starting from 2026, and the target is the industrial sector to which CBAM is applied.

Recital 50 in the proposal contains why the European Commission proposed to apply the three years transition period.<sup>96</sup> The European Commission emphasises that it was a decision to facilitate the smooth adoption of CBAM with minimal impact on international trade. During the transitional period, a quarterly report is mandatory as it aims for information collection on actual embedded emissions and carbon prices paid in the country of origin. Moreover, Recital 52 underlines that the European Commission will evaluate this regulation before the last term of the transition period.<sup>97</sup> The evaluation will be about collected information, including other sectors with a high risk of carbon leakage. Also, the European Commission has

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<sup>94</sup> Ibid., Article 21

<sup>95</sup> Ibid., Article 31

<sup>96</sup> Ibid., Recital 50

<sup>97</sup> Ibid., Recital 52

a plan to develop another method so that it can expand applying CBAM to indirect emissions.

Lee et al. (2021) argue that the European Commission's plan to implement CBAM from 2026 instead of 2023 can be seen as reflecting the opinions of the industry in the EU.<sup>98</sup> There exist strong opposition from European industries to phasing out the free allocation under the EU ETS. It is because companies in the EU will have to purchase carbon credits the same way as companies outside the EU once the free allocation is phased out.

#### **4.4 Coverage**

During the CBAM preparation period, a wide range of sectors was considered by European institutions. Among them, the proposal Articles 1 and 2 illustrate that the EU will start the implementation with cement, electricity, fertiliser, steel, and aluminium.<sup>99</sup> 'Annex I' contains the most critical sectors among 63 sectors considered to be at risk of carbon leakage associated with the EU-ETS between 2021

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<sup>98</sup> 이천기, 박지현, 박혜리. 2021. "EU 탄소국경조정 메커니즘에 대한 통상법적 분석 및 우리 산업에의 시사"

<sup>99</sup> European Commission. 2021. "Proposal For A REGULATION", Article 1 and Article 2

and 2030.<sup>100</sup> The criteria and background for the European Commission to compose Annex I are explained in recitals 30 to 36.<sup>101</sup>

Recital 30 deals with industries the EU plans to include in CBAM. It uses the first criterion mentioned in recital 29. Also it determines that the EU reveals its intention to promote " iron and steel, refineries, cement, organic basic chemicals, and fertilisers" as CBAM coverage sectors.<sup>102</sup> However, recital 30 includes sectors not covered by Annex I. As the recital is for the supplementary explanation, Recital 32 to 36 explains the reason for including or excluding planned target sectors to Annex I.

First, Recitals 32 and 33 provide reasons for excluding organic chemicals and refinery products in the CBAM coverage.<sup>103</sup> Due to technical limitations, it is not easy to clearly distinguish the embedded emissions of individual imported goods. Similarly, limitations exist in applying CBAM to organic chemicals and whole refinery output since the indicators used as benchmarks in the EU ETS is not for individual products. Therefore, recitals explain that these two sectors are not yet suitable for CBAM coverage.

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<sup>100</sup> 정훈, 여영준, 조해인. 2021.탄소국경조정 대응 산업지원 정책과제와 정책효과 예측 연구. 국회미래연구원. 연구보고서. 제 35 호 p.43.

<sup>101</sup> European Commission. 2021. "Proposal For A REGULATION", Annex I and Recitals 30 to 36

<sup>102</sup> Ibid., Recital 29

<sup>103</sup> Ibid., Recital 32 and Recital 33

In Recital 36, the European Commission provided additional explanations for the individual items excluded from CBAM: “ferrous scrap (under CN code 7204), ferro-alloys (CN code 7202) and certain fertilisers (under CN code 3105 60 00).”<sup>104</sup> The reason for excluding these products was that the emissions in the production process were not meaningful enough.

On the other hand, Recitals 34 and 35 determine why aluminum products and steel tube fittings are included in the CBAM coverage.<sup>105</sup> The first reason is that these sectors might be used as a substitute for steel products with a high carbon leakage risk. The possibility of circumventing the usage of CBAM-applied products such as steel items exists because the steel sector has been continuously discussed from the preparation period. In particular, concerns about avoiding the cause of carbon leakage are also expressed in Recital 58.<sup>106</sup> For the second reason, the proposal included aluminum under the coverage list because the European Commission could extend the scope of CBAM to include indirect emissions. Overall, the European Commission included direct emissions that are relatively easy to calculate and sectors expected to replace the CBAM coverage list representing a high risk of carbon leakage. It also considers future expansion in the coverage range to indirect emissions.

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<sup>104</sup> Ibid., Recital 36

<sup>105</sup> Ibid., Recital 34 and Recital 35

<sup>106</sup> Ibid., Recital 58

Article 3(16) defines that “‘direct emissions’ mean emissions from the production processes of goods over which the producer has direct control.”<sup>107</sup> It confirms that the proposal does not include indirect emissions in CBAM coverage. However, Articles 32 and 35 in the proposal stated that indirect emissions are subject to reporting obligations during the transition period.<sup>108</sup>

The initial list of eligible sectors is narrow as many of the industries covered by the EU ETS are not included in the proposal.<sup>109</sup> However, European institutions are continuously raising the possibility of expanding the scope. Recital 17 of the proposal examines the reconsideration of the CBAM coverage after the end of a transition period.<sup>110</sup> It is expected to cover indirect emissions, which mirror 'the scope of the EU ETS'. Also, CBAM could be expanded to include glass and chemical products, which the European Parliament requested in the resolution. Responding to this, Article 30 of the proposal points out that the European Commission will review whether to extend the scope of CBAM to more goods and services, including 'indirect emissions'.<sup>111</sup>

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<sup>107</sup> Ibid., Article 3 (16)

<sup>108</sup> Ibid., Article 32 and Article 35

<sup>109</sup> Lee, Cheon Kee. 2022. "EU CBAM: Legal Issues And Implications For Korea".

<sup>110</sup> European Commission. 2021. "Proposal For A REGULATION", Recital 17

<sup>111</sup> Ibid., Article 30

In particular, the European Commission emphasised that it will re-evaluate the implementation performance of CBAM after the transition period. It also includes the possibility of expanding the scope of application.<sup>112</sup> Regarding these European institutions' opinions, Lee (2021) argues that it is highly likely to be applied to industries included in the carbon leakage indicator once institutions consider expanding CBAM.<sup>113</sup> Therefore, it is necessary to pay attention to industries with high carbon leakage that are not yet related to CBAM but are included in the indicator. In detail, the EU ETS Directive Article 10b specifies the carbon leakage indicator.<sup>114</sup> It determines industries with a high risk of carbon leakages, such as leather clothes, basic chemicals, pulp and paper.

## Chapter 5 Conclusion

CBAM has controversial positions on four conflicting issues starting from the preparation period to the proposal period. Although, European institutions have agreed on the CBAM objective based on the contents analysis. Especially. This result

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<sup>112</sup> European Commission. 2021. "Carbon Border Adjustment Mechanism: Questions And Answers". [https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_21\\_3661](https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661). [Accessed 7 July 2022].

<sup>113</sup> Lee, Cheon Kee. 2022. "EU CBAM: Legal Issues And Implications For Korea".

<sup>114</sup> European Commission. 2018. "Commission Notice Preliminary Carbon Leakage List, 2021-2030 (Text With EEA Relevance) (2018/C 162/01)". [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOC\\_2018\\_162\\_R\\_0001&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOC_2018_162_R_0001&from=EN). [Accessed 7 July 2022].

aligns with Schulz and Konig (2000) argument that the relatively shorter legislative period for EU policies shares a common goal. <sup>115</sup>

The WTO compatibility of CBAM shows the highest conflict and complexity in both periods in the creation of CBAM. Measures used in detail are the number of recitals and articles.<sup>116</sup> The European Parliament's resolution contains the largest number of articles on creating WTO-compatible CBAM by applying these tools used in the existing literature to address policy complexity. Notably, it is related to the implementation and other conflicting issues. For instance, the issue of CBAM revenues affects CBAM's compliance with WTO by accepting the waiver of Article XX of GATT. It is still complex, although European institutions share the same opinion about using CBAM revenues as their own resources under the EU budget. The proposal shares the same view with documents from the initial period. Therefore, the complexity of CBAM revenues remains just like the issue of CBAM violating WTO rules.

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<sup>115</sup> Schulz, Heiner, and Thomas Konig. "Institutional Reform and Decision-Making Efficiency in the European Union." *American Journal of Political Science* 44, no. 4 (2000): 653–66. <https://doi.org/10.2307/2669273>.

<sup>116</sup> KAEDING, MICHAEL. 2006. "Determinants Of Transposition Delay In The European Union". *Journal Of Public Policy* 26 (3): 229-253. doi:10.1017/s0143814x06000547. ; Hurka, Steffen, and Maximilian Haag. 2019. "Policy Complexity And Legislative Duration In The European Union". *European Union Politics* 21 (1): 87-108. doi:10.1177/1465116519859431.

The most outstanding feature regarding context and structural complexity in the proposal period is the CBAM design deeply connected with the EU ETS. Chapters in the proposal explain how the European Commission would design the CBAM. It addresses the CBAM certificates and the transition period by phasing free allocations out. The content has been more specified with clear application guidelines of the CBAM design compared to the initial period.

Moreover, the proposal clearly states CBAM coverage under Annex I. Recitals emphasise reasons for including and excluding particular sectors. In the initial period, the range was wide and did not meet a consensus on a specific direction. However, the proposal insists that the EU will apply CBAM to sectors with high carbon leakage risk and easy to calculate direct emissions embedded in the products. Thus, the proposal specified CBAM coverage and its intention so that the European Commission reduced complexity in the proposal period compared to the initial period.

The remaining features that the European Commission offered through the proposal are the CBAM certificate and a transitional period. These are specific implementation plans for the CBAM. It is a more step-by-step implementation plan compared to the previous goal of implementing CBAM in 2023. The transition period set the CBAM procedure differently from the preparation period. In particular, the measure will take effect from 01 January 2023, but a transition period will apply

until 2025. The importer will not need to purchase a CBAM certificate during this period. Only reporting of information on the actual direct and indirect emissions embedded in the product and the carbon price paid abroad is mandatory. From 2026, after the transitional period for compulsory reporting of carbon information embedded in imports, importers will purchase certificates according to the carbon price determined by the EU ETS. CBAM follows a separate Emissions Trading Scheme (ETS) for EU importers. CBAM is not the EU ETS but shows an expanded form. Therefore, countries highly affected by CBAM should follow the decisions of the European institutions on these features during the ordinary legislative procedure.

In conclusion, the proposal introduced solutions to resolve two conflicting issues from the initial period. First, the European Commission agreed with the European Parliament's suggestion of relating CBAM design with the EU ETS. The proposal stresses the strong connection with the EU ETS while having a separate pool. Second, CBAM coverage contained a wide range of sectors in the initial period. Annex I of the proposal clearly states CBAM coverage at the beginning of its implementation. Also, recitals explain why the European Commission chose these sectors under the CBAM. The possibility of expansion in the coverage still exists, but the proposal gave a clear outline of its coverage plan concerning the transition period. However, the European institutions still have to work on resolving the issue of creating WTO-compatible CBAM. It includes the conflicting issue of using CBAM revenues as own-resource.

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## 국문초록

본 연구는 유럽연합이 탄소국경조정제도를 수립하는 과정에서 상충하는 문제 해결 방안을 분석한다. 유럽의회 결의안과 그 이전의 유럽 집행위원회의 법안 발의를 위한 과정의 문서들을 바탕으로 유럽 입법 기관 간의 상충하는 문제점들을 파악한다. 이후 유럽 집행위원회가 발표한 입법 초안에서 대립하는 이슈들에 대한 합의점 도출 방식을 정책 복잡성 이론을 바탕으로 파악한다. 결과적으로 다음과 같은 세 가지의 흥미로운 사실을 확인할 수 있었다. 첫째, 탄소국경조정 제도의 WTO 규범 충돌에 이슈에 관한 대립은 입법 초안에서 합의가 도출되지 않았다. 둘째, 수립과정에서 두 견해로 나뉘었던 탄소국경조정의 설계는 입법 초안을 통해 유럽 배출권 거래제도와 연계하는 방안의 절충안을 도출했다. 셋째, 탄소국경조정제도 적용 범위는 입법 초안에서 일시적인 합의를 이루었지만, 여전히 변동 가능성을 내재하고 있다. 한국과 같은 탄소국경조정제도의 영향을 받는 국가들은 대응 정책을 수립할 때 이러한 결과를 바탕으로 유럽연합 입법과정에서 상충하는 이슈와 해결 여부를 지속해서 관찰할 필요가 있다.

