

# Institutional Innovation Insight

Aug. 31  
2023  
(Vol. 1, No.3)

Highlights and Outlook  
for the EU Carbon Border Adjustment  
Mechanism (CBAM)

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## Highlights and Outlook for the EU Carbon Border Adjustment Mechanism (CBAM)

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### Summary

- The Carbon Border Adjustment Mechanism (“CBAM”) is closely linked to the EU Emissions Trading Scheme. Starting in 2026, importers of six products—steel, aluminum, electricity, fertilizer, cement, and hydrogen—will be obligated to purchase and submit CBAM Certificates, calculated based on the product’s embedded emissions, from competent authorities.
- As the EU is one of Korea’s top 10 export countries, the government needs to identify key issues related to the CBAM to strengthen domestic exporters’ ability to respond to the CBAM and establish industrial and export strategies suitable for the carbon neutral era.
- In Korea, relevant ministries are requesting improvements to CBAM legislation through bilateral and multilateral channels and are seeking joint public-private responses by strengthening communication with the industry. However, there is an urgent need to provide government support for the development of reduction technologies and investment in equipment for items and industries primarily affected by the introduction of the CBAM and to develop domestic standards for calculating carbon emissions considering the characteristics of domestic products and train relevant human resources.

★ **Keywords:** Carbon Border Adjustment Mechanism (CBAM). EU Emissions Trading System (ETS), Environmental Regulation, Industrial Policy, Trade

## 1 Background

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### » Progress and Plan of Introducing the CBAM

- ◆ Since the announcement of the Green Deal, the EU has raised its targets to carbon neutrality by 2050 and a 55% reduction compared to 1990 by 2030, with the expansion of the EU Emissions Trading Scheme (EU-ETS) and the introduction of the CBAM as part of the plan to achieve this.
  - The European Commission (the “Commission”) has published the Fit for 55 Package draft to meet the interim targets of the European Climate Law, which took effect in June 2021,<sup>1)</sup> and the CBAM draft is included in this package.
  - In June 2021, a draft proposal for a regulation establishing a CBAM was partially released, and the Commission published the draft on July 14 of the same year.
- ◆ On February 9, 2023, the legislative bill agreed upon between the EU Parliament’s Committee on Environment and the EU legislative bodies was passed; on April 18, it passed the Parliament’s plenary session; and on April 25, five bills related to the Fit for 55 Package, including CBAM, passed the Council.
  - The above legislative bill is subject to the ordinary legislative procedure of jointly adopting the draft submitted by the Parliament and the Council and is finalized through mutual review and amendment or trilogues.
  - The Parliament’s bill made in June 2022 was more radical than the Commission’s proposal, including expanding the scope of CBAM, covering indirect emissions as well as direct emissions, and establishing a centralized enforcement body at the EU level.
  - The Council, Parliament, and Commission provisionally agreed on the CBAM legislative bill on December 13, 2022, and agreed on the amendments to the EU-ETS Directive and the CBAM legislative bill on December 18, 2022.
  - Following the EU Council’s final approval of the CBAM legislative bill in April 2023, it officially took effect in May. On June 13, the draft implementing legislation for the implementation of reporting obligations during the transition period was published, with stakeholder feedback sought until July 11.

## 2 CBAM Highlights

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### » Covered Industries and Items

- ◆ Six item groups are covered: steel, aluminum, electricity, fertilizer, cement, and hydrogen, including certain raw materials and materials (precursors), such as iron ore, and some steel downstream products.

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1) For more information on the Fit for 55 Package, see Han, M., Choi, G., Kim, M., 2021, The European Union's Legislative Package for a Decarbonized Society 2021 (Fit for 55 Package), GTC BRIEF Vol.2 No.4, Green Technology Center

- Previously, the Commission and Council had proposed five items, excluding hydrogen, and the Parliament had adopted the Commissions's proposal to include hydrogen, organic basic chemicals,<sup>2)</sup> plastics, and ammonia.
- The EU will decide whether to add additional covered items during the transition period from October 1, 2023, to December 31, 2025\*, with plans to extend coverage to the full range of EU-ETS by 2030.

\* Companies must report carbon emissions information during the transition period and will be required to purchase certificates beginning January 1, 2026.

- ♦ The finally approved legislative bill includes raw materials and materials such as iron ore, ferromanganese, and chromium iron, as well as downstream products such as screws, bolts, and nuts, expanding industries and items\* covered compared to the Commission's proposal.

\* Detailed items and corresponding greenhouse gases (GHGs) are specified in Annex I based on the EU Combined Nomenclature

## » Emissions Calculation Scope

- ♦ The scope of GHG emissions covered by the CBAM is direct and indirect emissions, including carbon dioxide, nitrous oxide (N<sub>2</sub>O), and perfluorocarbons (PFCs).
- GHG emission areas are categorized into direct emissions (Scope1), indirect emissions (Scope2), and other indirect emissions (Scope3) depending on the type and scope of emissions.

**Table 1** Classification of GHG Emission Sources and the CBAM Coverage

Area	Definition	CBAM Coverage
Direct emissions (Scope 1)	GHG emissions generated within the boundaries owned and controlled by a company	Fall under the coverage (Only direct emissions are calculated for steel, aluminum, and hydrogen; indirect emissions are specified in the implementing legislation)
Indirect emissions (Scope 2)	GHG emissions from electricity and steam purchased by the company or otherwise brought into the boundary via another route and consumed	
Other indirect emissions (Scope 3)	GHG emissions from facilities that are the result of a company's activities but are not owned or controlled by the company	Not applicable

Data: Rewritten by the authors using the World Resources Institute (WRI) & World Business Council for Sustainable Development (WBCSD), GHG Protocol (2004)

- In accordance with Annex II, steel, aluminum, and hydrogen are subject to the calculation of direct emissions associated with each product but also include indirect emissions\* embedded in the product in accordance with Article 7.4 and Annex IV 4.3.

\* Annex IV 4.6 provides the basis for determining emissions, but the methodology for calculating indirect emissions will be concretized during the transition period.

2) Ethylene, propylene, C4 oils, benzene, toluene, xylene, methane, etc.

- All covered items include carbon dioxide as a target GHG, with the addition of nitrous oxide for fertilizers and perfluorocarbons for aluminum.
- ◆ During the transition period, companies must report the amount of carbon emitted in the production of their products, known as embedded emissions, and purchase and submit certificates corresponding to embedded emissions after implementation.
  - The calculation method distinguishes between simple products\*, which are produced in only one facility and do not include emissions from the production of inputs and fuels, and complex products that are not simple, expressed as CO<sub>2</sub>e emissions per ton of product.
    - \* Attributed emissions resulting from the production of products within the organizational boundaries of the production facility
  - By default, embedded emissions are calculated based on the actual emissions generated from the production of the product, but the calculation of the actual emissions is difficult or there is no reliable average emissions, the default value\* is referred to for calculation.
    - \* The default value is calculated based on the average emissions of the lowest-level business site in the EU for the relevant product type

#### » Countries Covered by the CBAM

- ◆ The CBAM is applied to all foreign nations that export the covered items to the EU and is not applied to nations and regions that already participate in the EU-ETS or operate a linked ETS.
  - Annex III specifies that items are not covered if their origin is in Iceland, Liechtenstein, Norway, Switzerland, or a part of the EU.<sup>3)</sup>

#### » CBAM Reporting and Validation Methods

**Table 2 CBAM Report Stakeholders and Tasks to Perform**

Stakeholders	Tasks to Perform
Declarant	<ul style="list-style-type: none"> <li>- Submit and report CBAM Certificates by May 31 of each year, excluding the total quantity of each type of commodity imported in the year preceding the declaration, the embedded emissions, the carbon price already paid in the country of origin, and the scope of the EU-ETS allocation</li> <li>- Each declarant* must have its CBAM declaration verified by an accredited verifier** in accordance with Section 2.6 of the legislative bill</li> </ul>
National Authority	<ul style="list-style-type: none"> <li>- The national authority must create an electronic form of the national register for the declarant and include the declarant's name, contact information, EORI number, CBAM account number, CBAM Certificate number, sale price, date of purchase, date of surrender, date of repurchase, or date of certificate canceled by the national authority</li> </ul>

\* Refers to a person submitting a customs declaration for distribution in his own name or an entity submitting such a declaration in accordance with EU Regulation No 952/2013.

\*\* Any accredited verifier falling within the scope of Implementing Regulation (EU) No 2018/2067 may be considered as an accredited verifier as defined in the legislative bill, and the national authority may additionally accredit persons with relevant qualifications as verifiers

Data: Rewritten by the authors using the European Commission (2021)

3) Büsingen, Helgoland, Germany; Livigno, Italy; Ceuta, Melilla, Spain

**Table 3 CBAM Validation Stakeholders and Tasks to Perform**

Stakeholders	Tasks to Perform
National Authority	<ul style="list-style-type: none"> <li>- A national authority can verify the declaration within four years of submission</li> <li>- If the CBAM report is not submitted by the declarant, the national authority should calculate the amount and verify it by December 31 of the fourth year after the year of submission and notify the declarant of the result</li> <li>- A national authority must notify the declarant of the verification results and take follow-up action (request additional submissions in case of certificate shortfall, return the difference in case of certificate overage)</li> </ul>

Data: Rewritten by the authors using the European Commission (2021)

### » Linkage with the EU Emissions Trading System (EU-ETS)

- ◆ The CBAM is closely linked to the EU-ETS as it is being introduced for the global scalability of the EU ETS and the global spread of carbon neutrality.
  - Once the CBAM is implemented, importers of covered products will be obligated to purchase and submit CBAM Certificates, calculated based on the embedded emissions of the product, from competent authorities.
  - The price of CBAM Certificates utilizes the weekly closing price of the EU-ETS auction, in accordance with Article 21 of the Commission's legislative bill.
  - Article 31 of the proposed legislative bill requires the EU to adjust CBAM Certificate submissions by subtracting the amount of free allocation received by onshore companies.
    - This is to maintain equity between local and imported products.
    - Therefore, during the period of 2026 through 2033, when the free allocation is being phased out, CBAM Certificate submissions equal to the amount of free allocation are waived.

### [Reference] The EU's Emissions Free Allocation and Phase-out

- ◆ EU allocates a certain level of emission for free to protect major industries in the region.
- ◆ However, according to the legislative bill agreed in December 2022, it was decided to phase out the free allocation by 2033 after a transition period until 2025 for six items: steel, aluminum, cement, fertilizer, electricity, and hydrogen (a decision will be made on whether to add the free allocation for plastics and organic chemicals during the transition period).
- ◆ During the transition period, there is only an obligation to report emissions, but after the CBAM is implemented, there will be an obligation to purchase CBAM Certificates, and the scope of emissions will be expanded to include indirect emissions under certain conditions (yet to be announced).

**Table 4 The EU's '26-'33 Phase-out Rates for Free Allocation**

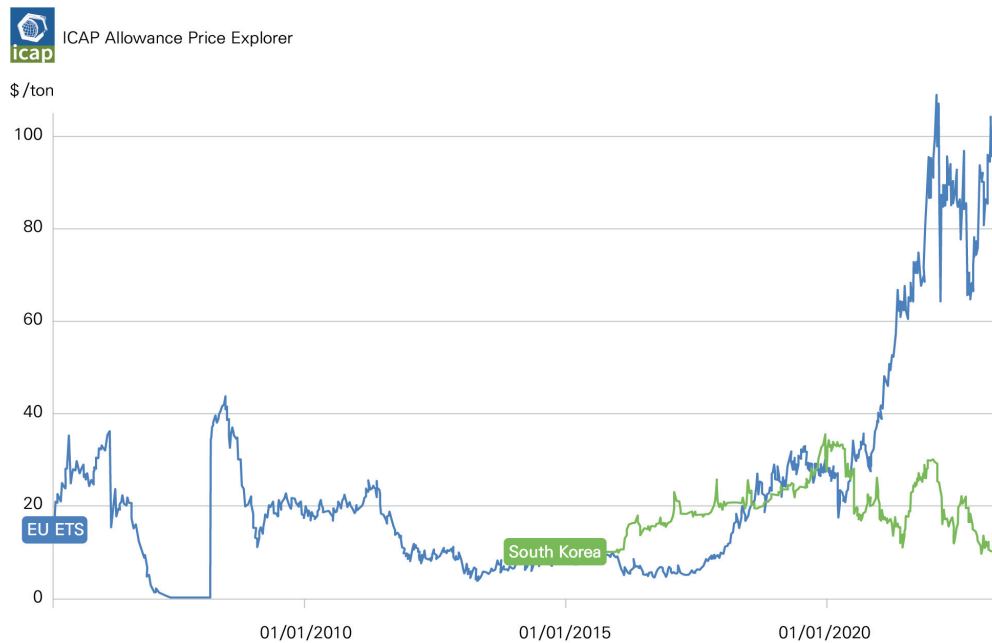
Year	'26	'27	'28	'29	'30	'31	'32	'33	'34
Abolition of free allocation [%]	2.5	5	10	22.5	48.5	61	73.5	86	100

Data: Kim, D.(2023)

- In addition, Article 9 of the Commission's legislative bill exempts CBAM Certificate submissions for the carbon price paid by the country of origin for the product.

- Only explicit carbon prices, such as carbon taxes and the ETS, are subject to exemption.
- Exemptions for paid allocations and paid purchases are available for nations that operate an ETS, such as Korea.
- However, based on the March 2023 price, there is a large difference in the price of carbon emissions: \$10.65/ton for K-ETS and \$95.54/ton for EU-ETS.

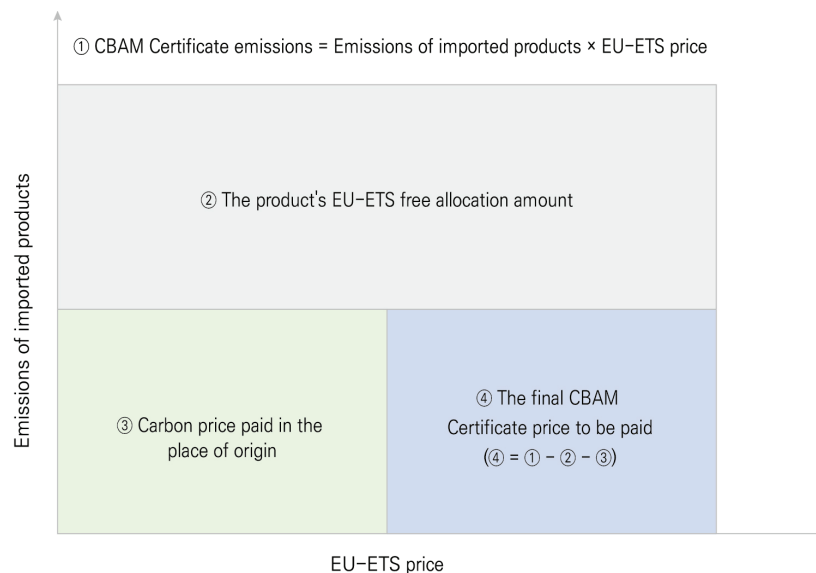
**Figure 1 Trends in ETS prices in the EU and South Korea (\$/ton, March 2005 to March 2023))**



Data: International Carbon Action Partnership (ICAP)

- ♦ Ultimately, the amount of CBAM Certificates that must be submitted is as shown in [Fig. 2] below.

**Figure 2 Amount of Carbon Border Adjustment Mechanism Certificates to be Submitted**



Data: Rewritten by the authors using Park, N. (2023)



## » Sanctions

- ◆ Fines of €100 per certificate are charged if a licensed importer fails to submit a CBAM Certificate on time, and three to five times that amount if an unlicensed importer imports a controlled product.
  - Paying a fine does not relieve the obligation to submit CBAM emissions.
- ◆ The EU Commission will implement enhanced monitoring measures to prevent circumvention of the CBAM, including artificial shipment splitting to apply minimum standards and minor product variations to apply HS code\* changes.
  - \* A commodity classification number established by the World Customs Organization to unify the item classification system to facilitate international trade and maintain consistency in the application of tariff rates.<sup>4)</sup>
  - In the event of a complaint of circumvention in the region, the Commission will conduct a nine-month investigation.

## 3 Korea's Response and Challenges

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### » Impact on the Korean Industry

- ◆ Steel and aluminum exports\* are expected to be impacted the most among export industries to the EU, but there are concerns about increased administrative burdens across all industries.
  - \* Exports to the EU are \$4.4 billion for steel and \$5.5 billion for aluminum industries.
- ◆ (Steel) The steel industry is a carbon-intensive industry with large exports to the EU and a high proportion of blast furnaces, so there is a concern that the application of CBAM will reduce the competitiveness of the industry.
  - In '22, the EU's steel imports came from Turkey (15.0%), South Korea (10.3%), India (9.3%), and China (8.7%), with South Korea accounting for a large share.
  - The proportion of blast furnaces in the domestic steel industry is 68%, which is 9% higher than the proportion of blast furnaces in the EU (59%).
    - \* Proportion of blast furnaces in major EU steel exporting countries: China (90%), Japan (76%), Russia (71%)
- ◆ (Aluminum) Carbon emissions from the input material (ingot) production process for aluminum production are high.
  - Most of the carbon emitted in the entire aluminum production process comes from the ingot production process, and Korean companies mostly import ingots from Malaysia, Australia, etc.
  - There are concerns over declined industrial competitiveness if it is determined that emissions from the production of inputs are included in the embedded emissions of products in the implementing legislation to be finalized later.

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4) Integrated Trade Information Service, <http://www.tradenavi.or.kr/CmsWeb/viewPage.req?idx=PG0000000853> (accessed on 2023.04.28.)

- ◆ (Administrative Burden) There are concerns about the administrative burden of calculating emissions and preparing documents for the obligation to report carbon emissions information across applicable industries.
  - Institutional differences exist between the Korean carbon ETS (business-site level) and CBAM (product level), and the lack of experience in MRV\* for small and medium-sized enterprises and enterprises of middle standing adds to the administrative burden.
    - \* Carbon emissions measurement, reporting, verification system
  - There are concerns about leaking company information as the carbon emissions information is reported to the importers instead of the Commission.

## » Korean Response

- ◆ Called for improved CBAM legislative bill through bilateral and multilateral channels.
  - (Ministry of Trade, Industry and Energy) Conducted consultations with key figures related to the CBAM, such as the top official of the EU Commission's Directorate General for Taxation, Climate, and Trade, and the Vice Chairman of the European Parliament's Committee on Environment, through the Trade Minister ('22.12).
  - A non-paper was submitted to the Committee, requesting that when introducing the CBAM, the system should be designed to comply with the World Trade Organization (WTO) and that sufficient consideration be given to Korea's ETS ('21.11).
  - Continued to express Korea's stance at WTO regular meetings, including the Committee on Market Access, the Council for Trade in Goods, and the Trade and Environmental Sustainability Structured Discussions (TESSD).
- ◆ Strengthened industry communication to explore joint public-private response measures.
  - (Ministry of Trade, Industry and Energy) Established Carbon Trade Advisory Group ('22.01), CBAM Steel Council ('21.07), and held a meeting with industry chaired by the head of the headquarters ('22.11).
  - (Ministry of Environment) Held a meeting for companies responding to the CBAM chaired by the Minister of Environment ('22.01) and established a dedicated response team to support Korean companies responding to CBAM\* ('23.01).
    - \* The head of the team is the head of the Climate Carbon Policy Office of the Ministry of Environment, and the members are experts from the National Institute of Environmental Science, the Greenhouse Gas Inventory and Research Center, the Korea Environment Corporation, the Korea Environmental Industry and Technology Institute, and other experts of the Ministry of Environment and affiliated organizations.
- ◆ Established a system to support information provision and capacity building for Korean companies to respond smoothly after the CBAM takes effect.
  - (Ministry of Trade, Industry and Energy) Held a Korea-EU infosession ('21.11), held a seminar on the status and challenges of carbon trade barriers ('22.04), and held a seminar

on countermeasures against the CBAM ('22.12).

- (Ministry of Trade, Industry and Energy & Korea Institute of Industrial Technology) Held a seminar on carbon trade regulation and a briefing on the introduction of the verification agency accreditation system ('23.02).
- (Ministry of Environment & National Institute of Environmental Research) Established and operated five specialized training programs for environmental information verification auditors and certified assessors, including verification theory and practice for each environmental information field ('23.04).
- (Ministry of Strategy and Finance) Supported capacity building for the steel industry with a large export volume to the EU, the aluminum industry with high input carbon emissions, and small and medium-sized exporters with weak response capabilities ('22.12).
- (Ministry of SMEs and Startups) Launched the "SME Carbon Neutrality Transition Support Project" to support implementation design support (consulting, process analysis, market research) and introduction of carbon reduction equipment for SMEs not subject to the domestic ETS or target management system ('23.02).
- ◆ Supported carbon emissions MRV schemes
  - (Korea Research Institute of Standards and Science) Signed an international mutual recognition agreement with international organizations related to GHG emissions verification to establish a foundation for MRV verification and recognition operation system ('22.01) and introduced an internationally accredited verification agency recognition system for product carbon emissions ('23.01).
- ◆ Responded to CBAM through cross-agency collaboration
  - (Prime Minister's Secretariat) Held 'CBAM Response Status Review Meeting' for all ministries ('22.12).
  - (Ministry of Trade, Industry and Energy, Ministry of Strategy and Finance, Ministry of Environment, Ministry of Foreign Affairs) Established the EU Trade Issues Task Force and held an inaugural meeting ('23.02)
  - (Ministry of Trade, Industry and Energy, 2050 Carbon Neutrality and Green Growth Commission, Ministry of Strategy and Finance, Ministry of Environment, Ministry of Foreign Affairs, and Ministry of SMEs and Startups) Established a cross-ministry TF for CBAM response and held an inaugural meeting ('23.02).

## » Key Implications

- ◆ There should be governmental support for the development and application of mitigation technologies, equipment investment, emissions measurement, related data management, etc. for items and industries firstly affected by the introduction of the CBAM.
- Measures to reduce emissions in the production process are needed, such as increasing the proportion of electric furnaces in the steel industry, which is expected to be mainly

affected, and introducing high-efficiency and green aluminum production technologies in the aluminum industry, such as hydrogen reduction steel technology.\*

\* A green process that removes oxygen from iron ore using hydrogen instead of coke, emitting water instead of CO<sub>2</sub>.

- Korea has a high proportion of fossil fuel-based electricity production and a high proportion of energy-intensive industries, so reducing indirect emissions requires the expansion of renewable energy-based electricity production and support for RE100, etc.
- How emissions will be calculated will be specified in the implementing legislation, but policy support for emissions calculations is needed as companies may be subject to unfavorable standards if actual emissions are difficult to calculate or if reliable national statistics are not available.
- Organic chemicals and plastics are typical carbon leakage risk industries, so R&D support and corporate investment incentives are needed to prepare for their inclusion in the covered items after the transition period.
- In order to minimize damage to Korean industries and secure competitiveness, it is necessary to proactively analyze the impact of CBAM introduction and establish consistency between international and Korean regulations due to the CBAM.
- ◆ Ongoing bilateral and multilateral negotiations are needed to ensure that the Korean government and industry are fully represented.
  - In particular, the detailed guidelines for the calculation of embedded emissions have not yet been determined and will be determined in the CBAM Enforcement Decree, so active input from the Korean government and industry is required.
  - Negotiations are needed to ensure that the characteristics of Korean industries and products and the Korean ETS are fully recognized in the calculation of CBAM Certificate submissions and that additional reductions are granted in the event of higher prices than in the EU.
  - In addition, the Korean entities should participate in the EU's emissions calculation results verification body, and it must be consulted to ensure that internal company information is not disclosed when reporting emissions.
- ◆ The Korean ETS needs to be reformed to respond to the CBAM in terms of fiscal revenues.
  - Since Korea has an ETS, the relevant amount of cost can be deducted from the CBAM submission, but in the end, the carbon cost itself cannot be waived.
  - It is more profitable for the Korean government to have the carbon paid to Korea than to have it paid in the form of tariffs to the EU.
  - Therefore, steel, aluminum, cement, fertilizer, etc., that are currently classified as free allocation industries need to be considered for transition to paid allocation in consideration of their export volume to the EU.
- ◆ There is a need to foster Korean industry-university-institute experts and human resources, including systems, technologies, and verification, to strengthen CBAM response capabilities.

- There is a need to support R&D investment in climate technologies\* to reduce emissions from industries and products from the medium to long-term perspective.
  - \* Hydrogen reduction steel technology to reduce steel industry emissions, carbon capture technology for applications in industries where emissions are unavoidable, and next-generation solar cell technologies such as perovskite for energy transition.
- To ease the administrative burden on relatively inexperienced small and medium-sized exporters and exporters of middle standing and to strengthen their capacity to respond to the CBAM, it is necessary to foster experts through continuous support, such as providing information on current issues and training on verification standards and procedures.

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※ The opinions expressed in this brief are those of the author and do not necessarily represent the official views of the Institute.

※ This article summarizes and organizes part of the content being analyzed for the National Institute of Green Technology's (NIGT) major project, "A Study on Regulation Improvement and Innovation Ecosystem Revitalization to Realize Carbon-Neutral Green Growth."

## ✓ Publication List of Institutional Innovation Insight

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TEL : 02-3393-3900 FAX : 02-3393-3919



Printed on eco-friendly paper.



9 772983 352001  
ISSN 2983-3523