BIJMT : Brilliant International Journal Of Management And Tourism

E-ISSN: 2827-8380
P-ISSN: 2810-076X

Research Articles

Implications of Carbon Tax Implementation on Financial Accounting of Industrial Companies in Developing Countries

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Abstract: This study explores the implications of carbon tax implementation on the financial accounting practices of industrial companies in developing countries. Amid growing pressure to internalize environmental costs, firms face significant challenges in adapting their accounting systems to accommodate carbon liabilities, particularly in contexts with weak regulatory infrastructure. The objective of this research is to examine how carbon tax policies affect financial disclosures, cost structures, and reporting behaviors, while assessing the mediating role of sustainability reporting and the moderating effect of regulatory quality. A qualitative case study approach was employed, drawing on semi structured interviews with finance professionals and regulatory officers, complemented by document analysis of financial statements and sustainability reports. Thematic analysis revealed three core findings: (1) carbon taxes compel firms to record environmental obligations as liabilities and operational costs; (2) companies with established sustainability reporting systems demonstrate greater adaptability in integrating carbon data into financial records; and (3) strong regulatory environments enhance policy compliance and accounting transparency. These results support an integrated framework linking fiscal environmental policy, institutional quality, and financial accounting adaptation. The study concludes that the effectiveness of carbon taxation in transforming accounting practices is highly contingent on corporate reporting capacity and governance conditions. Policy recommendations emphasize the need for synchronized development of carbon tax regulations, institutional support, and adoption of international reporting standards to foster accurate and consistent environmental disclosures across the industrial sector.

Keywords: Accounting Adaptation; Carbon Tax; Developing Countries; Environmental Accounting; Financial Disclosure

Received: May, 30 2025
Revised: June, 14 2025
Accepted: June, 28 2025
Published: June, 30 2025
Curr. Ver.: June, 30 2025

1. Introduction

The evolution of financial accounting practices within industrial firms in developing countries is increasingly influenced by environmental and fiscal regulations, particularly the introduction of carbon taxation. Financial accounting is no longer confined to recording traditional financial transactions; it is progressively required to incorporate environmental liabilities, particularly carbon emissions, into formal reporting structures [1]. The application of carbon pricing mechanisms, such as carbon taxes, compels companies to reassess their cost structures, recognize carbon liabilities, and improve disclosure to stakeholders and regulators [2]. For industrial firms operating in developing economies, these changes pose significant challenges due to limited institutional capacity, underdeveloped reporting infrastructure, and inconsistent regulatory enforcement [3]. Consequently, understanding the implications of carbon tax on financial accounting becomes critical in assessing corporate readiness and the efficacy of environmental fiscal policy in these nations.

Prior research has predominantly focused on the macroeconomic effects of carbon taxation, such as its impact on national energy consumption and economic output, with limited attention to its direct influence on corporate accounting systems [4], [5]. Studies addressing carbon accounting practices have primarily concentrated on voluntary carbon disclosures or sustainability reporting, often detached from the fiscal policies driving such disclosures [6]. Moreover, prior methodologies typically do not consider the interaction between institutional governance and accounting outcomes in a carbon regulated environment. These gaps underline the necessity for a more integrated framework that connects carbon tax policy to financial accounting outcomes, particularly within the industrial sector of developing nations where regulatory environments are often volatile and under resourced [7].

The implementation of carbon tax serves as the independent variable in this study, representing an environmental fiscal instrument designed to internalize the negative externalities of greenhouse gas emissions. Carbon taxes create economic incentives for emission reductions by increasing the cost of carbon intensive production activities [8]. For industrial firms, this manifests in increased production costs, reallocated investment priorities, and adjustments to financial statements to reflect environmental liabilities [9]. However, in developing countries, carbon tax enforcement is often uneven due to administrative limitations, corruption, and lack of standardized measurement tools, which may dilute the intended impact on accounting practices [10]. Therefore, this study focuses on how carbon tax policies affect financial accounting structures, disclosures, and reporting behaviors at the firm level.

Nevertheless, the relationship between carbon tax policy and financial accounting is rarely linear. Many companies mediate their response through sustainability reporting mechanisms, which serve as structured frameworks for communicating environmental impacts and regulatory compliance [11]. As sustainability reporting has evolved from a voluntary practice to a semi regulatory expectation especially under the influence of international standards like GRI, SASB, and IFRS S1/S2 it becomes a pivotal mediating variable in this study [12]. Firms that have robust sustainability reporting systems are generally better positioned to integrate carbon related data into their financial records and meet regulatory expectations [13]. Thus, sustainability reporting is hypothesized to mediate the relationship between carbon tax enforcement and changes in financial accounting practices.

Moreover, the regulatory quality in developing countries acts as a crucial moderating factor. Regulatory quality encompasses the government's ability to formulate and enforce sound environmental and fiscal policies, which directly influences the implementation and effectiveness of carbon taxation [14]. Countries with high regulatory quality ensure better compliance, higher data reliability, and stronger institutional pressure for accurate financial reporting of environmental liabilities [15]. Conversely, weak regulatory environments allow for regulatory arbitrage, incomplete disclosures, or even financial misrepresentation regarding carbon costs [16]. Accordingly, this study considers regulatory quality as a moderating variable that potentially alters the strength and direction of the relationship between carbon tax and financial accounting practices.

Based on the above discussions, the objective of this study is to examine the impact of carbon tax implementation on the financial accounting practices of industrial firms in developing countries, with sustainability reporting as a mediating variable and regulatory quality as a moderating variable. The theoretical contribution of this study lies in integrating environmental fiscal policy into the domain of financial accounting, offering a more comprehensive framework for environmental accounting convergence. Empirically, the study is expected to provide actionable insights for policymakers, especially in developing countries, to design carbon tax systems that align with corporate reporting capacities and promote financial transparency in environmental matters.

While carbon taxation has received substantial attention in macroeconomic research, particularly in its effects on national energy consumption and economic output [1], [2], limited empirical work has investigated its implications for financial accounting practices at the firm level. Studies such as those by Gupta and Shaw [3], Umwama [4], and Hernández et al. [5] focus largely on voluntary sustainability disclosures, often omitting direct connections to fiscal environmental policies. Moreover, most findings stem from developed nations, overlooking the institutional challenges typical of developing economies, such as weak regulatory frameworks, limited administrative capacity, and underdeveloped reporting infrastructure [6], [7], [8]. Even though Nguyen et al. [9] and Oko and Mbeki [10] highlight the importance of regulatory mechanisms in shaping environmental reporting, they stop short of addressing how carbon taxes specifically influence formal financial statements. As a result, there remains a significant research gap in understanding how carbon tax obligations are recognized and reported in financial statements under institutional volatility, particularly in industrial firms in emerging economies.

Furthermore, the existing literature often neglects to examine mediating and moderating variables that could influence the relationship between carbon taxation and financial accounting practices. For instance, sustainability reporting is usually treated as an outcome variable rather than a mediator that could bridge policy implementation and financial disclosure [3], [5], [11]. Likewise, the role of regulatory quality as a moderating factor despite its acknowledged influence on compliance behavior remains underexplored in the context of environmental fiscal enforcement [6], [12], [13]. Only limited studies, such as Howell and Zhang [14], investigate the institutional impact on environmental disclosure quality, and their insights are mostly confined to high regulation contexts. Therefore, this study is novel in developing an integrated model that positions carbon taxation as the independent variable, sustainability reporting as a mediator, and regulatory quality as a moderator. This framework provides both theoretical and empirical contributions by linking fiscal environmental policy with financial accounting structures in developing countries, offering a comprehensive perspective that aligns regulatory design with corporate reporting capacity.

2. Literature Review

This literature review explores the implications of carbon tax implementation on the financial accounting practices of industrial companies in developing countries. It discusses key theoretical frameworks, such as environmental accounting and fiscal governance, while analyzing empirical findings from both developed and emerging economies. The review highlights the institutional challenges faced by firms in adopting carbon related financial reporting, and the mediating role of sustainability disclosure practices. It also examines how regulatory quality moderates the relationship between carbon tax policies and accounting adaptations, setting the foundation for an integrated model contextualized to developing country conditions.

2.1. Theoretical Foundations of Carbon Tax and Environmental Accounting

Carbon taxation is grounded in Pigouvian theory, which advocates for internalizing environmental externalities through fiscal mechanisms. This has proven effective in countries like Sweden and British Columbia, where carbon tax led to significant emissions reduction with minimal economic disruption [1], [2]. Scholars have increasingly called for aligning accounting standards with environmental policy, proposing frameworks to integrate carbon liabilities directly into financial statements. Ramanna and Kaplan introduced the E-liability model, treating emissions as auditable financial entries within a firm's supply chain [3].

Despite this, such theoretical models remain under validated in emerging economies. Many developing countries lack the institutional infrastructure needed to support accurate emissions tracking and reporting. While these conceptual frameworks are compelling, especially from a cost accounting perspective, they have yet to demonstrate practical feasibility or adoption in contexts characterized by weak regulatory systems and limited administrative capacity [4], [5].

2.2 Carbon Accounting Models and Financial Integration

Recent advancements in carbon accounting propose integrating emissions data into existing financial systems. The E-liability model, piloted by firms like Hitachi Energy, demonstrates how emissions tracing can reshape sourcing and production decisions [3]. These models rely on auditable, double entry systems to ensure integrity and comparability across firms and sectors. However, the empirical application of these models is currently limited to developed economies with robust regulatory ecosystems [6].

In addition, innovations such as AI based knowledge graphs are emerging to support carbon traceability across complex supply chains [7]. However, there is a lack of literature addressing the implementation of these advanced tools in industrial firms within developing countries. Issues such as data scarcity, audit reliability, and reporting capabilities are seldom addressed in current empirical studies, highlighting a gap between theoretical development and practical application in resource limited settings [8].

2.3 Empirical Evidence from Developing Economies

Studies focusing on carbon disclosure in developing countries reveal a trend of voluntary, rather than mandatory, sustainability reporting. For example, research in Nigeria shows that firm characteristics such as size and auditor type influence disclosure behavior, but do not link directly to carbon tax pressures [9]. Other studies in Southeast Asia indicate increasing GRI adoption, but disclosures often lack standardization and audit credibility [10]. Moreover, broader institutional studies suggest weak governance impairs environmental compliance and data transparency [11], [12]. Yet, few studies examine how environmental fiscal policies like carbon tax affect formal financial accounting. Most developing country research centers on energy consumption or sectoral modeling rather than corporate accounting structures, leaving a significant empirical gap [13].

2.4 Sustainability Reporting as Mediator

Sustainability reporting frameworks such as GRI, SASB, and the new ISSB standards have significantly influenced corporate ESG practices globally [14], [15]. These standards aim to provide structure and comparability to environmental disclosures. While the literature supports their impact on transparency, little is known about their role as mediating mechanisms in translating policy pressures such as carbon taxes into financial reporting changes. Most empirical work considers sustainability reporting as an outcome rather than a pathway connecting fiscal regulation to accounting practices [16]. The mediating effect of structured reporting remains a theoretical possibility that has not been tested under carbon taxation mandates, particularly in developing contexts where fiscal enforcement and ESG maturity vary widely [17].

2.5 Regulatory Quality as Moderating Factor

Regulatory quality is known to influence the effectiveness of policy implementation, including environmental disclosure. In countries with high regulatory enforcement, such as those under the European CSRD, firms are more likely to adopt rigorous sustainability standards [18]. Conversely, nations with poor institutional performance exhibit weaker compliance and higher risks of greenwashing [19]. Although regulatory quality is widely studied in macro policy literature, its moderating role in firm level carbon accounting remains underexplored in developing countries. Howell and Zhang found that stronger regulatory systems improved reporting accuracy in Europe [20], but similar evidence is absent for countries with less mature environmental governance. This presents a critical research gap with practical implications for environmental policy design and compliance assurance.

3. Method

This study adopts a qualitative case study approach to explore the implications of carbon tax implementation on financial accounting practices within industrial firms operating in developing countries. The qualitative method is selected for its strength in providing deep contextual understanding of complex social phenomena in real life settings [1]. The object of this research includes industrial firms subject to carbon taxation policies, focusing specifically on how these policies affect financial disclosure, liability recognition, and sustainability integration within accounting systems.

Data collection was conducted using semi structured interviews with key informants including financial managers, internal auditors, and environmental policy officials. In addition to interviews, the study also gathered secondary data from financial statements, sustainability reports, and relevant regulatory documents. Informants were selected using purposive sampling to ensure relevance and depth of insight [2]. To ensure the credibility of the data, triangulation across sources and methods was applied, and member checking was conducted to validate interpretation accuracy [3].

Thematic analysis was employed to process the qualitative data. This involved transcription, open coding, theme identification, and interpretation based on the theoretical framework outlined in the literature review. A conceptual flow diagram was developed to illustrate the interactions between the independent variable (carbon tax policy), mediating variable (sustainability reporting), and moderating variable (regulatory quality) in shaping financial accounting changes. This approach aligns with recent methodologies in accounting and environmental governance research, which emphasize multi variable interaction in policy compliance behavior [4].

3.1. Research Design

This study employs a qualitative case study design to investigate how carbon tax implementation affects financial accounting practices within industrial firms in developing countries. The case study method is chosen due to its strength in exploring contemporary phenomena within real world contexts where the boundaries between the phenomenon and context are blurred [1]. This design allows for an in depth understanding of how companies internalize environmental fiscal obligations into their accounting structures and how sustainability reporting systems mediate this transformation under different regulatory conditions.

The research focuses on firms operating under emerging carbon taxation policies, particularly those subject to institutional constraints such as weak enforcement, limited technical capacity, and underdeveloped reporting standards. The study does not seek to generalize across all contexts but rather to develop analytical insights through a detailed examination of selected cases. Theoretical sampling guided the selection of firms that represent a range of responses to carbon tax regimes, ensuring relevance to the research questions while capturing contextual variation [2]. This design supports the construction of a multi variable conceptual framework that integrates policy, institutional, and organizational factors affecting financial disclosure practices in the context of environmental taxation.

3.2. Data Collection and Sampling

Data collection was conducted using semi structured interviews and document analysis to capture both experiential and institutional perspectives on how carbon tax policies are integrated into financial accounting practices. Interviews were carried out with finance managers, internal auditors, environmental officers, and regulatory representatives who are directly involved in the implementation of carbon tax or sustainability disclosures. This format allowed for flexibility in exploring interviewees' unique experiences while ensuring that all relevant themes were addressed. Supporting documents such as corporate financial statements, sustainability reports, and policy guidelines were also gathered to provide triangulated insights and contextual grounding [1].

Purposive sampling was used to select informants who possess direct knowledge and experience of the research topic. Criteria included firms that are formally subject to carbon taxation regimes and have published sustainability disclosures or financial reports addressing environmental liabilities. Sampling continued until theoretical saturation was achieved, meaning no new themes emerged from the interviews [2]. To ensure trustworthiness, the study incorporated strategies such as member checking, where respondents reviewed interview summaries, and methodological triangulation, where interview data were compared with documentary evidence to validate emerging findings [3].

3.3. Data Analysis

Data collected from interviews and document reviews were analyzed using thematic analysis, a method well suited for identifying patterns and constructing meaning from qualitative narratives [1]. Thematic analysis began with open coding of interview transcripts, followed by axial coding to group related codes into overarching themes. These themes reflect how carbon tax policies are interpreted and operationalized within accounting systems, how sustainability reporting structures evolve in response to fiscal regulation, and how regulatory quality facilitates or constrains accurate reporting of carbon related financial data. NVivo software was used to assist in the coding process, ensuring systematic data handling and traceability across categories.

To enhance analytical rigor, the study employed a conceptual model that visualizes the relationship between carbon tax (independent variable), sustainability reporting (mediating variable), and regulatory quality (moderating variable) as they affect corporate financial accounting practices. This framework was iteratively developed and refined based on emerging data insights and cross case comparisons. Constant comparative methods were used to evaluate theme consistency across different firms and regulatory settings [2]. The goal of the analysis was not merely descriptive but explanatory, aiming to uncover the mechanisms through which environmental fiscal policy reshapes accounting logic and practice in resource constrained institutional environments [3].

4. Results and Discussion

This study utilized NVivo software for thematic data analysis, supported by high performance laptops for managing large volumes of qualitative data. Interview transcripts were manually processed to maintain the accuracy of contextual interpretation. Data were sourced primarily from semi structured interviews with 12 key informants comprising financial managers, internal auditors, environmental officers, and regulatory agents from industrial firms operating under carbon tax mandates. Supplementary data included corporate financial statements, sustainability reports adhering to GRI or SASB standards, and relevant carbon tax policy documentation. Thematic analysis was performed through open and axial coding, culminating in three dominant themes: the structural impact of carbon taxes on financial reporting, the mediating influence of sustainability reporting, and the role of regulatory quality as a moderating factor in corporate accounting responses.

The results affirm the research hypothesis that carbon tax implementation compels industrial firms to modify their financial accounting practices. Many firms reported adjustments in cost structure and liability recognition, particularly by recording carbon related obligations as short term liabilities and operational expenses. For instance, 9 out of 12 respondents acknowledged incorporating carbon costs into accounts payable, while 10 indicated that carbon taxes directly impacted their cost of goods sold. Notably, companies with formal sustainability reporting frameworks demonstrated greater readiness and systematic integration of carbon data into financial records. This supports the hypothesis that sustainability reporting functions as a mediating variable that facilitates the translation of policy obligations into accounting structures [1], [2]. Conversely, firms without such frameworks tended to adopt fragmented and ad hoc reporting approaches, highlighting institutional limitations.

Furthermore, the moderating role of regulatory quality emerged as significant. In regions with more robust regulatory environments, firms showed higher compliance with carbon accounting requirements, suggesting that strong institutional oversight enhances policy effectiveness [3]. Respondents from these regions reported consistent inclusion of carbon tax information in the explanatory notes of financial statements and were more likely to align disclosures with international standards. This confirms the second hypothesis: regulatory quality strengthens the impact of carbon tax policy on financial accounting practices by ensuring accountability and improving data reliability [4], [5]. In contrast, firms in weaker regulatory environments cited ambiguity in measurement standards and lack of enforcement as barriers to accurate environmental reporting. Thus, the interaction between fiscal policy, sustainability frameworks, and regulatory governance forms a crucial nexus in shaping corporate environmental accounting in developing economies.

These findings reinforce the theoretical proposition that the integration of environmental fiscal instruments into financial accounting is not linear, but rather conditioned by mediating and moderating institutional factors. The practical implications are substantial: policymakers in developing countries must not only design effective carbon tax frameworks but also invest in strengthening reporting standards and regulatory institutions. Moreover, while the qualitative nature of this study yields rich contextual insights, it limits generalizability. Future studies should employ quantitative or mixed method designs to test these relationships on a broader empirical scale and across different industrial sectors.

The results of this study reveal that carbon tax policies have induced notable adjustments in the financial reporting practices of industrial firms. Interview data show that firms respond in varying degrees, depending on the maturity of their sustainability reporting frameworks and the quality of regulatory enforcement in their respective regions. Key adaptations include recognizing carbon liabilities in financial statements, adjusting cost structures, and incorporating carbon disclosures into reporting formats. These variations are summarized in Table 1 below.

Table 1. Summary of Accounting Changes Due to Carbon Tax

Adjustment Type	Firms Reporting (n=12)	Reporting Format	Regulatory Setting
Carbon liabilities	9	Short-term liabilities	Strong regulatory control
Production cost increase	10	Cost of Goods Sold (COGS)	Widespread
Sustainability disclosure	7	Notes in financial reports	With GRI/SASB compliance
Ad-hoc reporting	5	Manual notes or footnotes	Weak regulatory oversight

Table 1 illustrates the range of accounting responses undertaken by industrial firms in developing countries as a result of carbon tax implementation. The most frequently reported adjustment was the incorporation of carbon costs into the cost of goods sold (COGS), as noted by 10 out of 12 firms. This adjustment reflects a direct operational impact, where carbon taxes are treated as variable production expenses. Firms acknowledged that such treatment allows for a more realistic representation of environmental cost burdens, aligning with environmental accounting principles. Nine firms also reported classifying carbon obligations as short term liabilities, indicating a shift toward recognizing environmental responsibilities within conventional accounting structures. This response aligns with the increasing institutional push for transparency in environmental performance and signals an emerging convergence between fiscal regulation and financial accountability.

Moreover, 7 firms had adopted formal sustainability disclosure mechanisms, primarily through explanatory notes in their financial reports, often following GRI or SASB guidelines. This demonstrates the role of structured sustainability reporting as a mediating factor that facilitates the incorporation of carbon-related data into financial statements. These firms tend to be located in jurisdictions with stronger regulatory oversight, suggesting that the quality of institutional enforcement plays a pivotal role in promoting best practices in carbon accounting. In contrast, 5 firms relied on ad-hoc disclosure methods typically manual annotations or informal footnotes particularly in areas with weak regulatory presence. This inconsistency in reporting formats underscores the institutional limitations that hinder standardized carbon reporting across firms and regions. Overall, the findings support the hypothesis that both sustainability reporting frameworks and regulatory quality condition the extent to which carbon tax obligations are reflected in financial accounting. The implications are clear: policymakers should not only implement carbon taxes but also invest in regulatory capacity and encourage adoption of international reporting standards to ensure transparency and comparability in environmental disclosures.

5. Conclusion

This study investigated how carbon tax implementation influences financial accounting practices within industrial firms in developing countries, with a focus on the mediating role of sustainability reporting and the moderating effect of regulatory quality. Through qualitative case analysis involving key financial and regulatory actors, the findings reveal that carbon taxation compels firms to adjust their accounting structures particularly by incorporating carbon related costs into production expenses and short term liabilities. Companies with established sustainability reporting frameworks were more likely to integrate these environmental obligations formally into their financial disclosures. These findings confirm that sustainability reporting acts as a critical intermediary in translating environmental fiscal policy into tangible accounting adaptations. Moreover, regulatory quality significantly influences the degree and consistency of accounting compliance across firms, highlighting the need for robust institutional support.

The results substantiate the research hypothesis that the relationship between carbon tax policies and financial reporting is neither linear nor automatic, but is shaped by both internal corporate capabilities and external governance conditions. This synthesis underscores the necessity for policymakers to consider institutional readiness and reporting infrastructure when designing and enforcing carbon tax schemes. The study contributes to the growing body of environmental accounting literature by providing an integrated model contextualized to the institutional realities of developing economies. However, limitations remain, particularly the small sample size and qualitative scope, which may restrict the generalizability of findings. Future research should adopt mixed method approaches or cross country comparative analyses to validate and expand the empirical robustness of the model. Encouraging the adoption of international reporting standards and strengthening regulatory institutions remain essential steps toward aligning corporate accounting with global climate objectives.

6. Acknowledgements

The author would like to express his deepest gratitude to Ibn Khaldun University Bogor for the administrative and technical support provided during the research process. Appreciation is also given to all informants, especially financial managers, internal auditors, environmental officers, and regulatory representatives from industrial companies who have been willing to take the time and provide very valuable information in the interviews. The author would also like to thank the data service unit and the university library for facilitating access to relevant sustainability report documents and environmental fiscal policies. All of this support greatly assisted the smooth implementation of this research.

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