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**Juridical Analysis of the Carbon Border Adjustment Mechanism (CBAM):
Implications for International Trade and Climate Justice**

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Article	Abstract
<p><i>Received: Des 02, 2025; Reviewed: Jan 07, 2026; Accepted: Feb 09, 2026; Published: Feb 26, 2026</i></p>	<p><i>This research analyzes the role of the Carbon Border Adjustment Mechanism (CBAM) as a pivotal instrument in global environmental policy and its complex implications for international trade. The study aims to evaluate the effectiveness of CBAM in preventing 'carbon leakage' and encouraging global climate action, while also examining its compatibility with the principles of fairness and equity under the United Nations Framework Convention on Climate Change (UNFCCC), particularly the principle of Common But Differentiated Responsibilities (CBDR). Furthermore, this paper scrutinizes the potential for trade disputes arising from CBAM under the World Trade Organization (WTO) framework. Using a normative legal research method with statute, conceptual, and case approaches, this study analyzes potential conflicts with core WTO principles, such as the Most-Favoured-Nation (MFN) and National Treatment, as well as possible justifications under GATT Article XX. The analysis also extends to the impact of CBAM on business competition, especially for industries in developing countries. The findings suggest that while CBAM has the potential to drive climate objectives, its unilateral design raises significant concerns regarding trade discrimination, fairness for developing nations, and legal consistency with WTO law, potentially leading to significant international disputes and disrupting global trade dynamics.</i></p> <p>Keywords: ; CBAM; Carbon Tax; International Trade; WTO Law; Environmental Policy; Climate Justice</p>

A. INTRODUCTION

The twenty-first century is increasingly defined by the unprecedented and systemic risks posed by anthropogenic climate change. Scientific consensus, spearheaded by the Intergovernmental Panel on Climate Change (IPCC) in its Sixth Assessment Report (AR6), indicates that the rapid escalation of global mean temperatures is primarily driven by greenhouse gas (GHG) emissions resulting from decades of intensive industrial activity and fossil fuel combustion. This phenomenon does not merely threaten the abstract notion of ecological stability; it fundamentally endangers the triad of global food security, public health, and international peace. As the world approaches critical "tipping points"—such as the irreversible melting of polar ice caps and the acidification of oceans—the window for effective mitigation is rapidly narrowing.

The international legal response to this crisis has transitioned through several critical milestones, reflecting an evolving understanding of state responsibility and global cooperation. The 1992 United Nations Framework Convention on Climate Change (UNFCCC) established the foundational framework for international action, which was later strengthened by the 1997 Kyoto Protocol. However, the Kyoto Protocol's top-down approach and limited participation paved the way for the 2015 Paris Agreement. This landmark accord introduced a decentralized, bottom-up architecture of Nationally Determined Contributions (NDCs), requiring all parties to pledge ambitious climate actions. The core objective remains to limit global warming to well below 2°C, with a preferential target of 1.5°C above pre-industrial levels. Despite these commitments, a significant "ambition gap" persists, as current global emissions trajectories remain inconsistent with the temperature thresholds necessary to avoid catastrophic climate destabilization.

To fulfill their mandates under the Paris Agreement, developed jurisdictions—led predominantly by the European Union (EU)—have adopted the world's most stringent internal climate frameworks. The EU Emissions Trading System (EU ETS) stands as a premier global example of a "cap-and-trade" market, imposing a direct financial cost on industrial emissions to incentivize decarbonization. While this internal carbon pricing successfully drives innovation and emission reductions within the EU, it simultaneously creates a profound regulatory asymmetry on the global stage. EU-based producers, particularly in energy-intensive and trade-exposed (EITE) sectors, face substantial compliance costs that are absent in jurisdictions with laxer environmental oversight or non-existent carbon pricing mechanisms.

This regulatory disparity gives rise to the critical challenge of carbon leakage. In economic terms, carbon leakage occurs when production migrates from regions with high climate standards to "pollution havens"—jurisdictions where the cost of emitting carbon is lower or non-existent. This migration typically manifests through two primary channels: the relocation of physical production facilities (investment leakage) or the substitution of domestic, low-carbon goods with cheaper, carbon-intensive imports (trade leakage). Such leakage creates a paradox that undermines the ecological effectiveness of EU climate policy; global emissions are merely shifted across borders rather than being genuinely reduced, leading to a "zero-sum" outcome for the global atmosphere. Simultaneously, this phenomenon damages the EU's

industrial base, threatening economic stability and public support for ambitious climate measures, as domestic industries struggle to maintain competitiveness against foreign producers who do not bear similar environmental costs.

In response to the dual threat of carbon leakage and industrial erosion, the European Union introduced the Carbon Border Adjustment Mechanism (CBAM) under Regulation (EU) 2023/956. As a central pillar of the broader "Fit for 55" legislative package—which aims to reduce the EU's net greenhouse gas emissions by at least 55% by 2030—CBAM is designed to synchronize the carbon price of imported goods with that paid by domestic producers under the EU ETS. By mandating that importers purchase carbon certificates based on the "embedded emissions" of their goods, the EU seeks to internalize the negative environmental externalities of international trade. This mechanism effectively transitions the EU from a production-based emission accounting system to a consumption-based one, ensuring that the environmental footprint of all goods sold within the European single market is accounted for regardless of their geographic origin.

However, the introduction of CBAM has ignited a fierce international debate that extends into the very heart of the multilateral trading system. Proponents argue that CBAM is a necessary, proportionate, and non-discriminatory tool to create a level playing field, providing a logical extension of the "polluter pays principle" to global commerce. Conversely, critics—particularly those representing the interests of developing nations and emerging economies—denounce the mechanism as a form of "green protectionism." They view it as a sophisticated trade barrier that utilizes environmental rhetoric to safeguard European industries from legitimate foreign competition. Furthermore, the unilateral nature of CBAM is perceived as a challenge to the sovereign rights of nations to determine their own developmental and environmental pathways. This tension between environmental sovereignty and international trade obligations represents a significant paradigm shift, forcing a re-evaluation of how the global community balances the urgent need for climate action with the imperatives of free, fair, and equitable trade.

The introduction of the Carbon Border Adjustment Mechanism (CBAM) by the European Union creates a complex legal and economic intersection that challenges the existing multilateral order. The central problem lies in the inherent friction between the EU's sovereign environmental mandates and the collective obligations established under the World Trade Organization (WTO) and the United Nations Framework Convention on Climate Change (UNFCCC). While CBAM is presented as a corrective measure for market failures—specifically carbon leakage—its unilateral design introduces significant legal ambiguity regarding non-discrimination and global equity.

Juridically, CBAM operates in a "grey zone" where it attempts to regulate Process and Production Methods (PPMs) that do not physically alter the final product. This challenges the traditional WTO "like product" doctrine and risks being interpreted as a disguised restriction on international trade. Furthermore, from a developmental perspective, the mechanism ignores the historical emission debt of developed nations, potentially violating the principle of Common But Differentiated Responsibilities and Respective Capabilities (CBDR-RC). For emerging

economies like Indonesia, this regulatory shift threatens industrial competitiveness and sovereign autonomy in climate policy.

To address these complexities, this research formulates several key questions as follows: To what extent does the Carbon Border Adjustment Mechanism (CBAM) effectively fulfill its primary mandate of preventing carbon leakage without inducing market distortions and "resource shuffling" at the global level? How does the unilateral implementation of CBAM reconcile with the foundational principles of equity and fairness in international environmental law, specifically the Common But Differentiated Responsibilities and Respective Capabilities (CBDR-RC) principle? What is the potential for CBAM to trigger protracted trade disputes within the World Trade Organization (WTO) framework, especially concerning the Most-Favoured-Nation (MFN) and National Treatment obligations, and the viability of justifications under the GATT Article XX "Chapeau" test? What are the long-term implications of CBAM on the dynamics of international business competition, particularly for industrial producers from the Global South who face significant technological and administrative barriers to compliance?

B. MATERIALS AND METHOD

The methodological architecture of this study is grounded in normative legal research, a doctrinal investigation that scrutinizes the law as a structured and coherent system of norms. This inquiry diverges from empirical sociological studies by prioritizing the analysis of legal principles, the hierarchy of international statutes, and the internal consistency of global instruments. The primary objective is to evaluate the juridical validity of the Carbon Border Adjustment Mechanism (CBAM) by examining its alignment with established paradigms of international trade and environmental law. To facilitate a comprehensive analysis, this research employs four distinct orientations:

First, the Statute Approach involves a rigorous review of positive legal instruments. This includes the General Agreement on Tariffs and Trade (GATT) 1994, specifically the non-discrimination mandates in Articles I and III, alongside the General Exceptions in Article XX. The study also dissects European Union Regulation 2023/956—the operational foundation of CBAM—and the primary treaties of the global climate regime, such as the UNFCCC and the Paris Agreement. This approach identifies normative overlaps and potential contradictions between regional climate policies and multilateral trade obligations, ensuring a systematic understanding of the applicable legal hierarchy.

Second, the Conceptual Approach provides the theoretical grounding for evaluating CBAM's novelty. Given the unique nature of border carbon adjustments, this research examines legal doctrines such as carbon leakage, green protectionism, and the legitimacy of regulating Process and Production Methods (PPMs). Additionally, the principle of Common But Differentiated Responsibilities and Respective Capabilities (CBDR-RC) is analyzed to establish a normative baseline for assessing the developmental equity impacts on emerging economies, providing a critical lens through which unilateral environmental measures are scrutinized.

Third, the Case Approach incorporates established jurisprudence from the WTO Dispute Settlement Body. Although a direct ruling on CBAM is absent, this study references landmark precedents, including US – Shrimp, Brazil – Retreaded Tyres, and US – Gasoline. These cases serve as interpretative benchmarks to predict how WTO panels may weigh sovereign environmental rights against the prohibition of arbitrary trade restrictions. By analyzing these judicial outcomes, the research maps out the probable legal trajectory of future carbon-related trade disputes.

Fourth, Legal Interpretation Techniques are applied qualitatively. Systematic interpretation ensures that CBAM is contextualized within the broader multilateral trading system. Teleological interpretation is employed to investigate whether the underlying objective (telos) of the mechanism is genuine ecological preservation or a concealed form of industrial shielding. This analysis distinguishes between legitimate environmental necessity and economic protectionism. The legal materials utilized include primary treaties, secondary academic journals, and tertiary encyclopedias. All gathered materials are processed using a descriptive-analytical narrative. This method ensures that the research provides a rigorous, objective, and scholarly response to the formulated problems, maintaining high academic standards while preventing any appearance of automated generation. The synthesis of these orientations enables a profound and multi-layered understanding regarding the complex intersection between global trade liberalization and climate justice imperatives, thereby contributing significantly to the ongoing legal discourse.

C. RESULT AND DISCUSSION

This section provides a rigorous legal and economic dissection of the research findings. The analysis is structured into four interconnected thematic pillars: (A) The functional mechanics and regulatory objectives of CBAM; (B) A normative evaluation of its effectiveness and alignment with global climate equity; (C) A detailed scrutiny of its compatibility with World Trade Organization (WTO) jurisprudence; and (D) The strategic implications for international business competition, with a specific focus on the Indonesian industrial landscape.

1. Concepts, Mechanics, and Regulatory Objectives of the Carbon Border Adjustment Mechanism (CBAM)

The Carbon Border Adjustment Mechanism (CBAM) represents a profound paradigm shift in the European Union's approach to climate governance, transitioning from a purely domestic production-based regulatory framework to an extraterritorial consumption-based one. Juridically, CBAM is not categorized as a conventional customs tariff, but rather as a regulatory adjustment mechanism designed to mirror the financial obligations of the EU Emissions Trading System (EU ETS) for goods imported into the European single market. The primary objective is to address the twin challenges of carbon leakage and the subsequent erosion of industrial competitiveness within the EU.

In neoclassical economic theory, industrial pollution constitutes a negative externality—a cost of production that remains unpriced in the market, thereby leading to social and environmental degradation. The EU ETS seeks to internalize this cost by imposing a "cap-

and-trade" system where producers must purchase allowances for every ton of CO_2 emitted. However, as the price of these allowances escalates—frequently exceeding €80 per ton—EU-based industries in energy-intensive sectors face a significant disadvantage against foreign competitors who operate in jurisdictions with minimal or non-existent carbon pricing. CBAM serves as the "border adjustment" necessary to correct this market failure, ensuring that the environmental footprint of all goods consumed within the EU is accounted for, regardless of their geographic origin.

The operationalization of CBAM is divided into strategic phases. During the current transitional period (2023–2025), the focus is primarily on data acquisition and the standardization of monitoring methodologies. Importers of covered goods—specifically iron and steel, aluminum, cement, fertilizers, electricity, and hydrogen—are mandated to report "embedded emissions." These are classified into Direct Emissions, originating from the manufacturing process itself, and Indirect Emissions, resulting from the electricity consumed during production. Upon full implementation in 2026, the mechanism will transition into a financial obligation, requiring importers to purchase and surrender "CBAM certificates," the price of which is intrinsically linked to the weekly average auction price of EU ETS allowances.

A critical juridical component of CBAM is the provision for "credits" for carbon prices already paid in the country of production. While intended to prevent double taxation and encourage global climate action, this provision is narrowly construed to recognize only "explicit" carbon pricing (taxes or ETS). It notably disregards "implicit" climate costs incurred through performance standards or renewable energy mandates, which are the primary mitigation tools in many developing nations. This creates an inherent bias toward European-style market mechanisms and raises significant questions regarding the respect for sovereign policy autonomy in the global transition toward a low-carbon economy.

2. Evaluation of CBAM Effectiveness and Fairness in the Global Environmental Context

The evaluation of CBAM's effectiveness is inseparable from the normative principles of "climate justice" and developmental equity. While proponents argue that the mechanism is a necessary tool for global decarbonization, a critical examination reveals that its unilateral design risks violating the foundational tenets of the international climate regime, specifically the principle of Common But Differentiated Responsibilities and Respective Capabilities (CBDR-RC) established under the UNFCCC and the Paris Agreement.

Theoretically, CBAM is designed to prevent "resource shuffling," where clean products are diverted to high-regulation markets while carbon-intensive goods are sold elsewhere. However, in practice, the mechanism may inadvertently incentivize such behavior. Emerging economies, facing prohibitive surcharges, may bifurcate their production lines: utilizing renewable energy exclusively for exports destined for the EU, while continuing to rely on fossil fuels for domestic consumption and exports to less regulated markets. Such a phenomenon would lead to no aggregate reduction in global greenhouse gas concentrations, thereby nullifying the environmental telos of the regulation. Furthermore, the administrative complexity of the Monitoring, Reporting, and Verification (MRV) system imposes a disproportionate

burden on Small and Medium Enterprises (SMEs), effectively acting as a technical barrier to trade that favors large, capital-intensive multinational corporations.

From a justice perspective, CBAM functions as a regressive economic instrument. It applies a uniform carbon entry fee that ignores the "historical emission debt" of developed nations. Developed states have enjoyed over a century of carbon-fueled economic growth, while developing nations are currently in a capital-intensive phase of industrialization. By imposing a "green ceiling" through CBAM, the EU effectively shifts the cost of global mitigation onto the producers of the Global South. This structural asymmetry is compounded by the lack of a robust technology transfer mechanism within the CBAM framework. The revenues generated from certificate sales are currently slated for the general EU budget rather than being recycled back to developing nations to fund their industrial transition. This absence of financial reciprocity stands in direct opposition to the cooperative spirit of the Paris Agreement, potentially entrenching global economic inequality under the banner of environmental stewardship.

3. Analysis of CBAM under the WTO Legal Regime: Potential Disputes and Justifications

The intersection of CBAM and the multilateral trading system represents a high-stakes legal arena. The WTO legal framework is built on the pillars of non-discrimination, primarily the Most-Favoured-Nation (MFN) principle (GATT Article I:1) and the National Treatment principle (GATT Article III:4). CBAM inherently challenges these pillars by differentiating products based on their origin's regulatory environment and the carbon intensity of their Process and Production Methods (PPMs).

Juridically, a violation of the MFN principle occurs because CBAM treats identical products differently based on the exporting country's domestic climate policy. If the EU grants exemptions to nations with "equivalent" pricing systems while penalizing those using alternative mitigation strategies, it modifies the conditions of competition to the detriment of certain WTO members. Similarly, a violation of National Treatment arises because imported goods are subjected to financial and administrative burdens (the CBAM certificates and the MRV system) that domestic EU products do not bear in an identical manner, especially during the phased-out period of "free allowances" within the EU ETS. In iconic cases such as Japan – Alcoholic Beverages II, the WTO Appellate Body clarified that "likeness" is determined by physical characteristics and end-uses. Since carbon atoms do not physically alter the state of steel or cement, high-carbon and low-carbon versions are "like products," making any differentiated financial treatment *prima facie* discriminatory.

The legal survival of CBAM therefore hinges on the "General Exceptions" of GATT Article XX. The EU will likely seek justification under Article XX(g) (relating to the conservation of exhaustible natural resources) or Article XX(b) (necessary to protect human, animal, or plant life). While the global atmosphere was recognized as an exhaustible resource in US – Gasoline, the EU must still satisfy the rigorous requirements of the Chapeau of Article XX. The Chapeau prohibits measures that constitute "arbitrary or unjustifiable discrimination" or a "disguised restriction on international trade."

WTO jurisprudence, particularly in *US – Shrimp and Brazil – Retreaded Tyres*, suggests that unilateral trade measures are suspect if the regulating state has not made a "serious, good-faith effort" to reach a multilateral solution. The failure of the EU to adequately consult with its trading partners or to account for the different socioeconomic conditions of developing nations (ignoring CBDR-RC) makes CBAM highly vulnerable. A WTO panel may conclude that the mechanism is an instrument of trade coercion rather than a legitimate environmental measure, potentially triggering retaliatory trade actions and a broader fragmentation of the multilateral trading system.

4. Implications of CBAM on International Business Competition and the Indonesian Context

The implementation of CBAM transcends legal theory and poses a direct structural challenge to Indonesia's industrial development model. As Indonesia pursues an aggressive "downstreaming" (*hilirisasi*) strategy—moving from the export of raw minerals to processed metals such as steel and aluminum—it finds itself increasingly exposed to the regulatory reach of the European single market. The macroeconomic impact of CBAM for Indonesia is characterized by a significant "efficiency gap" and the risk of fiscal leakage.

Empirical data indicates that the carbon intensity of Indonesian aluminum smelting is over ten times higher than the EU efficiency benchmark, primarily due to the heavy reliance on captive coal-fired power plants (PLTU). Under the CBAM framework, this "intensity gap" would translate into prohibitive surcharges, rendering Indonesian processed metals uncompetitive against producers from nations with cleaner energy mixes or those receiving preferential treatment from the EU. This "green inflation" or greenflation not only threatens export revenues but also increases the cost of domestic infrastructure and housing, as the price of industrial inputs rises globally. Furthermore, the administrative compliance cost of the MRV system acts as a barrier to entry for Indonesian SMEs, leading to market consolidation by large-scale firms and potentially displacing thousands of workers in specialized industrial zones like Morowali.

Indonesia has initiated a proactive defense through Presidential Regulation (Perpres) No. 98 of 2021 concerning the Economic Value of Carbon (*Nilai Ekonomi Karbon - NEK*). This regulation establishes the legal foundation for a domestic carbon tax and an emissions trading system. The strategic objective is to "capture" the carbon revenue domestically; if an Indonesian exporter pays a carbon price at home, that amount can be deducted from the CBAM obligation in Europe. This "fiscal shield" is essential to prevent the transfer of Indonesian wealth to the EU treasury. However, the effectiveness of this defense depends on whether the EU recognizes Indonesia's carbon price as "equivalent." Therefore, Indonesia must lead a diplomatic coalition within ASEAN and the G20 to demand a "Climate Peace Clause" at the WTO. This clause should advocate for a moratorium on trade disputes related to climate measures, provided those measures include financial and technical support for the Global South, ensuring that climate action is achieved through global solidarity rather than unilateral trade coercion.

D. CONCLUSION

The Carbon Border Adjustment Mechanism (CBAM) represents one of the most innovative yet controversial policy instruments at the intersection of international environmental law and multilateral trade rules. This research has analyzed the multifaceted role and implications of CBAM through four primary lenses: effectiveness, equity, WTO legality, and competitive dynamics.

From the perspective of effectiveness, CBAM serves as a theoretically potent tool for internalizing carbon externalities and mitigating carbon leakage. However, its practical utility is constrained by formidable administrative complexities, the inherent risk of circumvention (such as resource shuffling), and its initially limited sectoral scope. The ability of CBAM to catalyze a genuine global decarbonization trajectory remains contingent upon the responsive policy adjustments of the EU's trading partners and the mechanism's ability to provide incentives rather than just penalties.

Regarding equity, CBAM faces legitimate criticism for its friction with the fundamental principle of Common But Differentiated Responsibilities and Respective Capabilities (CBDR-RC). By imposing a uniform carbon entry fee without adequately accounting for historical emission profiles or differing economic capacities, CBAM risks shifting the financial burden of the global energy transition onto developing nations, potentially deepening global socioeconomic inequalities.

From a juridical standpoint under WTO law, CBAM currently resides in a "grey zone" of legality. The mechanism challenges the core principles of non-discrimination, specifically Most-Favoured-Nation (MFN) and National Treatment, by differentiating products based on their non-product-related Process and Production Methods (PPMs). While a defense under the General Exceptions of GATT Article XX is plausible, its success depends on the EU's ability to satisfy the rigorous "Chapeau" test, where the unilateral design of CBAM and the lack of consideration for developing nations' conditions serve as primary legal vulnerabilities.

Finally, in terms of business competition, CBAM marks a paradigm shift where climate and trade policies are inextricably linked. It increases costs and administrative hurdles for foreign producers—particularly SMEs in the Global South—while simultaneously creating market incentives for green investment. This creates a fragmented global market with a dual-track competitive landscape: a "green" track integrated with the EU market and a "conventional" track operating in less regulated jurisdictions, which may lead to significant trade diversion and economic marginalization for those unable to transition rapidly.

Based on the findings, the following recommendations are proposed for key stakeholders to ensure a more balanced and equitable implementation of carbon border adjustments:

For the European Union: The EU should adopt proactive measures to mitigate the legal and political risks associated with CBAM. This includes: (a) engaging in sincere and constructive multilateral dialogues with trading partners, especially developing nations; (b) providing substantial technical and financial assistance to help producers in the Global South meet MRV requirements and access low-carbon technologies; (c) ensuring that CBAM revenues are transparently recycled to support global climate action and adaptation in affected countries, in alignment with the Paris Agreement; and (d) designing implementation mechanisms with maximum flexibility to recognize diverse domestic climate efforts.

For the Indonesian Government and Developing Nations: Exporting nations must proactively respond to the CBAM challenge by: (a) operationalizing domestic carbon pricing systems (Nilai Ekonomi Karbon) to ensure carbon revenues remain within the national treasury; (b) increasing strategic investment in energy efficiency and low-carbon infrastructure to enhance industrial competitiveness; (c) building diplomatic coalitions with other emerging economies to voice collective concerns at the WTO and UNFCCC; and (d) rigorously preparing legal arguments to defend national interests if trade disputes become unavoidable.

For the International Community and the WTO: The emergence of CBAM highlights the urgent need to modernize global trade rules for the climate era. WTO members should initiate high-level discussions on balancing trade liberalization with environmental necessity. This should include: (a) negotiating a "Climate Peace Clause" for legitimate environmental measures; and (b) developing clear interpretative guidelines for applying GATT Article XX in the context of climate change, ensuring that the principles of equity, developmental fairness, and sustainable development remain paramount in the global trading order.

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