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**Pandora's Box?:
Countervailing Duties and the Environment**

by

Robert T. Stranks
Economic and Trade Policy Division (CPE)
Policy Staff

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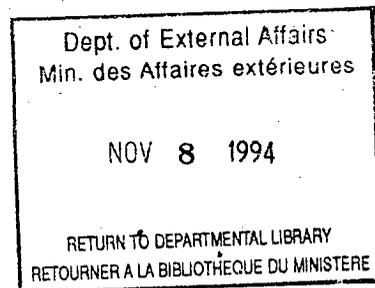
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Executive Summary

This Paper raises some questions on the possible application of countervailing-like duties in response to environmental concerns. There has been little constructive international dialogue on the issue. An important question is: should natural resource pricing practices, with the caveat that there is a significant environmental impact, be candidates for countervailing-like duties? To pose the question of whether such subsidies should be countervailable, however, is not to suggest that it is acceptable to use countervailing-like duties to compensate for differences in countries' environmental standards that are appropriate in terms of differences in local ecosystems, including resource availability.

Under World Trade Organization rules, "generally available" subsidies are not subject to countervailing duties, and many government practices with subsidy-like effects are not considered "subsidies". Yet from a certain environmental perspective, these trade rules may pose a problem. Increases in resource user charges to reflect costs more fully, such as for water and forests, may well support environmental objectives. If natural resources are underpriced, trade and trade liberalization may have an adverse environmental effect. This, however, does not imply that trade or trade liberalization should be avoided. Rather, as a first best solution, it implies that appropriate domestic environmental policies to internalize environmental costs are required to avoid negative environmental effects. Moreover, fuller cost internalization for a particular resource will lead to different pricing results in each country, and this legitimate, market-based variation should be taken fully into account.

The questions surrounding what multilateral trade-related discipline to apply to subsidies in this broader sense are fundamental for the trade-environment interface. With the conclusion of the Uruguay Round, and the decision for the World Trade Organization to establish a committee on trade and environment, there is an opportunity to consider countervailing-like duties more fully in an environmental context, and to make recommendations on the matter. This said, there should be no illusion about the intensive effort that would be required to address this very complex issue properly.

In sum, the Paper explores how we might begin to address more methodically one important issue in the trade and environment universe. The Paper highlights the complexities of the issues involved and the dangers that such an exercise could be captured by those whose protectionist instincts are as strong if not stronger than their environmental concern. The questions raised pose serious doubt that multilateral agreement could easily be reached on operationalizing countervailing rules to address

environmental concerns. More importantly, a high degree of uncertainty exists about whether a new form of countervailing duties would be effective in achieving its professed environmental objectives. For the time being, until the issues are more fully understood, it would be prudent for governments to resist pressure to employ countervailing-like duties to influence the manner in which foreign countries address environmental concerns.

Résumé

Le document pose certaines questions relativement à l'imposition éventuelle de droits apparentés aux droits compensateurs comme solutions aux préoccupations environnementales. On note peu d'échanges constructifs sur le plan international à ce sujet. Pourtant une question importante demeure : les pratiques de fixation des prix pour les ressources naturelles, compte tenu des répercussions importantes sur l'environnement, devraient-elles être soumises à de tels droits? Demander si de telles subventions devraient donner matière à compensation ne veut pas dire pour autant qu'il soit acceptable d'imposer ces droits pour compenser les écarts entre les normes environnementales des divers pays, écarts qui s'expliquent par la différence entre les écosystèmes locaux, y compris de la disponibilité des ressources.

En vertu des règlements de l'Organisation mondiale du commerce, les subventions « généralement accessibles » ne donnent pas lieu à des droits compensateurs, et nombre de pratiques gouvernementales ayant des répercussions apparentées aux subventions ne sont pas considérées comme des « subventions ». Pourtant, d'un point de vue environnemental, ces règles commerciales peuvent poser un problème. L'accroissement des frais d'utilisation des ressources pour refléter les coûts de façon plus globale, dans le cas de l'eau et des forêts par exemple, peut fort bien soutenir les objectifs environnementaux. Si le prix des ressources naturelles est trop faible, le commerce et la libéralisation du commerce peuvent avoir des effets environnementaux néfastes. Cela ne veut pas dire qu'il faut s'abstenir de commercer ou de libéraliser le commerce, mais plutôt que des politiques environnementales nationales visant à internaliser les coûts environnementaux sont nécessaires pour éviter les répercussions négatives sur l'environnement. Par ailleurs, une internalisation plus poussée du prix d'une ressource naturelle donnée entraînera un prix différent dans chaque pays, et cet écart légitime, basé sur la loi du marché, devrait être pleinement pris en considération.

Les questions concernant la discipline multilatérale à appliquer aux subventions dans ce sens général sont essentielles à l'interface commerce-environnement. La

conclusion de l'Uruguay Round et la décision de l'Organisation mondiale du commerce de créer un comité sur le commerce et l'environnement nous permettent d'examiner ces droits plus à fond dans un contexte environnemental, et de faire des recommandations. Cela dit, nous ne devrions pas nous faire d'illusions sur l'effort intensif que nécessitera l'examen de cette question très complexe.

Bref, le document examine les façons dont nous pourrions nous y prendre pour commencer à étudier plus méthodiquement un aspect important de l'univers commercial et environnemental. Il souligne la complexité des enjeux et le risque qu'un tel exercice puisse être dominé par ceux dont les instincts protectionnistes sont aussi forts, sinon plus forts, que leurs préoccupations environnementales. Les questions posées soulèvent de sérieux doutes quant à la possibilité d'en arriver facilement à un accord multilatéral sur le recours aux droits compensateurs pour régler les préoccupations environnementales. Qui plus est, une grande incertitude demeure quant à savoir si une nouvelle forme de droits compensateurs réussirait à atteindre les objectifs fondamentaux mis de l'avant. Pour le moment, d'ici à ce que les questions en jeu soient mieux comprises, les gouvernements devraient, par prudence, éviter de recourir à des droits apparentés aux droits compensateurs pour influencer la façon dont les autres pays abordent les questions environnementales.

"Indeed, the subsidies question in relation to environmental policies may be one of the most intricate and difficult of those facing the world trading system during the next decade."

John Jackson, "World Trade Rules and Environmental Policies: Congruence or Conflict?"

1. Introduction

This Paper makes some observations and raises several questions on the trade-environment policy interface. Environmental considerations are having an increasingly important role in shaping the international trading system. In a general sense, the Paper gives a positive response to the broad question of whether environmental objectives can be attained without destroying the GATT/WTO. Trade measures are already included in a number of International Environmental Agreements, and the GATT allows for the use of nondiscriminatory market access restrictions to protect a country's environment.¹ The question of whether the GATT should allow for the use of trade measures in response to environmental degradation in foreign countries remains. Is there a certain range of circumstances when multilaterally agreed trade measures could potentially play an environmental role? This Paper raises some questions on the possible application of trade measures, specifically what may be considered a new form of countervailing duty, for environmental reasons. The issues raised are complex and more than occasionally politicized. Our analysis indicates that the likelihood of developing a new and effective form of countervailing-like duties to address subsidization with adverse environmental affects is problematical.

There has been little constructive international dialogue on revising multilateral trade rules to allow for the use of countervailing-like duties to take into account environmental concerns more fully. To the limited extent that there has been a discussion, it has been polarized, with some environmental groups arguing for a broad application of countervailing-like duties, and the trade policy community holding the view that such environmentally related duties are undesirable and would have adverse implications for the international trading system. One commentator, reflecting the environmentalist view, has concluded that "it is an anachronism that at a time when people are focusing on changing development practices to make them sustainable, the trading community is forbidding the use of trade measures to assist in this process."²

¹A number of International Environmental Agreements contain trade restrictive measures. These include the Montreal Protocol on Substances that Deplete the Ozone Layer, the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) and the Basel Convention on the Transboundary Movement of Hazardous Wastes. See Keith H. Christie, "Stacking the Deck: Compliance and Dispute Settlement in International Environmental Agreements", Policy Staff Paper No. 93/15, Department of Foreign Affairs and International Trade, December 1993.

²Edith Brown Weiss, "Environment and Trade as Partners in Sustainable Development: A Commentary", American Journal of International Law, 86 (1992), p.731.

For each group, their respective view rests on serious concern about very real public policy issues.³

Fundamental questions of what may be the acceptable scope or criteria for introducing countervailing-like duties on environmental grounds, and the practical problems with using such an instrument to encourage a change in a foreign country's policies, have not been fully explored. One important question that we will address more fully in this Paper is: should generally available subsidies, with the important caveat that there is a significant environmental impact⁴, be candidates for countervailing-like duties? The key notion of the question is that of applying a trade instrument to encourage adjustment of subsidization practices that have detrimental environmental effects and affect a tradable good.

2. Environmental Concerns

There appears to be broad agreement that subsidies may contribute to environmental degradation.⁵ A recent World Bank report stated that: "Some government policies are downright harmful for the environment. Notable here are distorted prices in general and subsidized input prices in particular."⁶ A key message of the report was the importance of removing subsidies that encourage excessive use of fossil fuels, irrigation water, pesticides and logging. The report noted that the

³In addition to the Policy Staff paper mentioned in footnote 1, other Policy Staff contributions that have explored how we might bridge the gap in the debate include: "Trade and the Environment: Dialogue of the Deaf or Scope for Cooperation?", by Michael Hart and Sushma Gera (No. 92/11); Section 4 of "Globalization and Public Policy in Canada: In Search of a Paradigm", by Keith Christie (No. 93/01); and "Dangerous Liaisons: The World Trade Organization and the Environmental Agenda", by K. Anne McCaskill (No. 94/14).

⁴"Environmental impact" often refers to specific impacts such as increased pollution, harm to ecosystems or depletion of natural resources, as well as indirect impacts that affect the quality of life. See Robert A. Reinstein, "Trade and Environment: Assessing Environmental Impacts of Trade Measures and Agreements", prepared for the OECD Environment Directorate, November 1993. As countries have diverse views on environmental degradation, reaching multilateral consensus on environmental criteria would be complex in its own right. For example, it could become a particularly daunting task to identify a threshold for subsidization that causes the serious loss of biodiversity.

⁵See World Resources Institute, World Resources 1995-95 and UNCTAD, "Sustainable Development", TD/B/40(2)/6, February 1994.

⁶World Bank, World Development Report (1992), p. 11.

removal of all energy subsidies, including those on coal in the industrialized countries, would sharply reduce local pollution and cut global carbon emissions from energy by 10 percent.⁷

Anecdotal evidence indicates that many governments underprice natural resources. Figure 1 presents some data on the ratio of user prices to production costs for some energy and agricultural inputs. From this data, it is evident that many users pay less than the production costs of natural resource inputs. In Mexico, farmers pay only 20 percent of the production cost of irrigation water. In the U.S., to give another example, it has been estimated that the Bureau of Reclamation provides a subsidy to the farms that use its water of over U.S. \$1 billion per year.⁸ The underpricing of timber rights (i.e., below replacement cost) may encourage excessive logging. The World Bank has reported that, in a sample of African countries, timber stumpage fees constitute only a small percentage (less than five per cent in the cases of Niger, Senegal and Sudan) of the replacement costs.⁹ Higher input costs, such as for energy, are also likely to stimulate interest in more efficient production processes, with corresponding environmental benefits¹⁰. Both the World Bank and the International Monetary Fund are increasingly trying to encourage countries receiving financing, such as for electric power projects, to adopt more environmentally (and economically) sound pricing policies.¹¹ There is a clear need for extensive empirical

⁷Ibid. p.12.

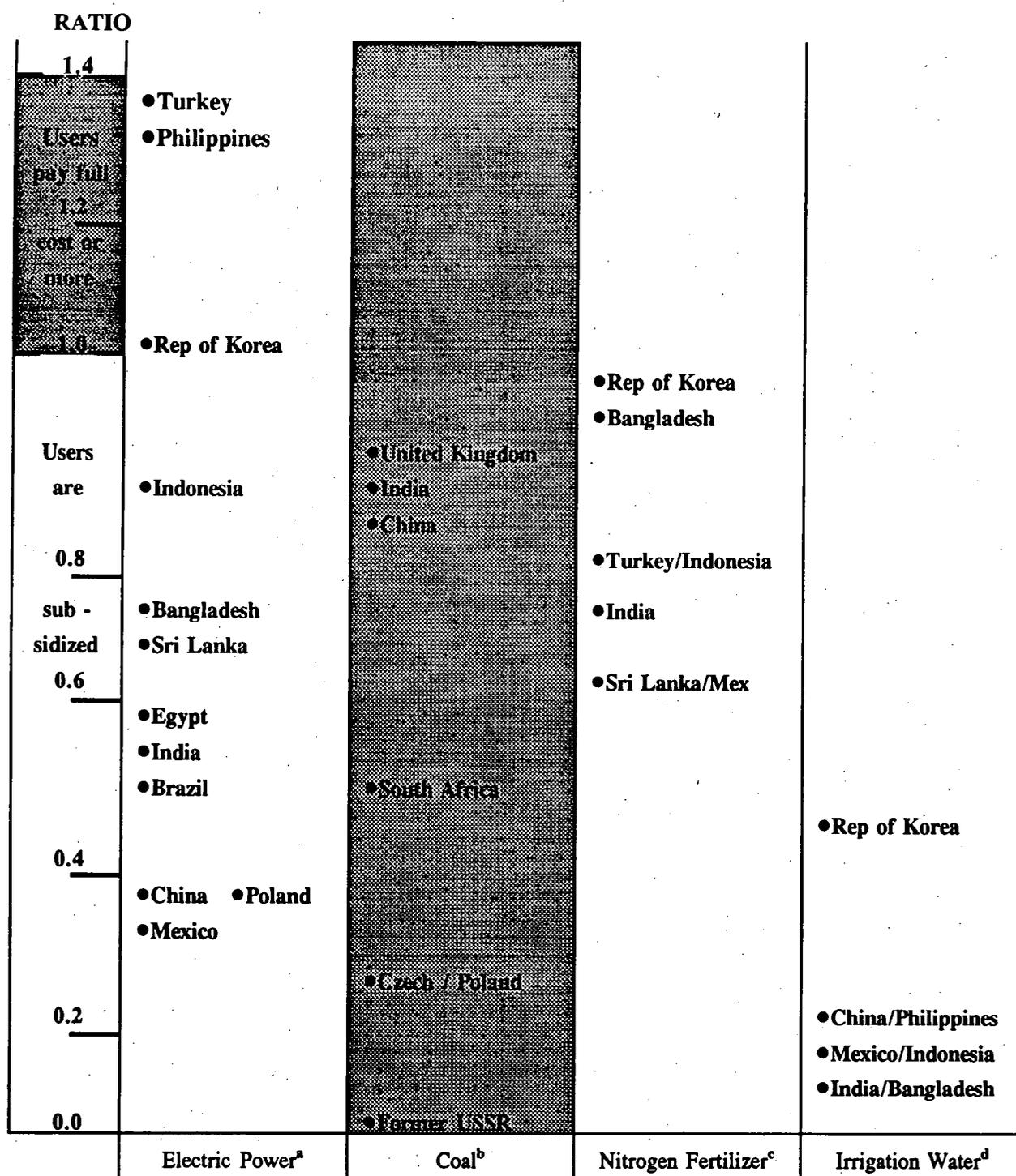
⁸John Proops, Paul Steele, Ece Ozdemiroglu, and David Pearce, "The Internalisation of Environmental Costs and Resource Values: A Conceptual Study", UNCTAD/COM/27, November 1993, pp. 9-11.

⁹World Bank, World Development Report (1992), p.149.

¹⁰In respect of government regulation of energy pricing, Article 604 of the NAFTA is important. William G. Watson has concluded that: "Two-price systems of the kind that, in the 1970s and early 1980s, kept domestic Canadian energy prices well below the world price and encouraged excessive consumption in this country are all but impossible under the NAFTA." See William G. Watson, "Environmental and Labour Standards in the NAFTA", Commentary No. 57, Toronto: C.D. Howe Institute, 1994, pp. 7-8.

¹¹The World Bank Annual (1993), p.49, reports that the Bank will be more selective about where it lends and that: "Support will not continue for energy-supply projects where poorly performing public energy enterprises and governments are unwilling to carry out fundamental structural reforms that could significantly improve the ways they do business. To receive new commitments from the Bank, governments should clearly show they are setting up structural incentives that lead to more efficient energy production and use". An UNCTAD report has noted that the World Bank and IMF have made

Figure 1 Ratio of price to production cost, selected energy and agricultural inputs



a. Average electricity tariff as a proportion of the incremental cost of system expansion (1987; Egypt, 1991).

b. Domestic price as a proportion of border price or long-run marginal cost (various years, 1987-91, except South Africa, 1982).

c. Farmgate price of urea as a proportion of the average production cost of urea (average of various years, 1980-88).

d. Direct water charge as a proportion of operating and maintenance costs plus midrange estimate of annualized capital cost (various years, 1985-88).

case studies on how natural resource pricing practices may contribute to environmental degradation.¹²

Nonetheless, it is also clear that, in several circumstances, increases in resource-user charges, such as for water and forests, may support environmental objectives. For example, the underpricing of water could result in excessive use, which in the long-term could result in the loss or reduced productivity of land due to salinization or waterlogging.¹³ Subsidies, by lowering costs to producers, may contribute to market failure and the accompanying negative environmental effects. The reduction of direct subsidies would comprise a step toward the fuller internalization of environmental costs.

If natural resources are underpriced, trade and trade liberalization may have an adverse environmental impact. This, however, does not imply that trade or trade liberalization should be avoided, nor that trade measures are the most appropriate response to subsidization of resource use. Rather, as a first best solution, an appropriate domestic environmental policy, crafted to internalize environmental costs, is required to avoid negative environmental impacts. The removal of local price distortions would be of benefit to the environment. Nonetheless, could trade measures play a useful supporting role? More specifically, could environmental countervail-like duties encourage a country to move toward internalizing its environmental costs by adjusting its resource pricing policy?

significant progress in taking environmental issues into account in the formulation of structural adjustment programs, but that more needs to be done if such programs are to adequately promote sustainable development. UNCTAD, TD/B/40(2)/6, p.11.

¹²This raises another complexity and case specific factor in the countervail-environment debate. Detailed work on specific causality would be required to ascertain how a country's natural resource policies contribute to environmental degradation.

¹³The World Bank's Operational Directive on Environmental Assessment provides that all approved Bank projects that could have significant adverse effects on the environment are subject to environmental assessments. World Bank, World Development Report (1992), p.81.

3. Subsidies and Countervailing Duties

The current GATT rights and obligations for subsidies and countervailing duties are contained in GATT Articles VI and XVI, as well as the Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the GATT (the Subsidies Code). With the entry into force of the World Trade Organization (WTO), sometime in 1995, the current Subsidies Code, which does not apply to all contracting parties, will be replaced by the Agreement on Subsidies and Countervailing Measures, which will apply to all WTO members.¹⁴

Countervailing duties are an exception to the general GATT obligation not to increase trade restrictions. Article II of the GATT obliges each party not to impose customs duties in excess of the level listed on its respective tariff schedule. Article VI defines "countervailing duty" as a special duty levied for the purpose of off-setting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any specific merchandise.¹⁵ Countervailing duties are intended to provide an offset to domestic producers when the producers are experiencing economic injury as a result of a foreign country's provision of targeted subsidies to its domestic producers who subsequently market their goods abroad. Under the rules of the WTO, in order to impose countervailing duties a country must determine that subsidization has occurred in the foreign country, and that the subsidization is causing, or threatening to cause, material injury to domestic producers of the like product, or is retarding the establishment of a domestic industry in the country of importation.

Multilateral trade rules draw a critical distinction between "generally available" and "specific" subsidies, and treat each type of subsidy differently. If a subsidy is "generally available", it is not countervailable. Conversely, if a subsidy is "specific" i.e., confined in law, regulation or practice to an enterprise or industry or group of enterprises or industries within the jurisdiction of the granting authority, it is not

¹⁴Several provisions in the Agreement on Subsidies and Countervailing Measures grant the developing countries special and differential treatment. For example, de minimis provisions exempt a developing country from countervailing duties when the subsidy level does not exceed 2 per cent of its value; or the volume of the subsidized imports represents less than 4 per cent, and cumulatively among developing countries benefiting from the provision, less than 9 per cent of total imports. Another provision provides that, in effect, the least-developing countries may maintain export subsidies, while other developing countries have eight years from the entry into force of the WTO to phase out such subsidies.

¹⁵Article VI of the GATT 1994.

excluded from potential countervail action.¹⁶

4. Countervailing-Like Duties and the Environment

To pose the question of whether subsidies, in a broader sense that goes beyond the current WTO definition of actionable subsidies, should be countervailable is not to suggest accepting the holus-bolus use of countervailing duties to compensate for differences in countries' environmental standards that reflect different environmental conditions or inevitable disagreements over the nature of the environmental threat or local environmental priorities. This Paper does not suggest that tariffs or other trade measures be put into place to alter competitive positions arising from differences in environmental standards or compliance costs per se. There is no suggestion that countervailing-like duties be used for the extraterritorial enforcement elsewhere of one country's domestic standards or to equalize prices on the basis of the cost structure of exploiting the resource in the country contemplating the use of such a measure. This dangerous view that there should be such compensating tariffs - "levelling the playing field" - has been put forth elsewhere.¹⁷

Varying production costs or environmental standards, either of which may differ across jurisdictions depending on the characteristics of local eco-systems, are not and should not be the basis for applying countervailing-like duties, nor is there a strong

¹⁶The WTO agreement on subsidies also identifies non-actionable (specific) subsidies on which countervailing duties cannot be applied. In the environmental context, payments up to 20 per cent of the cost of adoption of existing facilities to new environmental laws and requirements, subject to certain conditions, are considered non-actionable subsidies. These conditions are that the facilities to be adopted must have been in existence for at least two years, and that the assistance must be of a one-time, non-recurring nature, and must be available to all firms that are able to adopt the new equipment and/or production processes. The environmentally related payment must also be "directly linked to and proportionate to a firm's planned reductions of nuisances and pollution in nature, and does not cover any manufacturing cost savings which may be achieved," and it must not cover the cost of replacing and operating the assisted investment, which must be fully borne by firms. The WTO Agreement on Agriculture also provides that "payments under environmental programmes" and "infrastructural works associated with environmental programmes", under certain conditions, are exempt from the subsidy reduction commitments in the rest of the agricultural text.

¹⁷The view that tariffs should compensate for differences in environmental costs was put forward by U.S. Senator David Boren. In 1991, Boren introduced a bill entitled the "International Pollution Deterrence Act", which proposed that tariffs which reflected the cost that a foreign producer would incur under U.S. standards. The Conference Board, "Understanding European Environmental Regulation", Report Number 1026, 1993, p. 14.

case for fully harmonizing environmental policies, as countries are at various levels of economic development, have distinct assimilative capacities and have different social preferences on environmental issues.¹⁸ Rather, this Paper raises the issue of whether below replacement cost practices with respect to renewable resources or below production cost practices with regard to such non-renewable resources as coal that have a negative environmental impact should be considered countervailable.¹⁹ If a country does not subsidize production, but production or replacement costs of a particular traded good were nonetheless lower than those of its trading partners, there would clearly be no basis for taking trade remedy or any other trade-based action.

Differences in countries' resource pricing, environmental regulations and policies can affect the competitiveness of their domestic producers. A popular public view is that, if foreign producers have lower environmental standards, imports from these producers constitute "social dumping," and that there should be some provision for imposing countervailing duties. But it is obvious that many, perhaps all, government policies, at least indirectly influence competitiveness. Many "benefits" conferred by governments, i.e., roads, education, social policies, health care, are not considered a subsidy. A GATT Working Group concluded that: "There are various actions by governments, economic or otherwise, which may provide an advantage to domestic producers, but which have not traditionally been considered subsidies." The question is where the multilateral community desires to draw the line on what is an allowable basis for competition, and which government policies might appropriately be considered countervailable subsidies.²⁰

In this regard, and from a certain environmental perspective, the distinction between "generally available" and "specific" subsidies may pose a problem. Both types of subsidies may contribute to environmental degradation and, in this respect,

¹⁸The OECD Polluter Pays Principle recognizes these types of differences. The Principle recognizes that: "Differing national environmental standards, for example with regard to the tolerable amount of pollution, are justified by a variety of factors including, among other things, different pollution assimilative capacities of the environment in the present state, different social objectives and priorities attached to environmental protection and different degrees of industrialization and pollution density." OECD, "Conceptual Framework for PPM Measures", COM/TD/ENV(93)114/REV2, p.24.

¹⁹ In respect to natural resource policies, such policies would first need to be redefined as a subsidy under revised multilateral rules.

²⁰GATT, Committee on Subsidies and Countervailing Measures, Group of Experts on the Calculation of Subsidy, "Criteria For Distinguishing Subsidies From Other Measures Having a Trade Distorting Effect", Working Paper No. 15, March, 1984, p.1.

the countervailability of "generally available" subsidies, in the WTO sense, may appear warranted. This does, however, muddy the trade rules water by introducing an environmental factor into current subsidy/countervail considerations. As noted above, the purpose of the existing countervailing duty rules is to protect domestic producers from unfair import competition that has benefitted from targeted subsidization. On the other hand, an environmentally based countervailing duty, as expressed by some environmental groups, would be an instrument for encouraging another country to adjust its environmental practices (even those not clearly linked to immediate global commons issues, e.g., user charges for water irrigation purposes) and not strictly, or even primarily, an instrument to protect domestic producers in the importing country from economic injury. Such a tool could become subject to manipulation not only by trade protectionists, but also by those who appear to believe that certain countries should have an extraterritorial right to oblige others to accept harmonized standards. Yet, is this seemingly irreconcilable clash of perspectives necessarily the whole story?

The underlying reason to consider penalizing such "generally available" subsidies through a trade action is an environmental one. In this respect, we face several dilemmas. Countries have already reached a consensus, reflected in the current, arduously negotiated multilateral rules, that "generally available" subsidies are not countervailable from a trade distorting perspective. In respect of natural resource pricing policies, which are often identified as contributing to environmental degradation, further complexities arise. Natural resource pricing policies include removal rights, such as the right to harvest timber, as well as the sale of raw material inputs. But the new WTO Agreement on Subsidies and Countervailing Measures provides an exhaustive definition of subsidy which is based on the concept of a financial contribution which confers a benefit. This definition does not appear to include natural resource pricing.²¹ Environmentalists, however, apply a broader definition of subsidization. From the environmental viewpoint, the question is how environmental concerns can be accommodated, or where to redraw the line on what

²¹Agreement on Subsidies and Countervailing Measures, Article 1, Definition of a Subsidy. If natural resource pricing were accepted as a form of subsidization in a revised WTO context, severe measurement problems would likely arise. The difference between the government price and a "market price" may not be known. One author has noted that "it could be argued that the practical difficulties of establishing the "market price" are so great, and the potential for an incorrect estimate so large, that the toleration of such potential subsidies would produce less distortion in the international economy than would the imposition of countervailing duties based on an inaccurate calculation of market price." See David Scott Nance, "Natural Resource Pricing Policies and the International Trading System," Harvard International Law Journal, Vol.30, 1989, pp.115-6.

constitutes a countervailable subsidy when the appropriate level of environmental effects is exceeded. While this line of reasoning is intuitively attractive from one vantage point, the issue of where the appropriate threshold might lie (10 percent underpricing? 50 percent? the same threshold regardless of resource availability or the impact on the environment?) is an extremely complicated question. In sum, the use of a countervailing-like duty for environmental reasons would require fundamental changes to the current trading rules and could be technically difficult to craft.

As a trade dependent country, ever wary of potential protectionist abuses, Canada has strongly supported discipline in the subsidy/countervail area of trade law. Experience with trade rules abuse necessitates a cautious approach to reform. Any potential loosening, unless very carefully crafted and reasoned, could create an instrument for the use of protectionists in Canadian export markets. Any contemplation of change from the existing rules would also require extensive federal-provincial-private sector consultations.

5. Further Practical Difficulties and Considerations

A range of other relevant issues arise and serve to illustrate the complexity of applying countervailing duties for environmental reasons. Foremost, is the question of effectiveness. Would countervailing-like duties encourage another country to adjust its policies or would such duties simply be considered a cost of doing business? For example, if a country's exports are only 5 per cent of total production of a given product, is it reasonable to expect a countervailing type duty placed on exports to prompt policy changes that will effect all production? Or are more punitive measures, i.e., economic sanctions that go beyond countervailing type duties justified on environmental grounds?²²

As indicated earlier, the issue of environmental effects is problematical. If the environmental effects are primarily local, affecting only the exporting country, should these effects be considered the same as effects which are transborder or global in nature? And when does "local" end and "global" begin, for example, in light of the carbon sink role of forests? Or is the critical difference simply whether the good

²²The effectiveness of economic sanctions and their ability to alter a country's behaviour is dependent upon a wide range of factors in both the sanctioner and target country. See Robert T. Stranks, "Economic Sanctions: Foreign Policy Foil or Folly?", Policy Staff Commentary No.4, Department of Foreign Affairs and International Trade, May 1994. This and other work undertaken by Policy Staff conclude that sanctions are not usually a very effective foreign policy tool.

containing "subsidized" inputs is traded or not? In establishing an environmental criterion, would there be a need to have some form of "environmental injury" test analogous and in addition to the economic injury to producers in the importing country that must be established under current international subsidy rules? In this respect, there is no reason to believe that the extent of detrimental environmental effects is directly related to the value of a subsidy. For example, the production of two firms receiving the same subsidy could have very different environmental effects because of different technologies employed. These types of considerations may make the use of an environmentally related countervail unpractical. They certainly require close and careful further analysis.

A significant further point to reflect on is how restrictions on imports, such as a countervailing-like duty on environmental grounds, would influence producers in the importing country, and the environmental effects stemming from this impact. Restricting imports will alter the incentives for domestic producers and may stimulate production. Unless appropriate policies are in place in the importing country, an increase in its production may contribute to environmental degradation. Indeed, countervailing-like duties could lead to an environmentally perverse result in a case where domestic production is environmentally more unsound than the production of the foreign imports, and the imports are restricted. Thus, the criteria for the use of a countervail-like duty for environment related purposes may need to consider the environmental and subsidy practices in the country seeking to use the trade measure.²³ This could go some way to ensuring that countervail-like duties are more completely directed at an environmental objective. One option would be to allow the countervail of such subsidies only if domestic firms in the importing country in the same sector were not themselves recipients of such subsidies, or to adjust the countervail duty to take into account differences in subsidy programs. Perhaps, for environmental reasons, there could be a case for linking domestic policy adjustment in the importing country to the use of countervailing-like duties.

²³A net subsidy concept was proposed by Canada (MTN.GNG\NG10\W\25) during the Uruguay Round, but did not muster enough support from the other contracting parties for inclusion in the final agreement. Under this concept, the determination of the amount of the subsidy would be based on the difference between the subsidy on imports and the subsidy on the domestic product. The Canadian proposal did not raise the net subsidy concept in an environmental countervail context.

6. Some Concluding Thoughts

The questions surrounding what multilateral discipline to apply to natural resource pricing practices, with the caveat that they have adverse environmental effects, are fundamental for the trade-environment interface. Canada has a strong interest in developing a transparent, rule-based trading system that integrates environmental and trade concerns. To date, the subsidy/countervailing duty dimension has not been adequately addressed. The GATT Working Group on Environmental Measures and International Trade did not consider the use of countervailing duties for environmental purposes.²⁴ Nor was the relationship considered within the context of the Uruguay Round, which did not consider the trade-environment nexus per se. Due to the scope of the Round itself, contracting parties thought that the addition of environmental linkages to trade would have further complicated and delayed the conclusion of the very protracted negotiations.

With the conclusion of the Uruguay Round, and the decision for the World Trade Organization to establish a committee on trade and environment, there is an opportunity to consider countervailing-like measures more fully in an environmental context, and to make recommendations on the matter.²⁵ This said, there should be no illusion about the intensive effort required to address the issue properly. Its intricacies are not yet understood, nor have the views of the major players been well formulated or articulated. The importance of the issue to certain environmental interest groups, however, necessitates that countries engage in a real dialogue on the use of countervailing duties in an environmental context.

Two aspects of environmental countervail policy are likely to give rise to considerable apprehension in the trade policy community and more broadly. These are the related fears of "slippery slopes" and the opening of Pandora's box. First, a clear need arises to prevent the countervailability of certain generally available subsidies, with environmental implications, from becoming a protectionist tool. Well

²⁴The Working Group's agenda comprised the following three issues: trade provisions contained in existing multilateral environmental agreements vis-à-vis GATT principles and provisions; multilateral transparency of national environmental regulations likely to have trade effects; and trade effects of new packaging and labelling requirements aimed at protecting the environment.

²⁵The first meeting of the General Council of the WTO will establish a Committee on Trade and Environment open to all members of the WTO. Pending the first meeting of the General Council, it has been agreed that the work of the Committee on Trade and Environment should be carried out by a Sub-Committee of the Preparatory Committee of the World Trade Organization.

thought out and circumscribed disciplines would be required. All parties to a negotiation must understand that the underlying objective is for all countries to adopt appropriate domestic environmental resource management practices. Secondly, an exception for an environmental countervail does not imply that the definition of a subsidy must be extended to a wider range of social or economic policies. The inclusion of environmental criteria in the use of countervailing duties should not be a step, for example, toward using trade policy instruments to adjust for differences in labour standards. Nonetheless, there are strong pressures in both the U.S. and the EU to use trade measures to address cost differences arising from differences in a broad range of domestic policies. These issues need to be considered on their own merits, but Pandora's box is already being pried open more than many feel comfortable with.

On the other hand, multilateral rules for circumscribed countervail of generally available subsidies, with some multilaterally agreed threshold of environmental effects, could decrease the domestic political pressure for countries, principally those countries with the most active and influential environmental groups, to act unilaterally.²⁶ If unilateralism were to occur, the smaller, trade-dependent countries may well find themselves under pressure to adopt environmental practices as directed by the larger players. If left unaddressed and unresolved, a country's exports, including Canada's, could be vulnerable to foreign countries' trade actions motivated by protectionist interests as well as environmental considerations.

Leaving immediate trade interests aside, from an environmental perspective the subsidization of resource inputs and the failure to internalize costs may have negative effects and, frankly, comprise bad economic policy as well. More generally, competitive conditions are influenced by environmental factors; and environmentally related problems, such as the over-harvesting of a renewable resource, could contribute to a reduction in a country's competitiveness over the longer term.

This Paper has explored how we might begin to address more methodically one important issue in the trade and environment universe. This Paper has highlighted the complexities of the issues involved and the dangers that such an exercise could be captured by those whose protectionist instincts are as strong if not stronger than their environmental concern. The questions raised pose serious doubt that multilateral

²⁶ It is also likely that, in negotiating the rules, a hard look at domestic environmental practices in the countries actively promoting this agenda would be required. This would also appeal to environmental interests.

agreement could easily be reached on operationalizing countervailing rules to address environmental concerns. More importantly, a high degree of uncertainty exists on whether a new form of countervailing duties would be effective in achieving its environmental objectives. For the time being, until the issues are more fully understood, it would be prudent for governments to resist pressure to employ countervailing-like duties to influence the manner in which foreign countries address environmental concerns. But this prudence should not prevent us from undertaking a careful and exhaustive review of the mechanics of how such a mechanism might be crafted in a trade and environmentally responsible manner.

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