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AGENDA ITEM 1: TRADE PROVISIONS CONTAINED IN EXISTING MULTILATERAL ENVIRONMENTAL AGREEMENTS VIS-A-VIS GATT PRINCIPLES AND PROVISIONS

Submission by New Zealand

1. Under Agenda Item 1 the Group is examining the relationship between GATT and trade provisions contained in existing multilateral environmental agreements (MEAs). Two of the core issues under this agenda item are the application of trade provisions against non-parties to an MEA and extraterritoriality.

2. In this paper some questions concerning the first of these issues are examined. The paper is not an expression of national position. It does not seek to provide definitive answers to the questions it addresses; nor does it pretend to be an exhaustive analysis. Rather it is an illustration of the sort of analytical work which New Zealand looks to the Group to undertake and an attempt to encourage further analytical consideration of the issue of application of trade provisions against non-parties to an MEA together with broader reflection on the role of trade measures in such agreements.

Trade provisions and non-parties to an MEA

3. This paper considers the situation of an MEA designed to address a transboundary or global environmental problem. It does not address agreements to determine a common approach to deal with domestic environmental issues which arise in many countries. Two broad possibilities arise:

- (i) MFN (most-favoured-nation) application to non-parties of trade measures between parties, or
- (ii) discriminatory application to non-parties of measures not in force between parties or non-application to non-parties of measures which are in force between parties.

4. Several delegations have pointed to the potential that may exist in certain circumstances for the actions of non-parties to undermine (the term "impair or nullify" has been used) the actions of parties in attempting to mitigate an environmental problem. In such circumstances it would seem logical that parties might seek to influence or determine the behaviour of non-parties.

5. When dealing with transboundary or global environmental problems, MFN extension of measures to non-parties primarily raises questions of extraterritoriality. For the purposes of this discussion on discrimination it will simply be assumed that the alternative to use of discriminatory trade measures is application of trade measures on an MFN basis. The appropriateness of trade measures per se is therefore not addressed.

6. In relation to use of discriminatory measures two questions seem central:

- (i) does discrimination make trade provisions imposed on non-parties more effective and, following from this,
- (ii) in what circumstances might therefore it be necessary to impose discriminatory measures on non-parties?

7. These questions can be explored in a variety of contexts. One possible context could concern a man-made substance that is harmful to the global environment. Parties to an agreement would presumably be interested in reducing global use of this substance. This will involve disciplines, where relevant, on domestic production and consumption in each of the parties. Formally, trade is the difference between domestic production and consumption so it can be taken that such disciplines will impact on trade flows.

8. The simplest case is a ban on domestic production and consumption in each party. Trade in this case is zero, both between parties and between parties and non-parties. What amounts to MFN imposition of the domestic measure on non-parties has accomplished all that can be achieved in terms of the environmental objective through imposition of a trade measure on the substance.

9. Alternatively production and consumption in relevant parties might be controlled at non-zero levels. In this case the aggregate level of activity within the parties to the agreement is established. If controls on domestic production and consumption are applied on an MFN basis the parameters for interaction with non-parties are also set. The upper bound on net trade flows with non-parties is the level of parties' production if there is no domestic consumption in parties or the level of their consumption if there is no domestic production. In either case, or as is more likely in some mixture of the two, by setting their aggregate level of activity the parties have made their contribution to the achievement of the environmental objective; a contribution which would seem not to be affected by any associated trade flows. (An interesting intermediate case is where controlled levels of production and consumption across parties are set at the same amount. In this case net trade flows with non-parties are zero.)

10. The alternative to MFN application of such measures is discriminatory treatment of non-parties; application of controlled and balanced levels of trade among parties accompanied by a ban on trade with non-parties is one possible example. What can such discrimination achieve in terms of the environmental objective over and above MFN application?

11. A number of possible situations might arise. Below five such situations are briefly examined. This is not necessarily an exhaustive list but it may provide a basis for further discussion. It should be noted that the following case definitions are intended to be exclusive. For instance, Case 3 should be read to mean that production facilities in non-parties, at the time of entry into force of the MEA, are either non-existent or negligible.

Case 1: Parties comprise the majority of production and consumption of the substance

12. If most sources and the majority of production and consumption are parties to the agreement the behaviour of non-parties will be only of marginal impact. In this case there would seem to be little purpose to the adoption of discriminatory trade measures.

Case 2: Non-parties include major sources of both production and consumption of the substance

13. If the major sources of production and consumption are among non-parties to the agreement any action by parties, including imposition of discriminatory trade measures, will be of only marginal impact. Alternatively non-parties may comprise a significant proportion of total production and consumption. In this case net trade flows between parties and non-parties will depend on the pattern of comparative advantage between producing countries. Where net trade flows are small, trade measures, whether discriminatory or not, are again unlikely to have much effect. Even if net flows are initially substantial, non-parties are likely to have the potential for collective self-sufficiency thus minimising the impact of any discriminatory trade measures.

Case 3: Non-parties include major sources of consumption

14. If major sources of consumption are non-parties, discriminatory trade measures, which could otherwise close off sources of supply before substitute products are available, might have the effect of providing an "incentive" for non-parties to join the agreement. But would the effect on the environment of such non-party consumption taking place within the agreement be any different to it taking place outside the agreement under the MFN imposition of parties' trade measures? Given that in this case supply side limitations on production in parties would largely determine global consumption potential the difference is not immediately apparent.

15. However, rather than providing an incentive for non-parties to join the agreement, discriminatory measures may alternatively have the effect of impelling non-parties to establish domestic production facilities to serve their own markets. Instead of relying on imports from parties as previously, non-parties might therefore become self-sufficient in the substance. Such an eventuality could tend to undermine the environmental objective by frustrating subsequent efforts of parties to supply non-parties with more environmentally friendly (but more expensive) substitutes.

Case 4: Non-parties include major sources of production

16. If non-parties are major sources of production they would likely be net exporters to parties. Discriminatory trade measures would certainly be effective in this case in undermining the viability of such production and thus might be thought to be effective in achieving the environmental objective. But would discriminatory measures be any more effective than measures applied on an MFN basis? In this case demand-side restrictions in parties applied on an MFN basis would establish the viable level of global production. If discriminatory measures were applied, however, one might also ask from where parties to the agreement would obtain their consumption needs during the transition phase before substitute products were available. Would new production facilities have to be established in parties or existing production expanded to supply this market? If so the question again becomes one of to what extent the environmental objective, in what is a global problem, is affected by the location of production facilities.

Case 5: Potential production in non-parties

17. Similar considerations apply with respect to non-parties which are potential net exporters to parties, regardless of whether they currently produce the problematic substance. This case embodies elements of Cases 1, 3 and 4 above but may also be relevant in situations where prior to the agreement there is no production or consumption activity in a particular country or group of countries.

18. Adjustment to lower levels of production and consumption within parties might be achieved on the consumption side through the price mechanism with accompanying non-market restrictions on the supply side. Any bidding up of the price level of the substance will make production in non-parties more attractive and tend to encourage new entrants to the industry. Application of MFN measures therefore may not prevent some migration of production facilities to non-parties whereas discriminatory measures would. But again the same question arises as in Cases 3 and 4. In the case of a substance which causes a global environmental problem is the environmental objective more concerned with the aggregate global level of production and consumption or its location?

19. In situations of truly global environmental problems, where local environmental conditions are very much a second order consideration, questions of location seem to rapidly come down to questions of economics. Who is to be granted the rights to the economic rents (profits) to be obtained from supplying the declining consumption markets in parties? This seems somewhat akin to the "free-rider" argument for discriminatory measures; that discriminatory measures are necessary to prevent non-parties from taking commercial advantage of their status.

20. This is an argument which several participants in the Group have rejected as a basis for discrimination. Presumably one basis for such rejection is that the distribution of profits between parties and non-parties has nothing to do with achievement of the environmental objective. Some proponents of the "free-rider" argument have suggested that this may not be the case. In more sophisticated expressions of the "free-rider" problem it is suggested that the possible competitive advantage to be gained from non-party status can also contribute to a nullification of the environmental objective. It is far from clear how this could come about. It might be argued, however, that the profits from declining markets in parties need to be reaped by producers within parties in order to finance research and development of more environmentally friendly substitutes.

21. This argument would not seem to arise in cases where the substance itself or the technology required to produce it were under patent to producers of countries party to the MEA. In that case the rents would still accrue to the patent holder regardless of the location of production. Conceivably, however, a situation might occur in which a substance which was either off-patent or shortly to go off-patent became the subject of an MEA. In this case there could well be some migration of production to new or unrelated facilities in non-parties with resulting reductions in profits of producers within parties.

22. The extent of such migration and of the profit reducing effect would, among other factors, depend on the degree of price movement engendered by restrictions on consumption, the characteristics of production technology, including whether substantial capital investment was required, and the length of transition to the development of substitute substances. In other words the degree to which possible migration of production to non-parties under the MFN imposition of trade measures might give rise to nullification or impairment of the environmental objective could only be determined through a thorough consideration of the particular circumstances involved, including the availability of other sources of finance for research and development of substitutes.

Conclusion

23. The above type of analysis might also be applied to contexts in which the substance or product could additionally be used as a component of other products. In such circumstances measures might also extend to products containing the environmentally damaging substance. Again similar questions

could be explored to determine what might be achieved in terms of the environmental objective through use of discriminatory measures over and above what could be achieved through use of measures applied on an MFN basis.

24. At the outset of this paper it was stressed that the questions raised in the above analysis were not intended to be exhaustive. Too there are doubtless many forms of discrimination other than the simple type considered here. What this paper does suggest, however, is that in the context of measures applied to a substance or product the effects of discrimination are not immediately obvious and in a number of instances may not act to further the environmental objective of an MEA.

25. New Zealand will be interested to further refine and extend this analysis, including in response to comments and analysis by other delegations.