TE 010
11 October 1994

Work Starts on Environmental Charges, Taxes and Product Requirements

Consultations Planned on Exports of Domestically Prohibited Goods and Possible WTO Relation with other Organizations

The Sub-Committee on Trade and Environment began its work after the summer break with a meeting on 15-16 September devoted to the relationship between the provisions of the multilateral trading system and (a) charges and taxes for environmental purposes, and (b) requirements for environmental purposes relating to products, including standards and technical regulations, packaging, labelling and recycling.

The Sub-Committee was established at the Marrakesh Ministerial Conference in April 1994. A Committee on Trade and Environment will be formally established at the first meeting of the General Council of the World Trade Organization, which is scheduled to enter into force on 1 January 1995. Ministers agreed in Marrakesh, however, that pending entry into force of the WTO work on this subject should begin at once in the Sub-Committee, one of four now active under the Preparatory Committee for the WTO. The Sub-Committee on Trade and Environment is chaired by Ambassador Luiz Felipe Lampreia of Brazil.

The Sub-Committee's next meeting is scheduled for 26-27 October. It will focus on the relationship between the provisions of the multilateral trading system and trade measures for environmental purposes, including those pursuant to multilateral environmental agreements. A further meeting towards the end of the year will focus on the effect of environmental measures on market access, especially in relation to developing countries, in particular the least developed among them, and environmental benefits of removing trade restrictions and distortions.

Meeting of 15 - 16 September

Charges and Taxes for Environmental Purposes

Environmental charges and taxes are becoming increasingly more widely used by GATT member governments as a means of pursuing national environmental policy objectives and of internalising their domestic environmental costs.

The rules of the GATT discipline the way in which governments may levy internal taxes and charges only inasmuch as they are applied to traded goods — either imposed on imported products or rebated on exports. That, nevertheless, is a matter of considerable interest and importance to trade and environment policy-makers, particularly so in the context of proposals in a number of countries to increase taxes on environmentally sensitive production inputs such as energy and transportation. The focus of the Sub-Committee on this issue is therefore considered highly relevant and timely for ensuring that policies in the field of trade and environment are properly coordinated.

In the view of many of the delegations which spoke at the meeting, environmental product taxes and charges are an efficient form of policy intervention to tackle environmental externalities, more so in general than regulatory measures which do not rely directly on market forces to achieve their objective. Some delegations noted that the choices governments make about which type of policies are the most appropriate to achieve a given outcome in specific circumstances are often influenced by a range of factors and not only by economic efficiency. Nevertheless, as Argentina pointed out, product taxes and charges have at least three major attractions from the trade point of view. First, they can be applied to imports and rebated on exports in a manner fully consistent with GATT rules, so that they offer a means of dealing with local producers' concerns about the possible effects of environmental measures on their competitiveness. Second, they are transparent and their economic and environmental costs and benefits can be relatively easily assessed, which leaves less room for creating trade disputes or for protectionist abuse. Third, they allow each country individually to estimate and address domestic environmental externalities in a trade neutral way.

Several delegations stressed that GATT member governments had a sovereign right to decide on the way and extent to which they would address the internalisation of domestic environmental costs, and they cited Principle 16 of the Rio Declaration in this regard. As India pointed out, it endorses the use of economic instruments, such as charges and taxes, as a means of promoting sustainable development, and encourages governments to endeavour to carry out cost internalisation through efforts at the national level while taking account of the national interest and without distorting international trade or investment.

Mexico took up the analysis of environmental taxes and charges in a generic way at the meeting, saying there was a need to develop a full understanding of their economic and environmental effects before examining how GATT disciplines might relate to them. Four considerations needed to be taken into account in Mexico's view. First was the issue of valuation, to determine what tax rate should be levied. Several delegations noted that this could be difficult, if not impossible, for addressing certain environmental costs or risks, such as species extinction. Second, the diversity of tax rates prevailing internationally would likely be high, given that environmental costs varied from product to product and according to specific conditions and social preferences in different national locations. Third, the effectiveness of product taxes and charges for tackling consumption pollution at source was well established, but enormous doubts existed over the effectiveness of using production taxes in one country to try to tackle production externalities elsewhere. India added in this context the need to examine the necessity of the measures in question. The fourth consideration was how environmental taxes and charges might affect relative competitiveness. Many claims were made in this area, yet the available evidence suggested it was incorrect to believe ecological externalities had any significant effect on business competitiveness.

Concerns about the competitiveness implications of environmental taxes and charges were discussed at the meeting by several delegations. In the absence of any tax adjustment at national borders, exports taxed in their country of origin could be placed at a price disadvantage on

world markets, while taxing domestically produced goods but not imported products could create a price differential in favour of imports. In this regard, GATT rules on border tax adjustment were considered to provide an important accommodation. Article III contains the principal GATT disciplines in this area. They were elaborated upon in 1970 by a GATT Working Party that explored the problem of border tax adjustment in detail and which arrived at a broad consensus that taxes levied directly on products are eligible for adjustment at the border (they can be imposed on imports and rebated on exports). Examples of such taxes include specific excise duties, sales and cascade taxes and value added tax. The purpose of the taxes does not affect their treatment under GATT rules. Many delegations at the meeting noted that if properly applied, border tax adjustment of environmental taxes and charges would not alter equality of opportunity in the conditions of competition between domestic and imported products. As Hong Kong pointed out, the importance of this had been stressed many times by GATT dispute panels as necessary to provide effective national treatment.

The 1970 Working Party concluded also, however, that at least certain taxes that were not levied directly on products were not eligible for border tax adjustment. These included such taxes as social security charges whether on employers or employees, payroll taxes and income taxes. In this context, several delegations noted that although GATT rules allow for border tax adjustment on incorporated inputs of final products, adjustment of taxes or charges on unincorporated process and production methods is not permitted.

As the European Communities observed, one reason for the distinction between which taxes can or cannot be adjusted at the border is the practical difficulty of verifying whether certain unincorporated inputs had been used in the production of a product. Korea noted also there was a risk of undermining trade neutrality by creating what would amount in effect to double taxation of products according to their production methods; for instance, if environmental costs have already been internalized by an exporter through complying with local environmental regulations on production methods, there is no justification for applying production taxes or charges on the exported products in overseas markets. Brazil pointed to the further problem that taxing overseas production methods would amount to unacceptable interference in countries' sovereign rights to evaluate and internalize as appropriate their domestic environmental costs. When it comes to problems of transboundary or global production pollution, Switzerland expressed a view shared by many in the Sub-Committee that the proper way of addressing them is through international cooperation and agreements.

Several other delegations took up the question from the point of view of the economic rationale underlying GATT rules on border tax adjustment, and in particular the point raised by Mexico about the effectiveness of environmental taxes and charges and of border tax adjustment for achieving environmental objectives. Nigeria gave a detailed analysis of taxes and charges from a fiscal point of view, while New Zealand looked at the effect of adding the trade dimension to the effectiveness of taxes or charges in addressing four types of environmental externalities: local production externalities; local consumption externalities; global/transboundary production externalities; and global/transboundary consumption externalities. The conclusions of New Zealand's analysis were as follows.

(i) For local production externalities, the purpose of a tax or charge was to reduce domestic production. Imposing a tax on imports of the like product would increase the price of imports, thus reducing (or possibly eliminating) the relative price effect of the tax between locally produced products and imports, raising the domestic market price and lessening the output-reducing effect of the tax on domestic production. In the case of an exportable, allowing for a tax exemption on exports would remove the relative price effect of

the tax on that proportion of output which was exported, again lessening the output-reducing effect of the tax on domestic production. Taxes and charges aimed at local production externalities could therefore be most effective when there was no adjustment at the border.

(ii) For local consumption externalities, the purpose of a tax or charge was to reduce domestic consumption. In the case of an importable, not to impose the tax or charge on imported like products would remove the price effect of the tax on that component of consumption which was imported, thus lessening the effect of the tax in reducing domestic consumption of the product. In the case of an exportable, there would seem to be no logical reason to impose the tax on products not being consumed in the domestic market. Moreover to do so would reduce the returns received by domestic producers from export markets with a resulting reduction in the price at which they were prepared to supply the domestic market, again lessening the effect of the tax in reducing domestic consumption. For a local consumption externality, therefore, adjustment at the border could be expected to contribute to the effectiveness of the domestic tax or charge.

Some products giving rise to consumption externalities, however, might be consumed as inputs in a production process. Where externalities arose from consumption of an input, demand for the input was derived from demand for the final product. If the input was taxed to reduce externalities, adjusting taxes at the border to account for the imputed value of the input tax contained in the price of the final product would have the effect of working against the objective of reducing demand for the input. Border adjustment would therefore be appropriate for imports and exports of the input, but not for imports and exports of the final product.

(iii) In the case of global/transboundary production externalities, the externality was not dependent on the location of production within the set of countries (all countries in the case of a global externality) affected by the externality. In cases of taxes or charges imposed at the domestic level under such circumstances, the conclusion drawn from the first case above continued to hold, i.e. exempting exports from the tax or charge would lessen the effectiveness of the policy. Considerations on the import side were more complex. For example, if the production tax was also levied on imports, this might lessen the effectiveness of the tax in reducing the externality generated by positive effects on the contribution of imported goods to the externality. Logically all sources of production (or at least the large majority of them) would need to be subject to measures aimed at internalisation of the externality.

(iv) In the case of global/transboundary consumption externalities, the externality was not dependent on the location of consumption within the set of countries affected by the externality. As with the third case, effective internalisation of the externality would require all (or the large majority of) sources of consumption to be subject to internalisation measures. In cases of taxes or charges imposed at the domestic level under such circumstances the conclusion drawn in the second case described above would continue to hold, i.e., imposition of the tax or charge on imports would contribute to the effectiveness of the domestic measure. However, considerations on the export side were more complex. In both this and the case of transboundary production externalities, consideration of these complexities involved further analysis of the context in which the domestic measure was being imposed. The prior assumption about the effectiveness of the original domestic measure did not automatically follow independent of such analysis.

Malaysia, speaking on behalf of the ASEAN countries, raised several questions for further reflection in the Sub-Committee. Had border tax

adjustment measures really been effective for attaining domestic environmental objectives? To what extent had such measures affected market access, especially for those countries which had inherent comparative advantages, e.g. endowed with natural resources, and which were producing without causing any adverse effect on the environment? How could it be ensured that border tax adjustment was not used for protectionist or discriminatory purposes?

Several other delegations felt it would be important for the Sub-Committee to take up in detail the issue of the justification for different treatment under the GATT of taxes and charges on products as opposed to those on production methods. For some, this raised the question of the definition of "like product". Sweden, speaking on behalf of the Nordic countries, questioned whether current GATT rules on border tax adjustment might not unduly influence the formulation of environmental policy. The European Communities also thought it would be important to examine this issue, and added that the new preambular language to the WTO which referred to sustainable development and environmental protection would have to be taken into account in interpreting WTO Agreements and asked then whether GATT rules on border tax adjustment should henceforth be examined in the light of the environmental aim of a tax. The United States felt the environmental objective of a tax should certainly figure in an analysis of how it was to be treated by the rules of the multilateral trading system, and also questioned the validity of drawing conclusions on the basis of existing GATT rules and jurisprudence that taxes on production methods could not be adjusted at the border. Austria noted that the 1970 GATT Working Party on border tax adjustment had produced a divergence of views on how *taxes occultes* should be treated, and that the Uruguay Round Agreement on Subsidies had provided for special treatment for rebating prior stage, cumulative indirect taxes on energy, fuels and oils at the border; these issues merited further examination, and in Austria's view one key task would be to resolve how a tax on production methods could be translated into a tax on the final product and could thus be adjusted at the border.

Many delegations felt the best way of proceeding on this issue would be through a case-study approach in order to formulate some general conclusions and recommendations.

Environmental Product Requirements

Several delegations recalled that a good deal of work had been done on packaging and labelling requirements in the Group on Environmental Measures and International Trade and that this should be taken into account and used as a basis for further work. Potential problems identified already as facing foreign producers from such measures were the relative costs of participation for foreign versus domestic producers, access to information about programmes, inability to participate in product and criteria selection, and transparency issues.

Several members referred to the importance of the Agreement on Technical Barriers to Trade for measures of this kind, and urged that any uncertainty regarding which measures were covered by the TBT Agreement should be eliminated. The United States noted that in the Agreement an important distinction was made between mandatory and voluntary measures, and said it would be important to bear in mind how the term "related to the final characteristics of the product" in the TBT Agreement might be applied. The European Communities felt that it would be premature to consider possible additional rules in the trading system for environmental product requirements before gaining some experience with the revised TBT Agreement. Sweden, speaking on behalf of the Nordic countries, felt nevertheless that certain important areas remained outside the scope of the TBT Agreement, including recycling and waste management requirements, and that the Sub-Committee should examine whether new provisions or amendments were needed. Argentina said that eco-labelling schemes which incorporated life cycle analysis might not fall en-

tirely within the bounds of the TBT Agreement since they included evaluations of unincorporated process and production methods which, as Egypt noted, many delegations considered was not a justifiable basis on which to discriminate between products at the border.

Canada noted that the Sub-Committee was not mandated to examine the relative effectiveness of environmental product requirements such as labelling and packaging requirements nor their legitimacy; they played an important role in environmental policies in many countries. The framework for further analysis for these measures should therefore include the following elements: an analysis of their effects on trade; an analysis of the necessity and effectiveness of applying them to imported products; and an analysis of whether, when imported products were subject to the measures, they should be treated in exactly the same way as domestic products.

With regard specifically to eco-labelling, Canada highlighted various characteristics of life cycle analysis which contributed to favouring domestic over foreign producers and problems associated with applying production stage criteria to imports. First, to learn everything about a product's full life and its impact on the environment, including everything about every input and the life of that input, would be too expensive and too time consuming to be practical. Therefore, when using a life-cycle approach a subjective decision had to be made about what constituted the "life" of a product and what selected elements of its life should be considered in the assessment. These decisions might be skewed by domestic circumstances and they might not reflect the environmental realities of a foreign market. Second, quantitative data about environmental impacts was difficult to find. Sometimes it was confidential business information, sometimes it had to be estimated, and sometimes it was available only by plant and not by product. This raised two questions: was the data good, and was it influenced by domestic realities. Third, there was no common unit of measure for product inputs. Some inputs were measured in value terms, others in BTUs or some other measure, and a subjective decision about the comparability of different measures had to be made. Again, domestic circumstances would necessarily play a role in this decision. Finally, environmental impacts were difficult to quantify and compare. For example, what was the value, and relative value, of potential impacts on human health, on the survival of a species or on the preservation of a forest? In order to make these assessments other subjective decisions had to be made, perhaps reflecting domestic values. On this issue, therefore, Canada considered that further study should proceed on a case-by-case basis.

Egypt considered that two principles should be observed when developing eco-labelling schemes. First, full and effective participation of developing countries should be ensured in the selecting and setting of criteria, particularly for products of export interest to them. In this context, it could be useful to look at products of export interest to developing countries and, if imported products constituted a large share of total consumption, then eco-labelling criteria should not be formulated without full consultation with trading partners. Second, governments and related bodies as well as standardization organizations should comply with the new provisions of the WTO Agreement on Technical Barriers to Trade to ensure there was full transparency and that labelling schemes were not set in such a way as to cause barriers to trade or to accord imported products less favourable treatment than that accorded to like products of national origin or originating in another country.

Argentina noted several factors which could make it possible to make the most of the advantages of eco-labels as environmental policy instruments while limiting their possible distorting effects on international trade: (a) ecological certification systems must have a clear environmental objective and not a trade objective; (b) it must be accepted that environmental conservation criteria applicable for the production cycle should take account of the factor endowment in each production location and not in the certi-

fying market alone; (c) all environmental certification systems should provide for consultation with interested countries prior to the establishment of a specific criterion for a specific product; (d) environmental certification systems should be included in an international agreement aimed at mutual recognition of certification standards and criteria, mutual recognition of certifying entities, and a mechanism for prior consultation with interested countries.

Noting certain efforts to label tropical timber, Malaysia, speaking on behalf of the ASEAN countries, said that although labelling schemes could be used to advance sustainability, they could also give rise to serious problems through the way they were implemented. Many labelling schemes were being promoted in consuming countries in the name of sustainability but were governed actually by political and economic expediency. Some schemes were being unilaterally advanced without any reference to multilaterally agreed guidelines or criteria. Many covered tropical timber exclusively, thereby putting competing temperate timber and other like-products which were not subject to such schemes at a distinct unfair advantage. Timber, to a certain extent, also competed with other substitutes such as plastic, aluminium and steel for which similar and comparable arrangements with regard to sustainability should be made. A producing country's efforts to address environmental concerns or impose certification were often viewed by third parties with scepticism and with a need for verification. On the other hand, third party initiatives, particularly in consuming countries, often lacked understanding of the situation prevailing in producing countries. This experience in timber labelling could also extend to other products. In general, the key principles of non-discrimination and the avoidance of unilateral action should be upheld.

The United States announced that it would be submitting a systematic framework for analysis of some of the issues and concerns regarding eco-labelling in order to facilitate the work of the Sub-Committee.

With regard to packaging requirements, Argentina said that earlier discussions in GATT had produced a certain consensus on the possibility of assimilating requirements on allowable types of packaging materials into technical regulations. This would mean that they would be covered by the rules of the TBT Agreement. Nevertheless, many packaging requirements still created difficulties for exporters. To minimize their adverse effects on trade, there must be strict compliance with the transparency provisions of the TBT Agreement and the harmonization and mutual recognition of packaging regulations must be promoted. Criteria and regulations should be harmonized so as to reduce costs and achieve greater transparency and the methodology and institutional environment for carrying out such harmonization should be examined. Systems for the recovery, re-use or disposal of packaging were different and might also have major trade effects, especially because all were designed taking into account primarily the needs of domestic industry. To minimize the negative trade effects, these systems should be subject to obligations similar to those established by the TBT Agreement for technical regulations and standards. Therefore, the future work on packaging should concentrate on analysing how this category of requirements could be incorporated into the TBT Agreement or some new legal instrument dealing specifically with this topic.

Argentina went on to note that a distinction existed between requirements that regulated the recyclability of a product or its packaging, and requirements that regulated the recycled content which a specific product or its packaging must contain. The first type of measure sought to regulate an environmental externality arising in the consumption stage, while the second aimed at regulating an externality that arose exclusively during the production stage and therefore should not have extraterritorial application. Whenever an environmental requirement was applied extraterritorially, this undermined the sovereignty of contracting parties. The real problem was the environmental unsustainability of cultures whose consumption patterns gave rise

to a proliferation of waste that exceeded the environment's natural biodegrading capacity. Recycling was a valid but inadequate instrument for tackling this problem. It should not, therefore, be considered an end in itself. In addition, if it was trade-distorting, far from serving its environmental purpose it would favour inefficient resource allocation. While recycling was environmentally important, the efficient allocation of economic resources, including natural resources, fostered by free trade was environmentally much more important. If that premise was not the starting point, environmental absurdities would be justified, such as the importation of waste in order to be able to re-export it as recycled content so as to meet certain environmental requirements.

It could therefore be useful for the Sub-Committee to try to reach a consensus on the criteria these measures should meet in order to be legitimately applicable extraterritorially. Broad lines of the criteria Argentina would like to see included were (a) recycled content requirements should only be applied to foreign producers when they were based on the abundance of recyclable materials obtainable in the production area and should not give preference to the use of materials that were abundant only in the consumer market; and (b) product recyclability requirements should only be applicable to foreign producers when they regulated an externality produced in the consumer market. The sole exception to this rule should be requirements adopted in the framework of a multilateral environmental agreement.

Participation of NGO community; ways and means for further transparency and openness

The United States said that in order to maintain a high level of credibility throughout the work of the WTO on trade and environment it was important to incorporate principles of transparency in the procedures of the WTO Committee on Trade and Environment, including allowing interested NGOs (which would include groups representing environmental, developmental and business interests) whose work was relevant to the Committee's work to observe its proceedings. The majority of WTO signatories had already recognized the constructive role of NGOs in other contexts. Article 71 of the UN Charter established the legitimacy of an NGO presence in international activities. Chapter 27 of Agenda 21 built on this early directive and urged signatories to invite NGOs to take part in the formulation of policies and implementation of development programmes. Chapter 38 of Agenda 21 called upon all intergovernmental organizations to design open and effective means to achieve cooperation and interaction with NGOs. NGO work in implementing Agenda 21 was noted and it was agreed that NGOs should have access to any UN reports and information.

The Uruguay Round Final Act recognized the value and legitimacy of consultation and cooperation with NGOs in Article V(2), which stated that the General Council may make appropriate arrangements for consultation and cooperation with relevant NGOs. NGOs had observed UN proceedings for many years and UNEP, UNDP and UNECE, among others, had taken proactive steps to address NGO involvement. The World Bank's current Directive on Disclosure of Information created a presumption in favour of disclosure, outside and within the Bank, in the absence of a compelling reason not to disclose. It had also established an Inspection Panel to ensure that the Bank's rules were being followed. The Bank's experience showed that external consultations enhanced the quality of its operations. In addition, the ECOSOC had granted NGOs consultative status to observe the proceedings of a range of UN organizations, such as UNEP and the Commission on Sustainable Development. Other international bodies had also allowed NGOs to observe and in some instances participate in a more structured approach. In the OECD input was channelled through the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) which held consultative status with the Secretariat and met annually with the Ministerial Conference Chair and the Secretary-General. Such a structured

approach permitted productive input but preserved the country-to-country nature of the organization.

The United States thought it would be helpful for NGOs to observe the proceedings of the WTO Committee since its work on trade and environment directly involved matters of broad public interest. In the area of the environment, NGOs had served a useful role as providers and disseminators of information and expertise. Many NGOs had been active in international fora for decades and had committed great enthusiasm, talent and money to educating lawmakers in environmental matters. Efforts had been characterized by sophisticated identification of and research on environmental issues and assistance to government agencies responsible for policy choices.

Many countries had expressed reservations regarding NGO observer status in the WTO due to numbers and possible disruption of the work programme. The United States agreed that permitting NGOs to observe Committee proceedings must not be allowed to interfere with its efficient operation. However, appropriate ways could be found to address these concerns by limiting the number of seats, with appropriate consideration to balance and diversity. The Committee should consider methods to structure NGO observership, drawing from the experience of other international organizations, which provided sufficient openness without compromising the Committee's country-to-country dialogue or impeding productive deliberations. The Committee might also wish to consider defining guidelines on when observation would be appropriate. Practical reasons existed for limiting NGO access to certain sessions as business could not be effectively conducted if every meeting were made available for public discussion. The specific needs of negotiations, for instance, would preclude the presence of NGO observers. However, relevant information to most meetings could be disclosed without problems. Non-transparent proceedings perpetuated a "fortress" image of GATT and diminished public confidence in, and support for, WTO work which contributed to misunderstanding and suspicion of the deliberative processes of the trading system. Insularity should not be allowed to undermine the WTO's progress, nor should openness compromise its effectiveness. Undue limitation on NGO involvement could impede the flow of ideas and information necessary for informed policy and complicated domestic trade liberalization agendas. The Committee could benefit from the "two-way street" that would result from allowing NGO observation of its proceedings. If properly structured, this practice could advance the Committee's deliberations and contribute to an open consideration of the complex issues that constituted its mandate.

Many delegations agreed with the United States that transparency and openness were important and conducive to more fruitful and productive deliberations. However, most did not consider that transparency equalled participation and felt there were many ways to provide for it in GATT such as derestriction of documents, further public meetings organised by the Secretariat, as well as other channels of effective communication. It was important to be creative and open-minded, but participation and coordination of NGOs in the policy-making process should remain at the national level where national governments had a fundamental and primary responsibility for transparency with NGO's in their jurisdiction. India felt that the problem lay not in the practical aspects of accommodating large numbers of NGOs but in the risk of politicizing the WTO, which was a legal contract between governments with rights and obligations and an advanced dispute settlement procedure. It was different in nature from other organizations such as the World Bank or the OECD.

The meeting concluded with members agreeing that the Chairman should hold informal consultations on this issue, the issue of observer status of additional inter-governmental organizations, and on restarting work on the issue of domestically prohibited goods.