

# Intelligence MEMOS



From: Lawrence Herman  
To: Canadians Concerned About Trade and the Environment  
Date: May 2, 2023  
Re: **BATTLES LOOM OVER GREEN SUBSIDIES**

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Clouds are gathering on the trade horizon as governments subsidize ever-expanding decarbonization measures, including Ottawa's \$13 billion for Volkswagen's new Ontario battery plant, which matched available US money.

Many of these national measures to aid the transition to net-zero emissions, even if based on the Kyoto Protocol and the Paris climate-change agreement, may run headlong against trade rules that prohibit both the subsidization of goods that enter international markets as well as local content requirements that discriminate against imports.

Governments have to find accommodation or the world could be in store for a proliferation of nasty trade wars.

The primary concern is over the massive decarbonization subsidies and preferential tax credits under Joe Biden's *Inflation Reduction Act*, but there are broader implications. Can governments take collective action to avoid cascading disputes over national climate-related measures?

The problem lies at two levels. At the multilateral level are the obligations in the World Trade Organization Agreement prohibiting these kinds of measures. The issue is that WTO rules were written decades ago, first in the 1947 General Agreement on Tariffs and Trade (GATT) and updated in the 1994 WTO Agreement itself.

Because of its dated origins, the agreement contains no exemption or leeway for environmental subsidies or local content requirements directed to net-zero carbon policies, which leaves a significant gap in the WTO framework. The same gap exists in regional agreements based on WTO principles such as the US-Mexico-Canada Agreement, the Canada-Europe free-trade pact, the Trans-Pacific Partnership and others.

One idea under consideration at the International Monetary Fund, the Organization for Economic Co-operation and Development, and the WTO itself is a "standstill" or peace clause by which governments agree not to challenge carbon-reduction measures of another WTO member for a specified time period.

The difficulties in getting international agreement cannot be underestimated. And there are a host of other issues surrounding the standstill idea. But talks are under way and, with political will, governments could find some basis for agreement.

The more likely source of future trade wars, however, is at the domestic level, where national trade remedy laws – as in the US, Canada, the EU, Australia, etc. – allow countervailing duties (CVDs) to be levied on subsidized imports that cause or threaten material injury to the domestic producers of the same product.

Canada has been the target of this kind of trade action in the long-running softwood lumber war with the United States. Because the availability of trade remedies are private rights and because of their heavy political element, finding any internationally agreed solutions is particularly daunting.

Canada's system is very close to the US one and comes under the *Special Import Measures Act*. It allows any Canadian industry or industry group to file a complaint with the Canada Border Services Agency. The agency will investigate and if it finds that the described imports are indeed subsidized, the matter goes to the Canadian International Trade Tribunal to inquire into whether those imports cause or threaten financial injury to the complaining producers.

While so far there have not been Canadian CVD cases involving imports benefiting from environmental subsidies, there have been worrying developments in the US, given the aggressiveness of the American trade law system. The concern is illustrated by the action against solar panels, notwithstanding their carbon-reduction attributes, where the American industry complained about subsidized exports from Malaysia, Thailand, Vietnam and Cambodia, ultimately winning their case with the application of CVDs to the goods in question.

In that case, Mr. Biden issued an order last June suspending the duties for two years because of the need for a sufficient supply of such panels to meet US climate policies. While that suspension has been welcomed, indicating solutions to this issue are available, it doesn't reduce concerns over the reach of trade remedy laws, whether in the US or other countries.

In the US, trade remedy rights have a kind of sacrosanctity, akin to the right to bear arms. While the US may be the most extreme example, the fact that invoking trade protection is a private right in Western democracies makes it politically difficult to remove or dilute them. And the fact that the complainants' own government, as in the US, may subsidize its own domestic production makes no difference under trade remedy laws.

All this means that even if some kind of standstill could be reached for state-to-state disputes at the multinational or regional levels, removing private-sector rights domestically is more sensitive. It is going to be a great challenge to forestall both state-to-state disputes as well as national trade remedy actions contesting legitimate decarbonization measures in coming days.

*Lawrence Herman, a former Canadian diplomat, is counsel at Herman & Associates and senior fellow of the C.D. Howe Institute in Toronto.*

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