Intelligence MEMOS

From: Lawrence Herman

To: Carbon Tax Watchers

Date: March 24, 2021

Re: MORE AT STAKE THAN OTTAWA'S CARBON PRICE IF SUPREME COURT KNOCKS IT DOWN

Tomorrow, the Supreme Court of Canada will issue its decision on the constitutionality of Ottawa's *Greenhouse Gas Pollution Pricing Act*. Politicians in Alberta, Saskatchewan, Manitoba and Ontario will dance in the streets if the legislation is overturned. They argued it was merely a disguised tax measure encroaching on provincial jurisdiction. For others, such a decision would be a regrettable setback, limiting and possibly preventing any meaningful pan-Canadian climate change policy.

In addition, however, a little-noticed outcome of finding the Act unconstitutional is that Canada can then say goodbye to any kind of border levy or tax on imports from polluting countries that send their goods here.

Border carbon adjustments (BCAs) – taxing imports from countries that don't have effective carbon-reduction measures – are seen as an important tool for combatting climate change.

At a well-attended (virtual) program in early March organized by the Canadian mission to the World Trade Organization, proponents pointed out that BCAs can accomplish three things: (1) incentivize delinquent countries to enact appropriate climate change measures; (2) level the playing field vis-à-vis offending imports, maintaining the competitive position of domestic industries that have to bear the costs of carbon reduction; and (3) neutralize "carbon leakage" by making it less attractive to move production offshore to countries with less stringent – and less costly – carbon-control measures.

The BCA concept remains controversial, however. John Kerry, the new US Special Presidential Envoy for Climate, recently voiced concerns about the European Union's plans for such a border tax later this year, saying it had "serious implications for economies, and for relationships, and trade."

When it comes to trade, there are rules in the General Agreement on Tariffs and Trade (GATT), part of the WTO Agreement, which is binding on Canada and all WTO members. Article 3 of the GATT, one of its cornerstone provisions, says:

"The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."

The reference to "treatment no less favourable" prohibits discrimination in the form of any kind of tax, regulation or other preference in favour of domestic products vis-à-vis imports. In other words, imports must be treated exactly the same way as the same domestic goods in all respects.

Interestingly, border adjustments meeting these GATT requirements have been in place for decades, well before there was any talk about climate change. Value Added Taxes – Canada's is the GST – are the best example. These are the simplest kind of permissible border tax adjustments. They pass the international trade test because there is no discrimination in their application, the rate being uniform across the board, with imports being treated identically – no less favourably – than domestic products sold in Canada.

In today's climate change era, devising border adjustments in line with these GATT rules is complicated. But what many analyses show is that, like the GST or the VAT, the most obvious route to ensure a measure is GATT-compliant is applying it at the same rate as the carbon price borne by the same type of domestic product.

Given the imperative to ensure Canadian industries and Canadian jobs aren't prejudiced by carbon leakage and unfairly priced imports from polluting countries, the federal government – and especially those aforementioned provincial governments – needs to come to grips with these issues. And this brings us back to the Supreme Court and provincial opposition to the federal measure.

If the *Greenhouse Gas Pollution Pricing Act* is ruled unconstitutional, it would leave carbon-reduction measures up to individual provinces, derailing a national carbon price in favour of a hodgepodge of measures across the country. With different measures in different provinces, it becomes difficult to see how a national border levy could be applied uniformly and in a non-discriminatory fashion to all imports. Unless that can be done, Canada will be exposed to a WTO challenge and possible retaliation.

It is curious that in all the talk about the constitutional inequities of the federal carbon tax and all the discussion in the media and elsewhere, little if any mention has been made of these challenging international trade issues. Depending on tomorrow's Supreme Court's decision, Ottawa and the provinces may have to deal with this.

Lawrence Herman is a former Canadian diplomat who practices international trade law at Herman & Associates. He is also a senior fellow of the C.D. Howe Institute in Toronto.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this Memo first appeared in The Globe and Mail.