

X.A.3. Strategic Trade and its Impacts on Environment under Different Tariff Regimes

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The main debate in the literature of environmental policy making was to argue about the use of instruments of the environmental policy for achieving trade-related objectives. In this paper, we show that trade policies can also be used to achieve environmental objectives. Here we show that, Preferential Tariff Regime (PTR) has got an endogenous advantage in taking care of environmental externalities than the Most Favoured Nation (MFN) regime although the world welfare is higher for the latter case. Under a strategic trade framework, with cost asymmetry (arising solely due to differences in abatement costs), we show that the global pollution is reduced under PTR than under MFN, if the high cost firm indulges itself with some pollution abatement activity which reduces its per unit pollution below that of the low cost firm.

The key results of the paper are: (1) The low cost country faces a higher tariff rate than the high cost country under PTR and the tariff rate under MFN is the mean of the two PTR tariff rates. (2) The low cost country always imposes a lower environmental tax than the high cost country under all regimes but the difference is much lower under PTR than under MFN as the low cost firm imposes higher tax rate under PTR and vice versa for high cost firm, than under MFN. (3) The absolute level of global pollution as well as the total damage caused by the pollution is less under PTR than under MFN.