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Integration of Environmental Aspects in Regional and Inter-regional Trade Agreements

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SUMMARY

1. Experiences with regional approaches to integration

By the end of 1999 there were almost 120 regional free trade agreements registered with the WTO. Approximately one third of these had been concluded in the last ten to twelve years. Only a small number of the integration agreements between developing countries had been able to keep to their time schedules. Some have been revived by newer initiatives. The continued success of the EU is, in the light of the just as continuous extension and intensification of the integration, an exceptional phenomenon in the international field. The intensity of integration in the numerous regional agreements is very varied. Most instances are free trade zones. The number of customs unions and (real) single markets is small.

▪ Legal aspects with regard to GATT

For regional integration agreements, there is an important exception with regard to the principle of most favoured nations status. Article XXIV GATT standardises this privilege for free trade zones and customs unions which facilitate trade between their members, without erecting trade barriers for third states. An *enabling clause* also applies for unilateral preference agreements between industrial and developing countries, e.g. the general preference system of the EU for developing countries.

⇒The WTO/GATT norms place far fewer restrictions on internal aspects of regionally planned environmental policies than is often assumed (Section 6.1).

▪ Economic effects of regional free trade

The positive effects of integration agreements have a magnetic attraction for third countries. It is therefore often necessary to make strategic decisions about whether to aim more at *intensifying* the integration, or to concentrate on *extending* the membership basis. There is a tendency for free trade zones with a deeper level of integration to incorporate environmental protection more strongly than others; NAFTA, however, is an exception.

Regional free trade agreements on the one hand induce *static effects*, which can be achieved in the short term by dismantling tariff and non-tariff barriers to trade. This relates on the one hand to the *creation of trade* with the zone, with resulting employment and incomes. On the other hand, there can be a *diversion (or deflection) of trade*, in so far as hitherto trade partners in third countries are displaced by enterprises in countries which are part of the integration zone. Further static effects are possible with regard to balance of trade and currency exchange rates.

What is often even more important, however, are the induced medium and long term *dynamic effects* of integration. These occur with regard to technology transfers, with consequences in terms of quantities and prices; learning processes for companies and those responsible for trade policy; development of human resources; effects on macroeconomic and political stability of the member states; investment flows; trends towards political and legislative harmonisation; strengthening of the private sector and democratic political culture; changes in patterns of consumption, competition, administrative structures, the tax system, local, national and regional power structure; the formation of institutions and many other things.

▪ **Forms of integration**

Forms of regional integration range from informal interstate coordination measures to, with increasing *depth of integration*, trade and co-operation agreements, agreements on preferences, agreements on association, free trade zones, customs unions, common markets, economic communities (economic unions) and currency unions, up to political unions. In the case of many existing integration agreements, terms such as "common market", "economic community", or "economic union" are at best declarations of intent, but descriptions of the actual situation.

▪ **Motives for integration**

The motive forces for regional integration are of an economic and a political nature. Regional free trade agreements which have a primarily economic motivation have, in comparison to those which are more politically motivated, more direct consequences for the environment. This is because they bring about greater consequences for trade, production, and consumption, which can have a significant effect on the environment. Integration agreements which are more politically motivated can also have direct positive environmental effects, if there is co-operation on environmental policy, or if the member states take part en bloc in international negotiations on environmental matters. In some integration agreements, economic and political motivations are very closely knit.

▪ **Conditions for success of regional free trade agreements**

Integration implies the disintegration of national structures. This is one of the important reasons why integration can only be understood as a long-term procedure, and must be clearly distinguished from co-operation agreement limited either to a certain time or to certain functions. The success of economic integration is an essential precondition for effective regional environmental policy.

- A vital precondition for success is that there must be a political will to integration on the part of all the states involved, and that they all support the aim. *Dedication and commitment* are essential. A further important precondition is the stability of the political and macroeconomic environment.
- There must be binding obligations between the members of the integration zone, together with the political will to implement these obligations. In many cases, measures are agreed on, but not implemented. The partners must be ready to give up at least a certain degree of sovereignty. Willingness to give up sovereign rights is, in fact, very low in all integration agreements.
- Deregulation of trade within the integration zone should not be opposed by any measures designed to restrict trade (tax distortions, administrative barriers, restrictions of the right to set up businesses, or restrictive competition laws, currency risks, currency exchange controls, etc.). The environment for investors is of especial importance.
- As a rule, the positive effects for trade are stronger, the higher the level of development of the countries involved is. The *creation of trade* is greater, the higher the customs duty barriers between the member states were before the union. The lower the out customs barriers were before and are after the union, the lower is the *diversion of trade*.

- In the case of free trade zones between developing countries with low levels of economic development, the liberalisation of trade must be supported by other efforts, in particular those aimed at developing the regional infrastructure, the labour force, mobility of capital, and measures to compensate for regional disparities.
- When efforts to achieve integration stagnate or fail, this is usually because of economic disparities and/or political differences between the partner nations. Economic integration requires political harmony, or at least mutual compatibility. Relations between the partners will be the less stable, the greater the economic or other problems between them are.
- The greater the differences in economic advantage between the partners in the integration process, the greater will be the significance of conflicts which exist between the partners at the beginning of the process, or which develop during its early stages. Conflicts have a very negative effect on the inflow of direct investments. Without investments, internal liberalisation of trade is not a sufficient driving force for integration.
- The greater the socio-political similarities are, the less powerful are the centrifugal forces of disintegration. The more similar the participating countries are, the more evenly the advantages and disadvantages of integration can be shared between them, especially with regard to trade, direct investment, and employment. Consensus and convergence of economic policy will promote integration.
- Large differences in the economic and social orders have a strong potential for disintegration, and often lead to the grounding of the integration process, or its restriction to aspects which are relatively uncontroversial. Instead of a multi-national integration, what then develop are more bilateral and partial approaches.
- In structurally homogenous integration zones, the problems of adaptation are much less significant. The political driving force must ensure that the institutional development keeps pace with the economic integration. This applies to the development of adequate institutional capacity as well as to effective legal structures. Restricting the integrational process to the level of the executive limits the participation of the people in the integration process.
- In the case of complementary economic relations, the economic structures must complement each other in such a way that the exchange of goods does not lead to a serious balance of payments problem because of severe asymmetries in trade. The higher the level of industrial development, the better the chances of increasing the complementary aspects and the complexity of the division of labour by trade.
- In substitutional economic relationships there must be a certain level of development of the partner countries in order to allow significant inter-regional trade to come into being. Integration at a common low level of development is not a promising prospect. The competitiveness of the partner countries must be comparable and the conditions of competition must be at least similar, if distortions are to be avoided.
- Larger, economically stronger countries tend to profit more from free trade agreements than their smaller, weaker neighbours. Within most of the south-south integration zones, therefore, asymmetrical relationships have developed.
- A prior period of "quiet integration" of trade policy, with social and political networking, before the formal establishment of free trade zones, has proved very favourable.
- Successful implementation of common policies and measures will depend upon the partners making the necessary funding and human resources available, and creating the necessary legal and administrative environment. Local administrative structures in particular tend to lag behind the development of integration.

- When the positive and negative effects of integration are divided unequally between the partners, then the weaker partners often have to be granted special status and special dispensations, in order to counteract the potential for disintegration. Compensation systems between partner countries can help in this respect.

▪ Strategic considerations

Regional integration can solve economic and ecological problems. It opens up opportunities which are hardly possible at a global level. Generally speaking, it can be said that the prospects for success of free trade and integration are all the better, the more modest the level of ambition is, i.e. the more limited the initial aims of the co-operation are, with any further aims being put off for future phases. It is useful to begin with only a few steps, but with a clear multiplier effect, such as with reduction of internal customs barriers and common customs tariffs for third countries. Regional environmental protection policies can already be realised at this stage in the development.

Extending the membership means in the first place the creation and the diversion of trade. When the new members have very different structures, as, for example, would the case with new EU members in Eastern Europe, the problems of internal adaptation are bigger. This can lead to asymmetric development, if appropriate countermeasures cannot be taken. Extending the zone of integration therefore requires that the "old" members have the potential to absorb the strain on the new members. This ability increases as the depth of integration is extended. It is therefore necessary to strike a balance between extending and intensifying the integration process; extension requires internal consolidation.

Even at a low level of integration, it can make sense to extend the zone of integration, because the resulting strengthening of the negotiating position in the global and international context is an important strategic factor. Gradual extension of the integration zone can prepare the way for later intensification. Bi-regional free trade agreements can be seen as strategic alliances and should be used more for environmental protection. This also applies to bilateral agreements between individual countries.

2. Consequences of regional free trade for the environment

There has been little systematic research of the effects on the environment of regional free trade agreements. A stringent *methodology* for such research also still has to be developed, although approaches have already been made. *Static* environmental effects are a direct result of the consequences of trade: e.g. emissions from transport, production, and consumption as a result of the creation and diversion of trade. *Dynamic* effects are of an indirect nature and are a result of reactions in different policy sectors (e.g. transport, agriculture, technology). The greater the depth of integration, the more significant the dynamic effects are. There are also consequences for products, technology, growth, economies of scale, structure (with regard to "hot spots"), and regulation.

Potential **areas of conflict** between trade and the environment are areas in which there are different environmental standards between the partners, not for reasons of natural circumstance, but because of human influence (or because of both):

- *Movement of investments and industry* because of deficiencies in the implementation of environmental policy. (This in fact happens less often in practice than is often thought.)
- *Extra-territorial application of environmental standards* in order to impose own ideas of environmental protection in other countries. This occurs especially where there are different levels of economic and ecological development. "Environmental dumping" can be countered by trade measures with regard to imports.
- *So-called "eco-protectionism"*, where motives of environmental protection are really just an excuse for trade barriers.
- *Cross-border environmental pollution*, especially by emission of pollutants into rivers and the air.
- *Over-use of shared resources*, especially scarce water or fish resources.
- *Breach of multilateral environmental agreements*.

Areas of action with relevance for the environment must be identified and seen as the basis for regional environmental policy. In all integration agreements, environmental policy is just one of many policy areas, and is only accorded special importance in exceptional cases. The cross-section function of environmental protection seldom has a concrete effect as an integration principle. Generally speaking, the agreements identify particular *sectors* of the economy, in which the member states wish to work together (e.g. agriculture, mining, transport, tourism, technology). It is less usual to agree on *measures and instruments* with which to reduce or avoid environmental problems (e.g. minimum standards, regulations, levies, taxes, etc.). Furthermore, there are institutional areas with regard to the *way of working together* on environmental policy. These overlap with organisational aspects, such as arbitration procedures or exchange of information.

Although hardly any free trade agreements refer to them explicitly, there are other **problematic areas** which are relevant to environmental policy. Among these are:

- Population pressure
- Global environmental problems, especially climate and the ozone layer
- Land-related aspects, such as preservation of the soil, use of the land, planning
- The role of civil society and awareness and participation by the people
- The necessary *capacity building*, mainly in the administration, but also in civil society
- Environmentally-relevant planning and prognosis capacity with regard to the evaluation of environmental effects in terms of *Environmental Impact Assessment*.

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Different kinds of needs for action exist for the following **types of integration agreement**:

- North-South agreements (e.g. with regard to different initial conditions, interests, and the will to implement)
- Agreements with high or low levels of integrational depth (e.g. with regard to the determination of regional minimum environmental standards)
- Agreements involving comprehensive deregulation of multiple sectors, as these can also affect sensitive areas

- Regional agreements vs. inter-regional agreements (especially with regard to the differences between the participating countries). Regional agreements tend to lend themselves to more intensive co-operation on environmental policy. The strategic possibilities to include environmental protection in inter-regional or other bilateral agreements could be used more effectively.

The **environmental effects** which may be expected to arise from a planned regional integration agreement should always be *assessed in advance*. This has so far never been done for a real free trade agreement. Whether it will be done for the planned Mediterranean Free Trade Zone is not yet clear. Methodologically, there are a large number of assessment and prognosis problems, as the environmental effects arising out of integration are very difficult to separate from other influential factors, which overlap, and are, to some extent, interdependent. The existing methodological evaluation proposals (e.g. from OECD, CEC, and WRI) are supplemented in this study by an *Environment Impact Assessment* approach consisting of six steps:

1. Analytical estimate of the *economic* effects of regional integration agreements, in order to identify the critical areas.
2. *Categorisation* of sectors and product groups with regard to their potential **ecological** consequences.
3. *Screening*: description of the environmental situation before integration (*status quo ante*).
4. *Gap analysis*: description of the potentially positive and negative effects of the foreseen *economic* development on the environment at regional and national level, in order to identify the priority problem areas; contrasting of the expected environmental situation with alternative measure scenarios.
5. *Policy responses*: evaluation of alternative environmental policy options taking into account the targeted environmental quality aims, derivation of concrete recommendations for action, including institutional and regulatory aspects.
6. *Monitoring and controlling* of environmental effects overtime (*follow up*).

This approach differs from the existing methods in, among other things, the following points:

- It is based on the concrete sub-regional and local action levels (location reference, *hot spots*)
- It clearly identifies *indicators* which can be used to describe the environment in terms of *status quo* and developments
- It is based on *gap* analyses which start out from different *first*, *second*, and *third-best* scenarios and also process dynamic reactions and changes in state policy on the environment, economy, and infrastructure.

The regional *ex-ante* environmental assessment should be carried out at intervals as continuous environmental monitoring.

3. Environmental policy in the most important regional integration agreements

Environmental protection is integrated into existing and planned regional integration agreements in different ways. Especially in newer and viable agreements, environmental aspects are more strongly integrated than in earlier times. This reflects the trend for greater emphasis to be placed on environmental policy both in industrial countries and in developing countries. The range of environmental policy topics is as impressive as the often ambitious environmental aims and intentions. In many cases, however, there is still a large gap between these intentions and their actual implementation.

The **extent of regulation** with regard to the environment (extent of inclusion of various environmental considerations) is, on the whole, large. The **depth of regulation** (the authority of regional institutions, measures) on the other hand, is much less. It is not the effects resulting from liberalisation of trade which are responsible for the unsatisfactory state of regional environmental policy, but the *inadequate implementation* of existing environmental protection regulations. This depends on criteria which are, at least in part, interdependent:

- The level of development of the members
- How similar the members are
- The size of the integration zone
- The targeted level of depth of integration.

As a result it is not surprising that groups of countries intending to achieve a greater depth of integration also had more ambitious aims in terms of environmental policy. In the case of integration agreements which were only aimed at achieving liberalisation of trade, environmental policy ambitions were lower. An important difference was between integration plans designed only to enable the exchange of goods (free trade zones, customs unions), and integrations aimed at greater depth, including mobility of the factors of production and harmonisation of sector policy (common market, economic community). Informal aspects are more important in this respect than formal ones. Some integration agreements, which are formally aimed only at a low level of integration, actually pursue a much more intensive cooperation and integration policy. In contrast, the environmental aspects of integration between some countries which formally pursue a deeper level of integration are relatively weak, both with regard to the policy profile and the willingness to implementation. It is not possible to draw a clear connection between the formally stated level of integration and the intensity of the environmental policy. *Commitment* is the decisive factor.

With regard to the **level of development** of the members, there are four **types of integration**:

Agreements between industrial countries alone, between developing countries alone, between threshold and developing countries, and between industrial, threshold, and developing countries. Integration agreements which are determined by industrial countries are, with regard to the inclusion of environmental action areas and instruments in the agreement, more highly differentiated. In order to achieve an effective regional environmental policy in the integration zone, it is therefore necessary for economically stronger partner countries to support the weaker ones in the transition period. It is a remarkable fact that there are highly developed verbal formulations of environmental policy aims in South-South agreements. However, as soon as the partners to the integration agreement come to terms on real agreements, where

environmental policies enjoy only low *priority*, it is no surprise to find that the *real* environmental policy lags a long way behind the fine theory of environmental policy.

To sum up, three issues can be noted from the analysis of the integration agreements studied:

- The intended depth of integration tends also to determine the intensity of cooperation on environmental policy. In a common market, regional environmental policy has a relatively firm basis, compared to a free trade zone, in which integration only goes as far as the free exchange of goods. NAFTA is atypical in this respect.
- A formal agreement for integration in depth is no guarantee for effective environmental policy. The actual results will depend much more on the political commitment and the readiness of the countries involved to really implement the environmental policy, and especially to provide the financial means to do so. The level of development of the partners is an important factor in this respect.
- Effective regional environmental policy also requires that economically stronger partners support weaker ones during the implementation phase.

4. Case studies on the environmental effects of regional integration

The case studies described in Chapter 4 range from the North American Free Trade Agreement (NAFTA) to the Mediterranean Free Trade Zone, and to MERCOSUR, and show a wide range of experience.

- The experience of NAFTA so far has been very limited. Nevertheless, there is already some evidence of how successfully ecological aspects of the Agreement have been implemented, and to what extent the agreed instruments and institutions are able to deal with problems and serve as orientation for other agreements.
- In the planned MFTZ there are a number of discrepancies with regard to agreement on environmental protection standards and their current implementation. Cooperation on environmental policy in an integration zone, in which the EU takes a strong lead on environmental policy, ought to be more consistent. This is a clear example of how difficult it is to plan and implement a regionally-oriented environmental policy for cooperation by partners who are so different from each other.
- The environmental policy status of MERCOSUR is at a weak stage of development. The large number of resolutions, declarations and minutes cannot disguise the fact that there is a huge gap between these statements of good intentions and their implementation. Progress on environmental policy is slow and restricted to sporadic activity.

5. Environmental policy instruments in regional free trade agreements

If environmental measures within a free trade agreement clash with WTO/GATT regulations, then the Vienna Convention on Contract Law (1969) prescribes that the regulation of the older agreements should be replaced by the newer one. Thus the WTO Agreement of 1995 has a dominant position compared to earlier environmental agreements. If, however, an environmental agreement has come into being after 1st January 1995, then it has priority over WTO between the member countries. In regional free trade agreements it is therefore quite possible to agree on instruments which *per se* clash with WTO/GATT regulations. An example of such conflict could be trade restrictions with regard to process and production methods (PPMs), as long as they do not have an adverse effect on third countries. Their application to third countries which are members of WTO is therefore only possible if WTO/GATT compatibility is respected.

The application of environmental policy instruments internally, between member countries of an integration zone, does not pose any problems in terms of WTO regulations. Problems can arise when such environmental policy measures are applied externally, to non-members of the zone. Such occurrences have to be assessed from *case to case*; no general rules are applicable (see Section 6.1.2).

Environmentally relevant **instruments** are put into groups in this study:

- Measures governed by statutory legislation
- Economic (market) measures
- Measures for interstate co-operation, especially political cooperation, indicative instruments of the state and
- Voluntary (informal) measures of the private economy.

Categorisation is not always precisely possible.

The suitability of various environmental policy instruments in the context of a regional integration agreement is evaluated below in a shortened **SWOT analysis**. Each instrument has strengths and weaknesses; i.e. internal advantages and disadvantages with regard to ecological effectiveness, economic efficiency, and social and political acceptability of its application. There are also opportunities and threats resulting from external factors, especially the environment of the regional integration. Strengths and opportunities are advantages, weaknesses and threats are disadvantages of the instrument.

Assessment of whether a particular instrument is suitable for a particular regional integration agreement is not the same as deciding whether the instrument is economically efficient or ecologically effective. To make this decision, it is necessary to balance the theoretical advantages and disadvantages of an instrument and the practical and political aspects in favour or against its application in an integration area. These practically-oriented aspects are dominant.¹

¹ Ecological taxation is, for instance, a first-best instrument. Because of serious methodological problems, and political problems with regard to national implementation and regional harmonisation, ecological taxes are practically unsuitable for integration in a regional free trade agreement.

There is a wide range of opinions about when, how, and in what combinations environmental instruments should be applied. Selection of the instruments is usually made according to the **criteria**:

- Effectiveness in terms of environmental policy
- Economic efficiency
- Social and political acceptance.

Problems of efficiency and acceptance in particular can, also with regard to administrative practicality and implementability in practice, override the environmental effectiveness of an instrument and result in it being less suitable. These criteria are also applied with **environmental principles** in mind. In the context of regional free trade agreements, the principles of *cause* and *prevention*, and, above all, *integration* (the so-called cross-section clause) are of prime significance. Assessment of the suitability of an instrument for a particular case, the level of development of the countries involved and the depth of integration must be considered. The overview on the following pages summarises some preliminary assessments on the basis of the criteria outlined above.

Summary of evaluation of environmental instruments

Instrument	Type of integration			
	IC/IC	DC/DC	NIC/DC	IC/NIC/DC
Statutory legislation	++	0	+	+
Standards	++	+	+	+
Protection of investments	++	+	++	++
Liability law	++	0	+	+
Ecological taxes	(+)	-	0	-
Charges	+	0	0	0
Removal of environmentally damaging subsidies	++	0	+	+
Payment of environmentally helpful subsidies	++	+	+	++
Certificates	(+)	-	0	(+)
Joint implementation	-	+	++	++
Trade preferences	-	-	0	(++)
Trade restrictions	0	0	0	0
Ecological duties	0/(-)	0/(-)	0/(-)	0/(-)
Border Tax Adjustments	+	0	0	(+)
Political dialogue	++	++	++	++
Environmental action plans	++	+	+	+
Co-operation	++	++	++	++
Adaptation support	+	-	(+)	++
Arbitration in disputes	++	++	++	++
Complaints procedures	++	(++)	(++)	++
Reports, monitoring	++	++	++	++
Institution building	++	0	+	0
Voluntary obligations	0	+	+	+
Ecological audits	++	0	+	+
Ecological labels	+	(+)	+	(+)

++ = very good; + = suitable; 0 = partly suitable; - = unsuitable;

In brackets = weaker; IC = industrial country; DC = developing country; NIC = newly industrialising country

For regional free trade agreements between industrial countries, nearly all environmental policy instruments are suitable or very suitable. In the case of "mixed" free trade agreements between industrial, newly industrial, and developing countries, environmentally relevant trade preferences and cooperative instruments are particularly useful. Industrial countries can especially push for the integration of such instruments in a regional free trade agreement which are associated with economic incentives for the developing countries involved. The concept of "good governance" also has an ecological dimension.

As a matter of principle, regional environmental standards should be agreed. However, not all national environmental standards necessarily need to be regionally harmonised. In the case of a low start out level of harmonisation of regional standards, it is best to agree on a step by step phasing up. Environmental protection measures have a much smaller detrimental effect on the competitiveness of most companies than is often thought. On the contrary, good environmental standards and a positive environmental image of the company are valuable marketing arguments.

6. Political conclusions and recommendations

(1) Contractual integration of trade and environmental issues

- **Free trade agreements as opportunities for regional environmental policy**

Recommendation:

The political motivation to create a free trade zone should be used to establish environmental policy as a high-priority part of the integration process. Regional free trade agreements offer a very good opportunity to establish a comprehensive environmental system beyond the national borders. The restructuring process always connected with economic integration is a favourable framework for a simultaneous development of environmental policy at national and regional level. The willingness to cooperate between member countries of an integration zone is always higher than that between unconnected countries. Free trade agreements mean a consistently higher level of trade liberalisation than that realised at the multi-lateral WTO level. They can therefore provide a lot more leverage which can be used to achieve environmental protection aims. The political commitment to economic integration triggers impulses that also reflect on economic integration.

Recommendation:

The dynamism developed in regional free trade agreements should be used increasingly to achieve environmental policy aims. An effective regional environmental policy improves the climate for environmental policy at the national level and contributes to overcoming fragmentation at the national level.

Recommendation:

Environmental agreements within free trade agreements should primarily have a regional perspective. This makes it possible for the globalisation of environmental damage to be countered by the re-establishment of territories. If environmental front line policy is borne by a whole region, this usually lessens fears of suffering from the disadvantages of being the first

to move on the issue. Individual nations would fear the loss of competitive advantages arising from unilateral national environmental policy.

• **Contractual foundation of environmental policy**

Recommendation:

The contracting states to a regional free trade agreement should more strongly include elements in their environmental policy which clash with the current WTO/GATT regulations.

In the description of instruments outlined above, it was shown that environmental agreements concluded *after* 1st January 1995 have priority over any WTO standards with which they may clash according to the Vienna contract law convention, provided that third countries are not thereby disadvantaged (see section 6.1.2 in the text).

• **Political and public dialogue**

Recommendation:

The political dialogue on environmental policy between the parties to a regional free trade agreement should be intensified.

The usually low quality of international environmental law should be remedied in high-level political dialogue. The usually vague commitments to environmental protection (*soft law* in the wider sense) have not immediate and real effect on the practical level, and are not backed up by sanctions for offences. The effectiveness of environmental standards depends on the goodwill of individual states and their willingness to implement these standards.

Political dialogue prepares the way for regional free trade agreements and accompanies their implementation. The dialogue should involve environmental experts from the state and the private sector. In the preparation of actual contractual negotiations, it is important to also involve the middle and lower levels of administration and politics in the preparation and decision-making process.

• **Strategic considerations**

Recommendation:

The strategic possibilities of inter-regional free trade agreements should be used more intensively for environmental policy aims.

The strategic qualities of free trade agreements should be used to promote ecological interests. Above all, bi-regional free trade agreements are strategic alliances in global competition. In the framework of free trade agreements with NICs and developing countries, environmental issues should be included more clearly, if appropriate in the form of an ecological conditionally with regard to ecological good governance. To achieve this, there must be mutual readiness to compromise in order to achieve progress on environmental policy. This is best promoted by package solutions (see Chapter 7, *single vs. parallel track*).

(2) Conceptional recommendations

Environmental policy is always most difficult to realise in situations in which other problems - economic and social problems - are more urgent. The environmental awareness of people in

such situations is not normally very high. Integration agreements involving only developing and newly industrialising countries include environmental aspects mainly in the form of declarations. It is not unusual for close links between industry and politics to have a strong retarding effect on environmental policy.

- Environmental protection and sustainable development should be included in the preamble and main text of free trade agreements.
- Basic principles of environmental protection (including the principles of cause and prevention) should be established in regional free trade agreements.
- Respecting the principle of subsidiarity, environmental policy should be included as a cross-sectional task for the formation of policy in all sectors (principle of integration).
- The necessity of budget funding for regional environmental policy should be established in the free trade agreement.
- Environmental quality objectives should be agreed on a regional level. At the same time, internationally recognised environmental agreements should be established in the free trade agreement.
- The free trade agreement should include an obligation to implement and enforce existing regional and national environmental standards. This obligation should be legally enforceable.
- The acceptance of regional agreements for environmental protection is increased if the right to a country's own national environmental policy is granted.
- Regional environmental policy agreements should take account of the differing capacities for implementation in the member countries. Where the differences between the countries are great, political concern about environmental problems can be expected to be lower in the economically weaker countries. The industrial countries can also be expected to try to use environmental policy to push forward economic interests. Willingness to agree on environmental policy can be improved by economic compensation measures, taking different capacities into account.

(3) Recommendations on contents

- A regional free trade agreement should be based on a prior *Environmental Impact Assessment*, and should provide for continuous environmental monitoring. Funding must be made available for the achievement of these aims. Ecological aspects should be included in *Trade Policy Reviews*. It is important to agree on a common methodology for the evaluation of environmental effects.
- A free trade agreement should include arbitration procedures for cases of disputes about environmental matters between states and between the state and private sector. Because of differing national legal systems, an interstate agreement on this matter should establish principles and guidelines.

- To support the enforcement of national and regional environmental standards, the free trade agreement should include ecological clauses in its stipulations about public procurement.
- The free trade agreement should enable the member countries to use their national laws with regard to competition to allow agreements and cooperation between business enterprises in order to improve industrial environmental protection. The freedom of the individual countries to formulate such laws will, however, be reduced: International companies occupy areas of influence parallel to or between the states and cannot be adequately controlled by national legal instruments.
- Regionalisation of environmental policy should be institutionally established. This requires appropriate political and administrative structures at regional and national level. Staff and funding must also be provided for these facilities. Among the most important institutional functions are: arbitration services for cases of dispute; the development of regional environmental standards; the development of regional, and the harmonisation of national eco-labels, and environmental monitoring and evaluation. Institutional deficits will be worsened if the political will to enforce these measures is lacking, and/or if the liability laws are inadequate.
- Liability for endangering the environment should be a basic principle of environmental liability. This principle of environmental liability should also apply for interstate and international law. State liability as a safety net to protect individual private persons from harm would be useful.

7. Strategic considerations for negotiations

(1) Single or parallel track

- In the case of *single track* (*single undertaking*) negotiations, environmental and trade aspects are included in a single contractual body. Consensus must be reached on all questions of detail.
- In *parallel track* negotiations environmental and trade policy are incorporated in separate contracts.

The essential difference is whether one part of the agreement can be agreed on without the others, or whether both can be had only as a "packet". These alternatives do not necessarily lead to significantly different results. The differences are mainly in the negotiating strategy and method. In both *single* and *parallel track* procedures, environmental and trade policy can be matched. In any case, an early assessment of the environmental consequences of the deregulation of trade should be carried out, which will require integration of the contents irrespective of the type of track chosen.

- Treatment of environmental and trade questions in the *single track* procedure requires that environmental policy be accepted as an integral part of the integration agreement, equal in importance to trade policy.

- Separate negotiations can lead to a separation of economic integration and environmental aspects. This may be advantageous if the structures of interests in trade policy and environmental policy are not congruent. In this case, consensus on environmental policy is possible without pressure from the trade or investment agenda. Another aspect is that the separation of trade and environment can lead to the loss of substantial cross-references, so that the environmental consequences of trade, and the consequences for trade of environmental policy cannot be adequately considered.
- If negotiations are carried out separately, they may progress at different rates. This can be an advantage or a disadvantage. Each of the negotiation procedures can develop its own dynamic.
- Leaving out or postponement of environmental policy could mean that it loses political priority.
- If negotiations of environmental and trade policy are held together, they can be aligned and adapted to each other at an early stage. This is also favourable for planning arbitration measures for cases of dispute at the interfaces of trade and the environment, which requires a high level of awareness of the interdependence between the two.
- Parallel negotiations can lead to procedures, institutions, and regulations being developed in parallel.
- A *single track* for trade and environmental questions is more suitable for agreements between industrial countries, because the environmental standards in the countries involved will be relatively similar, and there will be less contention about questions of competition policy than in North-South agreements.
- There are often co-operative mechanisms for solving cross-border problems in place before an integration agreement is made. These mechanisms can be used and further developed for environmental co-operation, without including them in the text of the trade policy agreement.

Recommendation:

In the context of a regional free trade agreement, environmental protection should be negotiated, if at all possible, in a *single track* procedure. Incorporation in an integrative approach which is primarily economic gives environmental policy greater political significance (also with respect to other areas of policy) and more realistic chances of being put into practice. If the *single track* procedure is not possible, then parallel track negotiations are an acceptable second-best solution; in spite of some disadvantages, they also offer advantages. The details of the case at hand will be decisive.

(2) Double track

A *double track* procedure would be, for example, an environmental framework or basis agreement which is integrated into the regional free trade agreement, but with fewer precise obligations, as a *soft law*. This basic agreement can be complemented by minutes, subsidiary agreements, programs, etc., which are themselves *hard law* in the sense of international law. The *double track* option should only be chosen if a specification of the basic environmental agreement is sure.