

Harnessing the Regional Trade Agreements (RTAs)¹

for the Post-2012 Climate Change Regime

Joy A. Kim

OECD, Environment Directorate

1. Why RTAs and Why include environmental provisions in RTAs?

In 2005-2006, the OECD first undertook an in-depth analysis of the ways in which governments deal with environmental issues in the context of the Regional Trade Agreements (RTAs), based on the understanding that RTAs can be a positive influence on framing trade and environment discussion at the global level of the WTO.² In fact, this has been proven in the past as a number of areas such as services, intellectual property, environment, investment and competition policies were negotiated at the regional level first, and later brought to the WTO.

WTO rules also allow the possibility of regional integration and bilateral agreements for members who wish to liberalise at a quicker pace, as RTAs have allowed a small group of countries to negotiate rules and commitments that go beyond what was possible at the multilateral level.

Over the past few years, the number of RTAs has significantly increased and is expected to reach 400 if the RTAs currently under negotiations are to be concluded. RTAs have become so widespread that practically all WTO members are now parties to one or more of them.

Why countries are pursuing RTAs? Continuous stalemates of negotiations at the WTO and ensuing frustrations can be one reason. In a broader term, such a phenomenon in fact is a manifestation that when it comes to contentious global issues, forging a regional consensus through regional cooperation can be instrumental. More often the merit of regional forums is underestimated, but greater use of regional

¹ For the purpose of the study, the term RTA includes bilateral and regional trade agreements, free trade agreements (FTAs), economic partnerships and other arrangements aiming at trade liberalisation between the parties.

² The OECD work on the RTAs and Environment has been carried out mainly under the auspices of the Joint Working Party on Trade and Environment (JWPTE), and has produced the 'Environment and the RTAs' in 2007, which will be followed by a 'checklist for negotiators on the environmental provisions of the RTAs' shortly. This note heavily borrows information from the 'Environment and the RTAs' (2007), OECD.

approaches can open possible avenues to advance negotiations since expanding the use of regional forums would mean that increasing number of forums will be available for countries to pursue their agendas and interact through the forums, which may allow them to surmount political obstacles that impede the negotiation.³

In addition, regional forums can serve as a useful venue for setting the agenda that can provide an additional space for discussing specific issues. They can also provide countries an opportunity to coordinate their positions among themselves before they move to the multilateral arena, through which consensus can be reached before the pressures of drafting a text. In this way, regional forums may provide a platform for cooperation, and serve as a bridge between the global and the national. Although there is a danger that additional regional meetings could further burden the already stretched capacity of developing countries, the benefits of regional channels if strategically used, can certainly outweigh the downside.⁴

This is not to say that there will always be uniformity of views among countries in the region. Nonetheless, there is still room to reach a consensus among some subset therein. Moreover, regional forums can facilitate the sharing of experience and best practices, which could help advance the agenda of common interest and pooling of resources in such areas as technology transfer, environmental impact assessment and monitoring, and capacity building.

RTAs negotiated by most OECD countries include some types of environmental provisions. Among OECD members, Canada, the European Union, New Zealand and the United States have included the most comprehensive environmental provisions in recent RTAs. Among non-OECD countries, Chile has covered fairly comprehensive environmental provisions in its RTAs.

Why do most of OECD countries include environmental provisions in RTAs? The answer is very much in line with the merits and advantages of pursuing regional approach in advancing difficult negotiations at times. Some countries consider that environmental provisions in RTAs provide an opportunity to pursue environmental objectives in a more efficient and rapid way than, through the Multilateral Environmental Agreements (MEAs), as negotiations of RTAs often provide an opportunity to obtain concessions in other, related fields that would otherwise be difficult to obtain.

³ Kim, 2007, *Advancing the Frontier of the Trade and Environment Agenda: Seeking for Regional Cooperation in Northeast Asia*, in *Envisioning a Sustainable Development Agenda for Trade and Environment*, New York: Palgrave.

⁴ UNU-IAS. (2005). *Promoting Enfranchisement: Toward inclusion and influence in sustainable development governance*. UNU-IAS Report. Yokohama: UNU-IAS.

On the other hand, many others are wary of incorporating trade and environment in RTAs for fear of prejudicing their multilateral positions. Some others fear that strong enforcement mechanisms will be used to create new barriers to their exports to developed RTA partner markets.

The scope and depth of environmental provisions in RTAs vary. The most ambitious approach takes the form of a comprehensive environmental chapter or an environmental side agreement or both. Examples include the North American Free Trade Agreement (NAFTA) and all RTAs subsequently negotiated by the United States with Singapore, Chile, Australia, Bahrain and Morocco as well as with the five Central American countries and the Dominican Republic (US-CAFTA-DR). Some take the minimum coverage of environmental issue in the form of exception clauses to general trade obligations under the agreements.

It is worth noting that the extent to which environmental issues are integrated in RTAs depends, primarily on the desire of the Parties to the agreement to do so, but is also related to the nature and the scope of the agreement. Some RTAs seek to establish free-trade areas to foster economic co-operation by reducing tariffs among the parties; others seek to establish partnerships that lay the institutional basis to foster dialogue for better economic relations. Some of the agreements deal comprehensively with regional integration, addressing a broad range of economic, political and social issues. The environmental components of all these agreements thus also come in many different forms.

2. Setting the scene; what is at stake in the run-up to the post-2012 climate change regime

In order to draw implications of RTAs for the post-2012 international climate change policy framework, the first step is to identify what the imperatives of the future regime are and sketch out some of the components in RTAs that might be harnessed to deliver the imperatives.

One of the key issues that divide countries on the future path of the climate change regime perhaps is how to address the differing distributional impact of climate change policy across regions. In this regard, the key to the successful designing of the post-2012 climate change regime would largely hinge on devising a burden-sharing mechanism which addresses the key concerns of both developed and developing countries, namely, competitiveness and equity concerns, based on a shared vision about the long-term goal of tackling climate change.

The OECD Environmental Outlook to 2030⁵ provides guidance for such a shared vision about the long-term goal; if efficient policy instruments are employed

⁵ OECD, 2007, Environmental Outlook, Paris; OECD

covering all the main emitters, sectors and gases, ambitious climate change targets of the 450ppm stabilisation pathway can be achieved at a relatively affordable cost in light of the expected costs of inaction and economic growth by 2050.

More than anything, achieving ambitious climate change target with minimum cost would require engaging with all major emitters, both countries and sectors. With the implementation of binding emissions targets in some parts of the world and not in others, emissions reduced in one region would be partly offset by emissions increased elsewhere and trade-exposed and energy-intensive activities in the carbon constraint economies might face competitiveness distortions coming from the lack of similar efforts taken elsewhere.

Yet, the uneven distribution of mitigation costs across regions hampers a wide participation of countries. What is crucial to garner all major emitter's participation therefore is devising an equitable burden sharing mechanism through financing and technology transfers, while addressing the competitiveness and carbon leakage concerns.

One rapidly emerging approach is so called 'international sector-based arrangements', which might open an avenue to engage major developing country economies early on, thereby enabling developing countries to limit and reduce 'quantified emissions' as called for by the Bali Action plan, but also subduing the increasing concern of climate change polices on competitiveness or carbon leakage.

For instance, if leakage is only likely to occur in a few large energy-intensive sectors in relatively a small number of participants, a sectoral approach could improve the effectiveness of reducing GHG by targeting at specific sectors, complementing to an agreement on national emissions targets.

It could also facilitate the diffusion of sector-specific technologies by setting a sector-specific target for technology transfer and addressing trade barriers facing them. In particular, a sector-based CDM could further facilitate financial and technology transfer by scaling up the project mechanism. One possible scenario would be that under the no-lose target carbon credits could be granted to those companies that exceed a baseline performance.⁶

Sectoral CDM could also strengthen the current CDM by enhancing its fundamental and practical problems, as it allows aggregate dispersed activities to a scale that is viable for the CDM, lowering transaction costs and enabling project activities that

⁶ Wolfgang Sterk and Bettina Wittneben, Enhancing the clean development mechanism through sectoral approaches: definitions, applications and ways forward, *International Environ Agreements* (2006) 6: 271-287.

are often not competitive in the CDM market due to their relatively high transaction costs, small scale and low yield of CERs, but can contribute to host countries' sustainable development (renewable energy, energy efficiency, transport project activities). A policy-based sectoral CDM would also reward governments initiating ambitious climate policies, thereby making sectoral transformations possible.

Implementing sector-specific CDM would require substantial technical assistance for developing countries though, particularly if sectoral crediting mechanisms are to be established, as they should be equipped to implement such sector-wide policies, and to monitor report and verify on performance.⁷

The operationalisation of a sectoral approach will also have to overcome many practical challenges such as data collection and a bench mark or baseline setting at the sectoral level. Given that many small and medium enterprises (SMEs) are operating particularly in the energy intensive industries in developing countries, capacity building for them would be essential. More importantly, it should be borne in mind that there will be an opportunity cost in employing a sectoral approach as it will lose the benefits of cross-sectors permit trading. Thus, it might be best considered as a transitional approach in energy intensive, trade-exposed industries during the absence of all major emitter's national emission targets.

Several other policy options to facilitate technology transfer could also be explored to provide incentives for wide participation of countries. For instance, lowering trade barriers to globally traded commercial mitigation technologies could facilitate the diffusion of low-carbon technologies. Harnessing foreign direct investment (FDI) could also enhance competition and foster the flow of clean technologies and knowledge across borders if well targeted at clean technologies instead of conventional ones.

3. Implications of RTAs for the post 2012

Based on these assumptions, a key question to pose in order to draw implications of RTAs for the post-Kyoto climate change regime is the following:

- How could rapidly increasing RTAs contribute to devising an equitable burden sharing mechanism with all major emitters engaged while addressing the competitiveness and carbon leakage concerns in the post 2012?

⁷ 'Sectoral approaches to greenhouse gas mitigation', summary document of International Workshop on Sectoral Approaches to international Climate Policy, 14-15 May, 2008, at IEA (IEA/SLT(2008)16).

The most direct channel through which RTAs can do so is by facilitating the diffusion of sector-specific technologies; addressing trade barriers to the technologies; and providing capacity building required for efficient operationalisation of a sectoral approach or sector-based CDM. If countries' positions are so divergent that regional cooperation is hard to garner, bilateral channels should be sought in tandem with the regional channel. Bilateral channel of dialogue through some of RTAs can facilitate discussions at the sectoral level. Eventually, such bilateral channels of cooperation in the region should converge with regional-level cooperation at some points for policy coherence.

This section will overview various tools embedded in RTAs to address environmental concerns; and explore how some of these tools might be used to contribute to shaping the post-Kyoto regime.

3.1 Multiple tools to address environmental concerns in RTAs⁸

Countries attempt to address environmental concerns in RTAs by using multiple tools. One such tool is environmental impact assessment to anticipate and manage impacts associated with increase in the trade volume. The findings of such assessment have led to capacity building for environmental management or increased co-operation. Another tool is environmental standards and enforcement of environmental laws in RTAs. Some countries, in recognition that countries maintain their prerogative to determine their own preferred levels of environmental protection, include these in RTAs to ensure that a lack of enforcement of environmental laws or the lowering of environmental standards would not lead to unduly competitive advantage. The agreements between Canada and Costa Rica, and Canada and Chile, for instance, reinforce Parties' commitment to maintain high levels of environmental protection. Agreements signed by New Zealand include references to the inappropriateness of lowering environmental standards.

RTAs providing for binding obligations related to enforcement of environmental laws also contain mechanisms to ensure enforcement of these obligations. Practically all RTAs allow derogations to the obligations under the agreement for the protection of health, the conservation of natural resources, or the protection of the environment, and many of them are modelled after Article XX of the GATT. Finally, governments are also increasingly involving with the public in the negotiation and implementation of RTAs to address environmental concern.

Among others, environmental cooperation mechanisms embedded in the RTAs provide a broad window of opportunities to address specific environmental concern such as climate change. Thus, this paper focuses on how environmental

⁸ See OECD, 2007, *Regional Trade Agreements and Environment*, Paris; OECD for more details.

cooperation mechanisms of some of RTAs can be further explored to contribute to i.e. technology transfer in the post 2012.

3.2 Some examples of environmental cooperation and capacity building of RTAs in the context of climate change

Often the installed tools to address environmental issues in many RTAs take the form of environmental co-operation mechanisms. The efforts at environmental cooperation are descendents of cooperation that pre-dates the entry into force of free trade agreements (e.g. US efforts in CAFTA-DR region, ASEAN and SAARC regions), as countries in the same region often share common environmental concern, and thereby endeavouring regional cooperation to address common environmental problems. In particular, MEAs such as the UN Framework Convention on Climate Change (UNFCCC) provided a reason for the region to cooperate through its implementation measures such as technology transfer and environmental investments. For instance, much effort has been made to curb the carbon emissions from China through regional cooperation, as according to a recent study, China's coal-burning power plants have caused acid rain affecting neighbouring countries.⁹

The scope of cooperation varies; some have agreed on broad-co-operation agreements, covering a large range of areas; others focus co-operation on specific issues of common interest. One such example is the agreement between ASEAN Member States and Korea (2005) under which Parties commit to "pursue [...] on a mutually agreed basis: cooperation in environmental technologies and policies, such as compressed natural gas technology and policy [...]" (Article 11, Annex of the Framework Agreement). (see Box 1)

The area of co-operation varies in different RTAs as well. One area that could be further explored in relation to climate change policy is the implementation of commitments under MEAs. While some RTAs refer to MEAs and generally do so in the Preamble and provisions on co-operation (e.g. the US-Chile agreement; The Environmental Cooperation Agreement (ECA) between Canada-Chile-Costa Rica; FTA between the EU-Bangladesh-Croatia), others such as MERCOSUR and the Japan-Mexico bilateral trade agreement contain more elaborate provisions on cooperation for the implementation of MEAs. For example, Parties to MERCOSUR have agreed to cooperate in the implementation of environmental agreements to which they are Parties. The framework agreement on environment in MERCOSUR

⁹ Hamada, M. (2004). *Response to Global Warming in Northeast Asia*. Working Paper. Economic Research Institute for Northeast Asia, Japan. Available online at <http://www.erina.or.jp/En/EC/Forum2000/3Session2/eMorita.htm>

also highlights the importance of regional cooperation for the implementation of Parties' international environmental objectives, and identify the possible area of cooperation such as the adoption of common policies for the protection of the environment, the conservation of natural resources, joint communications on subjects of common interest and exchanges of information about national positions in international fora". In the Colombia-Ecuador-Peru-US ECA, parties agree to work together to strengthen the capacity to implement MEAs and to develop proposals to enhance the work performed under MEAs.

The agreement with the most specific reference to cooperation for the implementation of the climate change policy is the agreement between Japan and Mexico. It provides more a concrete reference to climate change issues; it states "promotion of capacity and institutional buildings to foster activities related to the CDM under the Kyoto Protocol...and exploration of appropriate ways to encourage the implementation of CDM projects".

RTAs between developed and developing parties often provide for capacity-building on a range of issues including better understanding of trade and environment linkages as they believe that capacity building efforts can have positive effects, if they result in increased capacity for regional environmental cooperation on issues of shared interest.

Box 1. Co-operation in one specific area of special interest to the Parties

- Agreement between ASEAN Member States and Korea (2005) under which Parties commit to "pursue [...] on a mutually agreed basis: cooperation in environmental technologies and policies, such as compressed natural gas technology and policy [...]" (Article 11, Annex of the Framework Agreement) <http://www.aseansec.org/18067.htm>.
- Japan-Thailand agreement (2007) (Article 153): Parties have agreed to "promote cooperation between the governments of the Parties [...] such as in the fields of "agriculture, forestry and fisheries" and "science, technology, energy and environment". <http://www.mofa.go.jp/region/asia-paci/thailand/epa0704/agreement.pdf>.
- Environment Cooperation Agreement between New Zealand and China (2008) (Article 2): "Cooperative activities may be in areas including but not limited to: environmental management, environmental remediation, nature conservation, and technologies for environmental benefit. Examples could include: a) management of water environment; b) coastal ecological conservation and pollution control; c) air pollution control and monitoring; d) improvement of environmental awareness, including environmental education and public participation; e) management and disposal of waste including hazardous waste; f) environmental management of chemicals; g) environment and trade; h) biodiversity conservation [...].
- Cooperation between Japan and Mexico in the field of environment (Article 147); Cooperative activities under this Article may include: ..b) promotion of capacity and institutional building to foster activities related with the CDM under the Kyoto Protocol to the UNFCCC, as may be amended, by means of workshops and dispatch of experts, and exploration of appropriate ways to encourage the implementation of the CDM projects; c) encouragement of trade and dissemination of environmentally sound goods and services..

Another area of cooperation that is relevant to climate change is the cooperation on promoting environmentally friendly goods and services.

While attempts to liberalise trade in environmental goods and services at the WTO are on a stalemate, a few key players have been channelling through RTAs their efforts in this area continuously. Making climate friendly technologies readily available in the market through trade liberalisation can contribute to technology transfer by reducing barriers on the supply side, although there are increasing evidences that addressing non-tariff barriers on the demand side such as diverse standards, costly certification and a lack of appropriate domestic policies are more important to diffusing some of climate friendly technologies.¹⁰ In this regard, efforts by the MERCOSUR Framework Agreement on Environment to harmonise environmental standards can positively contribute to removing non-tariff barriers to some of climate friendly technologies.

The US Trade Act of 2002 for example, explicitly mentions that one of the principal trade negotiating objectives is to seek market access, through the elimination of tariffs and non tariff barriers, for US environmental technologies, goods and services". US RTAs thus systematically include text related to market access for environmental goods and services (e.g. the US-Morocco agreement).

The environmental cooperation agreement (ECA) signed in conjunction with the US-CAFTA-DR agreement provides a comprehensive framework for environmental co-operation between the countries that builds on previous environmental capacity building in the region. Priority areas for cooperation under the ECA include, *i.e.* *promoting clean technologies and environmentally friendly goods and services.*

The National Interest Analysis of the New Zealand Thailand Closer Economic Partnership (NZTCEP) also predicts possible benefits from liberalisation of trade in environmental goods, while the MERCOSUR Framework Agreement on Environment encourages the development of clean technologies.

While currently only a few RTAs include a direct reference to climate change related cooperation activities, there is much room for such activities to be taken up in both existing and upcoming RTAs a more concrete manner as many RTAs tend to take an open and flexible approach to environmental cooperation. For example, Trans-Pacific Strategic Economic Partnership (TPSEP) and NZTCEP, the scope of environmental cooperation is left open in the agreement and is determined during the implementation phase through discussions among environmental officials.

3.3 Implications of RTAs for the post 2012 regime

¹⁰ For more information, see *Facilitating trade in selected climate change mitigation technologies in the energy supply, buildings and industry sectors* by Kim and Steenblik, forthcoming, OECD, (COM/TAD/ENV/JWPT(2007)37/REV2).

What implications can be drawn from these examples of environmental cooperation mechanisms for climate change? Firstly, if there is mutual desire among Parties concerned, environmental cooperation mechanisms can be used to address specific environmental concern such as climate change. As seen above, the scope of cooperation can vary ranging from the implementation of Parties' international environmental objectives, the adoption of common policies for the protection of the environment, the conservation of natural resources, and joint communications on subjects of common interest and exchanges of information about national positions in international forums to cooperation in specific technology transfer. The language to identify specific technologies can also be as broad as environmental or clean technologies or it can be more specific. For instance, the environmental cooperation mechanisms can be targeted at the transfer of certain climate friendly technologies that relevant Parties have common interest and might be useful to reduce emissions in energy intensive sectors.

It is important to understand that cooperation is not one way as technology-sharing through such cooperation could also have economic benefits. Developed countries can also use the cooperation mechanisms as a way of enhancing their own understanding of critical issues. A good example is the cooperation activities under the NZTCEP and the TPSEP where NZ is the beneficiary; a vehicle emissions study tour to engage Thailand and Singapore expertise on methods to control vehicle emissions, including vehicle emission testing technologies, transport management policies and strategies, vehicle emission enforcement programmes, fuel economy labelling and climate change policies.

Secondly, capacity buildings between developed and developing partners can be also envisaged to facilitate the operationalisation of a sectoral approach or for the implementation of sectoral CDMs: possible areas of capacity buildings include data collection and a bench mark or baseline setting at the sectoral level; capacity building for small and medium enterprises (SMEs) operating in the energy intensive industries in developing countries. While not in the area of climate change, the declaration on a MERCOSUR biodiversity strategy, for example, provides for training and capacity building through, exchange programmes, joint training activities and information exchange.

Thirdly, while it is a common belief that FDI can enhance competition and foster the flow of clean technologies and knowledge across border and RTAs increases investment flows through a liberalisation in trade and investment, the extent to which RTAs can facilitate FDI flows might be limited as many RTAs refer investment issues to bilateral investment agreements that relevant Parties have signed. The link between increased FDI through RTAs and its impact on clean technology transfer also remains uncertain as there is still little evidence that increased FDI went to clean technologies rather than conventional technologies. Therefore, more study needs to be carried out to examine which categories of technologies have benefited the

most from increased FDI; the proportion of investment received in clean technologies versus conventional ones.

4. Concluding remarks

Despite the potentials of RTAs to be explored in the context of climate change, a number of challenges are ahead to tap in the potentials. One of such challenges is that the RTAs regime is still evolving and new. As of today, there are only a few RTAs which have been implemented or the implementation can be evaluated. It's only NAFTA that is at the stage where an evaluation of its environmental performance might be feasible. In other words, successful implementation of environmental cooperation laid out in a number of RTAs still remains to be seen and the same applies to that in climate change arena.

In addition, although environmental cooperation mechanisms appear to be widely incorporated in diverse types of RTAs, it is uncertain whether all types of RTAs can fulfil such potentials as it may depend on the nature and the scope of the agreement. As mentioned earlier, some RTAs aim at establishing free-trade areas, while others aim at seek to establish partnerships or regional integration. More in-depth analysis is required to have a clear understanding of the types of RTAs and their potential capacity to address specific environmental concerns. In this regard, developing taxonomy of RTAs based on the way how they incorporate environmental provisions in general and certain mechanisms which might be useful to address specific environmental issues such as climate change could be useful.