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ENVIRONMENTAL ISSUES IN FREE TRADE AGREEMENTS

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China Environment Press

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Preface

Since the establishment of the World Trade Organization (WTO), a diversity of Free Trade Agreements (FTAs) have thrived and flourished around the globe. By 31st January 2016, there were altogether 239 FTAs that had been reported to the WTO and had taken effect, of which over 85% contain environmental provisions. Environmental provisions in FTAs refer to articles and contents including environmental protection or sustainable development in the text or appendix or affiliated agreement of FTAs. Environmental issue is often known as one of “economic and trade issues of the 21st Century” together with E-commerce and government procurement etc. In recent years, environmental contents in FTAs are becoming the new norm. First, a lot of FTAs contain environmental provisions, such as in the preamble, and relating to services, investment, technical cooperation, sanitary and phytosanitary measures, technical barriers to trade, and government procurement, adding up to as much as 24 environmental provisions (taking the environmental chapter as one, while the actual articles in this chapter may be over 20 in number). Second, it has already become a new norm to include independent environmental chapter in an FTA, aligned with chapters on services and investment. By 31st January 2016, there are 36 FTAs with independent environmental chapter. Third, it has already become a new normal for the environmental content in FTAs to evolve from a statement of general practice to measures which are specific and obligatory in nature, and FTAs increasingly cover specific articles on environmental cooperation as well as environmental disputes settlement. Rough counts show that around 80% of environmental chapters in FTAs include articles on disputes settlement.

In addition, more and more economies are accepting the idea of including articles and chapters specifically on the environment in FTAs. This leads to a constant expansion of a “*Hub-and-Spoke*” structure around the globe. For example, after signing its FTAs with the US and EU respectively, Republic of Korea has vigorously pushed for independent environmental chapter in FTAs to be signed with other trading partners. In addition, the negotiation on environmental provisions in the Trans-Pacific Partnership Agreement (TPP) has become a hot topic, and it also represents a consistent trend for FTAs globally.

This trend will see environmental provisions in FTAs become ever more extensive, comprehensive and stringent.

Environmental provisions in FTAs have experienced a gradual evolution driven by multiple-forces. First, much theoretical and empirical research has proven the interactive relationship between trade and environment, which demands policy coordination through relevant measures. This is the fundamental basis and precondition for setting up environmental provisions in FTAs. Second, a number of documents or trade agreements, such as the Agenda 21, Rio Declaration, General Agreement on Tariffs and Trade (GATT) and the rules of the WTO, all have stipulations or articles concerning environment and trade, providing the major legal basis for the establishment of environmental provisions in an FTA. On the other hand, the US and EU have clearly put forward stipulations to ensure the mutual support of trade and environmental policies, seek instruments for environmental protection and international cooperation, and to optimize the utilization of world resources, which contributes to the establishment of environmental provisions in FTAs.

In China, the *Decision on Some Major Issues Concerning Comprehensively Deepening the Reform* adopted at the Third Plenary Session of the 18th Central Committee of the communist party of China has spelt out the requirements of “speeding up the construction of free trade zones... and accelerate negotiations on environmental protection, investment protection, government procurement... so as to form a global, high-standard network of free trade zones”. Viewed from current international situation and background, establishing environmental provisions or independent environmental chapter in FTAs is not a question of yes or no. Environmental provisions have become one of the key elements in establishing the high-standard global free trade zone network. In addition, the establishment of environmental provisions and chapters in FTAs serves also as a vital mean to resolve environmental problems from the root and demonstrates the strong commitment to the overall plan for promoting economic, political, cultural, social, and ecological civilization constructs. According to relevant research, the environmental situation in China remains grave at the present moment. The discharge volume of such pollutants as embodied effluent, SO₂ and smoke and dust incurred by relevant international trade in the decade following China’s entering into the WTO accounted for up to 25%~40% of the overall discharge volume of such pollutants during the same period nationwide. Therefore, comprehensive consideration must be given to both environmental and trade policy to promote the integration of environment and economy, while the

establishment of environmental provisions in FTAs constitutes a specific measure to avoid negative environmental impact brought by trade. As a matter of fact, China has not only included environmental provisions in all the FTAs signed, but also included independent environmental chapters in China-Switzerland FTA and China-Rep. of Korea FTA.

Based on the above-mentioned background and actual need, we believe the research on environmental provisions in FTAs is of vital significance to the promotion of the development of FTAs, as well as to the quality of FTAs and the level of environmental protection. However, up to now, the research on environmental provisions in FTAs remains limited both on the domestic and international front. Most of the existing studies focus on specific aspects, lacking overall review of the current situation, analysis of underlying reasons and relevant solutions. A number of questions need to be addressed regarding the theoretical supporting, international and domestic status quo, major contents, negotiation focus, arguments of each side, the strategy that China should take, and so on. This book aims to provide insights on the above-mentioned issues through in-depth research.

In an effort to fulfill the above objective, we have done an analysis of the FTA Database of the WTO including all 239 FTAs that have entered into force by the end of January of 2016. However, due to a range of barriers and limitations including language (e.g. data only available in Spanish rather than Chinese or English), time and material available, we have only conducted analysis and research on relevant environmental provisions in 212 accessible FTAs while focusing on systematic and key research on 36 independent environmental chapters contained in such FTAs. In the process of research, many experts in this area were consulted.

The book offers a systematic analysis of environmental provisions in FTAs in 9 chapters, which could be divided into 4 major parts. The first 4 chapters constitute part 1, which makes a general analysis and research of environmental provisions in FTAs; chapters 5 to 7 form part 2 which deals with 3 major environment-related issues contained in FTAs or closely related to FTAs; chapter 8 makes up part 3 which provides analysis of environmental provisions and chapters in FTAs signed by China; and chapter 9 is part 4 which analyses future prospect and provides policy recommendations.

Chapter 1 mainly covers the background, current situation and significance of the research, identifies the subject and scope of research and introduces the research method and technical roadmap. Chapter 2 looks at the theory of

environment and trade including the theory of Kuznets curve, Pollution Haven Hypothesis as well as the Trade Induced Degradation Hypothesis. It also briefly reviews the empirical research on the correlation between environment and trade, with deliberations on the relationship between environment and FTAs as well as the theoretical foundation for including environmental provisions in FTAs. Chapter 3 makes a thorough analysis of the development status quo and characteristics of environmental provisions in FTAs by studying the environmental articles in the FTAs of economies such as the US, EU, Japan, Rep. of Korea and India. It analyzes and discloses the apparent and the interior reasons for economies to promote or reject the establishment of environmental provisions in FTAs. Chapter 4 analyzes the environmental content of FTAs, especially those in independent environmental chapters, and carries out the case studies of 3 typical FTAs, North American Free Trade Agreement (NAFTA), US-Rep. of Korea FTAs (KORUS) and EU-Singapore FTAs. Based on macro-analysis and systematic identification of environmental provisions in FTAs, this book has also targeted several major environmental issues contained in or closely related to FTAs. These include environmental cooperation, environmental dispute settlement mechanism as well as the environmental impact assessment (EIA) for FTAs. Chapter 5 to 7 make specific deliberation on these three issues respectively. Chapter 5 makes a comprehensive and thorough overview of environmental cooperation in FTAs from the perspective of general situation, evolution over time, motivation for cooperation, type of cooperation, funding mechanisms, institutional arrangements as well as areas of cooperation. Chapter 6 mainly studies the environmental dispute settlement mechanism in FTAs by analyzing dispute settlement mechanism and the environmental disputes appearing in FTAs. It studies environmental dispute settlement mechanism in FTAs and relevant case studies and explores the selection of court for the settlement of environmental dispute and law applicability. Chapter 7 analyzes and discusses the EIA of FTAs by comparing the EIA methodology system of the US, Canada and EU and specially studying the EIA of US-Rep. of Korea FTAs, the sustainable impact assessment of the Doha Round of WTO carried out by the EU as well as the EIA of NAFTA. Based on the macro and specific analysis of relevant issues, Chapter 8 reviews and analyzes the practice of the establishment of environmental provisions in FTAs of China and compares the practice of China with other economies by employing the case study of China-Switzerland FTA, thus defining the incentives of China of to promote environmental provisions in FTAs. Finally, Chapter 9 makes a prediction of the future development trend of environmental provisions in FTAs and

consequently puts forward policy recommendations on the solutions of environmental provisions in future FTAs based on the prediction.

The book was edited by Li Liping, Zhang Bin and Yuan Qingdan from the Policy Research Centre for Environment and Economy (PRCEE), Ministry of Environmental Protection (MEP), China. Chapter 1 (Introduction) was jointly authored by Li Liping, Zhang Bin and Yuan Qingdan from PRCEE; Chapter 2 (Research on the Theory of Environment and Trade Agreements) was authored by Zhang Bin; Chapter 3 (Analysis of the Development and Rationale for Environmental Provisions in FTAs) was jointly authored by Li Liping, Chen Chao, Zhao Jia and Xia Yang from PRCEE; Chapter 4 (Content analysis of environmental provisions in FTAs) was authored by Li Liping; Chapter 5 (Environmental Cooperation Provisions in FTAs) was authored by Zhang Bin; Chapter 6 (Environmental Dispute Settlement of FTAs) was authored by Bian Yongmin from the University of International Business and Economics; Chapter 7 (Environmental Impact Assessment of FTAs) was jointly authored by Zhang Bin, Li Liping and Mao Xianqiang from Beijing Normal University; Chapter 8 (Analysis of Environmental Provisions in FTAs of China) was jointly authored by Xiao Junxia and Li Liping from PRCEE; Chapter 9 (The Development of Environmental Provisions in FTAs and Recommendations) was authored by Li Liping. Additional assistance in finalizing this book was provided by Xiao Junxia, Zhao Jia and Xia Yang. Anja von Moltke, Head of Environment and Trade Hub Unit, UNEP, and Ying Zhang, Associate Programme Management Officer, Environment and Trade Hub Unit, UNEP have also contributed to this book.

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Due to the limitation of material, time and professional expertise, the research done in this book on environmental provisions in FTAs is rather preliminary, demanding further deliberation and study. We sincerely hope to receive comments and suggestions from the readers.

Authors
June 2016

Contents

Chapter 1 Introduction	1
1.1 Background.....	1
1.2 Literature Review.....	5
1.3 Significance of Research.....	6
1.4 Scope.....	7
1.5 Methodology	8
1.6 Structure	8
Chapter 2 Research on the Theory of Environment and Trade Agreement	10
2.1 Environment and Trade Theories	11
2.2 Empirical Research on the Correlation between Trade and Environment.....	19
2.3 Trade, Environment and the Governance System	22
Chapter 3 Analysis of the Development and Rationale for Environmental Provisions in FTAs.....	26
3.1 Development of Environmental Provisions in FTAs	27
3.2 Status of Environmental Provisions of FTAs in Major Economies.....	45
3.3 Analysis of Rationale for the Establishment of Environmental Provisions of FTAs	64
Chapter 4 Content Analysis of Environmental Provisions in FTAs	72
4.1 Main Environmental Provisions in FTAs	72
4.2 Case Study of Environmental Chapter in FTAs	80
Chapter 5 Environmental Cooperation Provisions in FTAs.....	109
5.1 General Analysis on Environmental Cooperation in FTAs	109
5.2 Evolvement of ECPs in FTAs	110
5.3 Main Motivations to Include ECP in FTAs.....	112

5.4	Types of Environmental Cooperation	113
5.5	Institutional and Financial Arrangements for Environmental Cooperation.....	116
5.6	Specific Areas of Environmental Cooperation.....	119
Chapter 6 Environmental Dispute Settlement under FTAs		124
6.1	Dispute Settlements Between States: an Overview.....	124
6.2	Environmental Disputes under FTAs.....	127
6.3	Dispute Settlement Mechanisms for Environmental Disputes under FTAs	129
6.4	Case Study of Environmental Dispute Settlement under FTAs	135
6.5	Choice of Forum and Application of Law	139
Chapter 7 Environmental Impact Assessment of FTAs		142
7.1	Overview and Characteristics of EIA of FTAs.....	142
7.2	Significance of conducting EIA of FTAs	147
7.3	Development Process of EIA of FTAs	149
7.4	Major Methodologies for EIA of FTAs.....	151
7.5	Case Studies—Environmental Assessment of KORUS FTA	157
Chapter 8 Analysis of the Environmental Provisions in FTAs of China		162
8.1	Current Situation of the Development of FTAs in China.....	162
8.2	Environmental Provisions in the FTAs of China	168
8.3	Case Studies	194
8.4	Comparison and analysis of Environmental Provisions in FTAs involving China.....	201
Chapter 9 The Development of Environmental Provisions in FTAs and Recommendations.....		203
9.1	The Future Trend of Environmental Provisions in FTAs	203
9.2	Recommendations.....	207
References.....		210

Chapter 1

Introduction

An FTA is an agreement that two or more economies, where the signatories agree to build on the WTO's most favoured nation treatment and further open up their markets to each other, remove the tariff and non-tariff barriers on goods step by step and to improve the market access in services, so as to achieve the liberalization of trade and investment.^① In the past decade, FTAs cover not only the barriers on goods and services, but also other trade related issues and rules, including the environment.

1.1 Background

1.1.1 International background of the environment and FTAs

Since the nineties of the twentieth century, both MEAs and trade organizations have started to stress the linkage of trade and environment at least in the multilateral forums, along with the introduction of sustainable development. On the one hand, the Rio Declaration on Environment and Development in 1992 regards Principle 4 *"in order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it"* and Principle 12 *"... trade policy measures for environmental purposes should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade..."* as key. In this regard, environmental protection, including the arrangements in FTAs, should be a part of the global efforts to promote economic development. Chapter 2, 2.3 of the Agenda 21 approved by UN Conference on Environment and Development emphasizes *"the international economy should provide a*

^① ZHU, Hong, "FTAs-the New Bridge of South-South Cooperation of China and Other Developing Countries", <International Trade>2009-9: The concept of Free Trade Agreement does not exist in GATT 1947. Article XXIV introduces the concept of Free Trade Area, which is "a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories".

supportive international climate for achieving environment and development goals by: (a) Promoting sustainable development through trade liberalization and (b) making trade and environment mutually supportive.” On the other hand, article XX (b) of GATT 1947 regards measures that are “*necessary to protect human, animal or plant life or health*” as one of the general exceptions. One of the main goals of the WTO which was founded in 1994 is to protect the environment, attaching much importance to the issue of environment in the trade sphere. The WTO has made many efforts in this area, including establishing the Committee of Trade and Environment, to identify the relationships between trade measures and measures related to the environment, so as to promote sustainable development. The Marrakesh Agreement Establishing the WTO states “*recognizing that their relations in the field of trade and economic endeavors should be.....allowing for the optimal use of the world’s resources in accordance with the objective of sustainable development , seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development*”. Furthermore, Agreement on Agriculture, Agreement on the Application of Sanitary and Phytosanitary Measures, Agreement on Technical Barriers to Trade, General Agreement on Trade in Services of the WTO all encompass provisions regarding the environment. For instance, the Agreement on Agriculture emphasizes environmental protection, regarding “*research in connection with environmental programs*”, and “*infrastructural works associated with environmental programs*” as government service programs, allowing the WTO Members to implement domestic support measures related to environmental protection, which have no, or minimal trade-distorting effects thus are exempted from the reduction commitments. Article 2 (Basic Rights and Obligations) of the Agreement on the Application of Sanitary and Phytosanitary Measures specifies that “*Members have the right to take sanitary and phytosanitary measures necessary for the protection of human, animal or plant life or health.*” Article 3 (Harmonization), Article 4 (Equivalence) and Article 5 (Assessment of Risk) all have provisions specifying the requirements for environment protection. These provisions set benchmark on trade measures affecting the environment and public health, regarding the environment as a priority, which provides reference for domestic policy-making. In addition, Decision on Trade in Services and Environment was approved in 1994. Nevertheless, the progress of discussions and actions taken on trade and environment was somehow limited in the multilateral forums, as the WTO

negotiations progressed slowly and the global environment continues to deteriorate.

In contrast with the slow progress in WTO negotiations, FTAs began to flourish. There are 239 FTAs notified to the WTO Secretariat that were in force by the end of January 2016. Apart from Mongolia, all WTO Members have participated in at least one FTA. It is estimated that about half of the trade in goods is the result of FTAs. The rapid development of FTAs can be attributed to the following reasons: first, from a legal perspective, WTO rules allow regional integration and trade agreements, while FTAs provide examples and experience for the multilateral rule-making, which complement the WTO rather than undermine it; second, the contracting parties of FTAs are relatively limited compared the WTO Members, and thus it is easier to reach consensus and coordinate regularly; third, the new issues, such as the environment, labour, competition and e-commerce, are more likely to be included in FTAs; fourth, the proximity is also an important factor. Over the years, the coverage of FTAs has expanded greatly to adapt to economic globalization. In addition to the traditional tariff reduction on goods, more and more FTAs incorporate the environment, along with services, investment, dispute settlement, intellectual property, competition, labour standards as equally important parts. As a result, the efforts on trade and environment started to develop bilaterally and regionally, which has become a feature and trend of the FTAs.

The environmental provisions in international free trade agreements can be dated back to 1971. The agreement signed by EU and the Overseas Countries and Territories (OCT) states that *“the development of international trade should be managed sustainably in accordance with relevant protocols. OCT’s special needs and respective development levels need to be taken into account in planning and implementing the measures related to the environment”*. Yet the earliest provisions on trade and environment with substantial contents can be found in the North American Free Trade Agreement (NAFTA) signed by the United States (the US), Canada and Mexico, which entered into force in 1994. After the founding of the WTO, the number of FTAs which cover the issue of environment increases every year. In some cases, the issue of environment in FTAs can become the determining factor in the negotiations as well as implementation. According to available statistics, there are 180 FTAs that cover the issue of environment, accounting for 85% of 212 FTAs in force, 36 of which have an independent environment chapter. In the spectrum of time, the environmental provisions on trade and environment have increased significantly

since 2002, especially in 2004, 2011 and 2012, when there were a number of FTAs including an independent environment chapter.

Among all WTO Members, the US, Canada, and EU are pushing most forcefully for including environmental provisions in FTAs. According to the statistics released by the office of the US Trade Representative's (USTR), out of the 15 FTAs in force that the US is a part of, 14 of them contain an independent environment chapter (other than US-Israel FTAs signed in 2001). The US, EU and New Zealand even designed specific bills, and established task forces in trade and environment agencies to promote the environmental provisions in FTAs. Furthermore, developing economies such as Republic of Korea and Chile currently are also pushing for including provisions on environment in their FTA negotiations. In short, along with the rapid development of the FTAs, the FTAs with environmental provision are growing even faster, becoming the highlight and new normal in the development of the FTAs.

1.1.2 Background of the Environment and FTAs in China

The environment has become the key element of China's FTAs strategy. The Decision on Some Major issues Concerning Comprehensively Deepening the Reform adopted at the Third Plenary Session of the 18th central Committee of the communist Party of China has spelt out the requirements of *"Speeding up the construction of the free trade zones..... accelerating the negotiation environmental protection, investment protection, government procurement and E-commerce so as to form a global, high-standard network of free trade zones."*

China is a large trader with high degree of trade dependence. China became the world's largest trade partner in goods as well as the first WTO member with a volume of goods trade to 4 trillion US dollars in 2013, with imports and exports of 4.16 trillion US dollars. Over the past decade, China's foreign trade dependence has grown to more than 40 percent.

The high-speed growth of trade leads to a rapid increase in the GNP, but also increases emissions of various pollutants bringing greater pressure to bear on the environment. Let's take CO₂ for an example: in 2014, Lin et al. from Peking University estimated the volume of CO₂ emissions attributable to exported goods from 2000 to 2009. The result implies that the CO₂ emissions significantly increased after China's accession to WTO. Also a study conducted by the Policy Research Centre for Environment and Economic of Ministry of Environmental Protection of China shows that along with the accession to the WTO, China's exports grew significantly, resulting in increased emissions of

various pollutants, where waste water, sulphur dioxide, dust, flue gas and other pollutants account for an increase of 25% to 40%.

China's FTA strategy is aligned with the internal demand of deepening the reform and opening up. In 2007, the 17th CPC central committee report clearly stated, "*to implement of the FTAs Strategy, and strengthen bilateral and multilateral cooperation in economy and trade.*" Government work report in 2009 and People's Republic of China for National Economic and Social Development Twelfth Five-Year Plan also proposed to "*speed up the implementation of the FTAs Strategy.*"

By 31st December 2015, China was involved in 22 FTAs, 14 of them have been already signed and implemented, namely China-Australia, China-Switzerland, China-ASEAN, China-Singapore, China-Pakistan, China-New Zealand, China-Chile, China-Peru, China-Costa Rica, China-Iceland, China-Switzerland FTAs and Closer Economic Partnership Arrangement between china and Hong Kong, China Closer Economic Partnership Arrangement between China and Macao China, the updated version of China-ASEAN. Environmental provisions have been included in all of the above mentioned FTAs. Environmental provision is one of the key requests of China's trading partners in the negotiating process.

1.2 Literature Review

The OECD has taken a leading role in researching the issue of environment in FTAs, publishing an annual report on environment and FTAs since 2007. Despite all this, The annual reports either lack through and systematic analysis or do not cover the ones came into force in recent years, and China case has not been focused on. In addition, there are sporadic, individual researchers who have done relevant studies, such as *Green Trade Agreements* by Dale Colyer, which lacks comprehensive analysis of environmental provisions in FTAs and in-depth analysis of the reasons behind; *Environmental Impacts of a Free Trade Agreement between China and Norway* by Ole Kristian Fauchald and Haakon Vennemo, *QUANTIFYING NAFTA ENVIRONMENTAL IMPACT in ENERGY AND AGRICULTURE* by Gloria Soto Montes de Oca's and others only focus on the environmental impact assessments.

In China, the researches on this issue are mainly focused on the North American Free Trade Agreement (NAFTA), for example, *The Impact on the Environment of NAFTA Chapter XI Dispute Settlement Mechanism-Metalclad V.S.*

Mexican Government by He Bingqing, *Interaction of NAFTA trade rules and environmental measures- from SDMI case* by Li, Zhihui, *The Issue of Trade and Environment in NAFTA*, *Public Involvement in Environmental Protection in NAFTA and Its Implications* by Xiao, Man and Zou, Ninghua, *Coordination and Revelation of NAFTA on Trade and Environment* by LI, Shouping, *Conflicts between Free trade and the Environment-study on NAFTA from the perspective of political pluralism* by Gu, Zhouyu. In addition, Li Liping and Zhang Bin et al. have conducted primary researches on the issue of environmental protection in FTAs, and published *Advancing the Negotiations on the Issue of Environment in FTAs*, *China-Switzerland FTAs Reinforces the Environmental Provisions* on China Environment News.

Overall, there are missing parts in the studies at hand such as full stock taking of the environment issues in FTAs, analysis on patterns, causes and solutions, which are not sufficient enough for policy-making. Therefore, it is imperative to conduct systematic, comprehensive and in-depth research on this subject.

1.3 Significance of Research

Research on the issue of environmental provisions in FTAs is relatively new, thus bears an important theoretical and practical significance.

Theoretically, research on environmental provisions in FTAs provides a broad and comprehensive perspective to dive deeper in environmental protection, which helps us better understand the relationship between trade and environment, coordinate environmental and trade policies, and further develop the theory on trade and environment.

Practically, the purpose of including environmental provisions in FTAs is to promote mutual supportiveness of trade and environment, reinforce environmental law enforcement, lift environmental standards, strengthen environmental cooperation, and enhance public participation in environmental matters. For some economies, to include environmental provisions in FTAs can be the driving force to accelerate the internal reform processes. In Morocco, the FTA negotiation with the US expedited several environmental laws which were shelved for years. The impetus for much of Chile's environmental legislation was the FTA negotiation with the US and Canada. Without these external forces, these environmental actions wouldn't have taken place or would have at least been postponed. For China, to include environmental provisions in FTAs, contributes to the environmental and economic integration. The construction of