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Green turnaround

Regulatory changes to the EU trade policy

CEE countries should change their attitude towards green trade and carry out a "green turnaround" on a regional scale. Accelerating the pace of the green transition will improve the competitive advantage of the region's producers, and will bring economic benefits to them. However, in their operations they need to focus on environmental issues more closely.

Kamil Laskowski, Wojciech Lewandowski



ENERGY, CLIMATE AND ENVIRONMENT

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Executive Summary

- The European Union has traditionally been one of the main advocates of free and open trade and the *Wandel durch Handel* approach. This attitude has to be changed due to the Covid-19 pandemics and the war in Ukraine and the trade policy of the EU has to be re-orientated along the principle of strategic autonomy and avoiding mono dependencies in imports of crucial goods and technologies. This strategic autonomy should have a green dimension and enable stronger inclusion of sustainability considerations.
- The CEE countries are on average more reliant on imports from Russia than the rest of the EU. Simultaneously, their domestic production can be often regarded as substitution to imports from the outside of the EU and therefore the green trade agenda of the EU should play in their favour and become a pragmatic postulate along with the proposed approach of “Green Realism”.
- Since 2019 the European Commission has been seeking methods of aligning the EU trade policy with other policy objectives, foremost the European Green Deal. The trade policy was reviewed in 2021 when the Commission published its recommendation for making the trade policy of the EU more sustainable. The communication on strengthening the enforceability of the trade and sustainable development chapters in free trade agreements followed in June 2022. These initiatives combined together may be labelled as the “green turnaround” of the EU trade policy.
- The actions to implement this “green turnaround” are two-fold – internal and external. In the context of internal initiatives the Commission presented various legislative proposals aimed at introducing regulatory requirements on the economic entities operating in the Internal Market of the EU. The outside repercussions for trade policy will depend on the “Brussels effect” related to the normative and market power of the EU and its bargaining position. These initiatives cover the Carbon Border Adjustment Mechanism, the directive on the due diligence in value chains, deforestation regulation and the Circular Economy Action Plan, together with the upcoming “right to repair” initiative.
- Externally, the EU relies on free trade agreements and in particular provisions related to the sustainability contained in the chapters on trade and sustainable development. The biggest challenge with the effectiveness of this approach was related to the enforceability of these provisions that were usually inconsistent and merely “promotional”. The European Commission intends to revise its approach as presented in the June 2022 communication. Other external actions of the EU relate to cooperation in multilateral bodies and the climate diplomacy, including so called “climate clubs”.
- These initiatives will have an asymmetric effect on the CEE economies, as the position of domestic producers and importers differs between sectors that will be covered as part of the new legislative package. Arguably the biggest difference will be related to the introduction of CBAM, therefore it deserves the most attention. However, other initiatives that are not so much in the spotlight will have an impact on market niches with a strong presence of CEE producers, such as the leather and textile industry.



- Global trade remains currently under big pressure and challenge. This situation is related to the still unfinished recovery after Covid-19 pandemics and the disruptions to the supply and value chains. The difficult economic and geopolitical situation and rising bi-polarity between G7-oriented countries and BRICS-block results in uncertainty, translating into a lack of trust. This can lead in the longer perspective to the increasing unanimity and make the “green trade” a hostage of the conflicting interests of global powers. Initiatives related to sustainability may also become “weaponized” as they target many of the practices associated with the BRICS countries – CBAM covers imports mainly from Russia, forced labour is informally targeted at the Chinese-based producers, and deforestation relates to the practices in Brazil.

1. Introduction

The European Union has a unique position on the global stage. Even though its role in the global economy has been declining over recent years, it still sets the standards and rules in many economic sectors thanks to its normative power and its “Brussels effect”. One such area is global trade. The EU, which is one of the biggest players in global trade, still has the power to exert significant influence on the rules and principles that are binding in the global exchange of goods and services. This influence, also executed through multilateral bodies such as the WTO, has mostly been used by the EU to ensure access to new markets and to promote democracy combined with the free market approach around the world.

This attitude, described also as the belief in *Wandel durch Handel* has recently received criticism from specialists concerned by the EU’s trade ties with Russia in the context of its invasion of Ukraine. The main argument of this criticism focuses on the naivety of the approach and the wishful thinking of its advocates. The main assumption of the *Wandel durch Handel* approach can be reconstructed as a belief in the transformative role of openness to trade and of globalization in eroding authoritarian regimes. Simultaneously, the tight economic ties between the EU and its trading partners would prove beneficial both for the EU companies (gaining new supply routes and export destinations) and the local economies (gaining an opportunity to embed in the global value chains). As exposed by Russia’s aggression, this approach had a limited impact on authoritarian regimes and the reinforcement of democracy in countries which the EU traded with.

However, complete discrediting of this approach and renouncing its implementation would not be the best solution. It deserves closer investigation in the context of the biggest (yet barely tapped) potential of EU trade policy – its effects on sustainability and the green *Wandel durch Handel*. If implemented in a coherent and robust manner, the sustainability requirements could have transformative effects on EU trading partners. Nevertheless, until very recently, the EU, and especially the European Commission, was highly reluctant to pursue this route and allow sustainable objectives of the climate policy to interfere with the objectives of the trade policy. As signalled above, this is now subject to change and the shift in the attitude of the European Commission could be observed in its recent review of the trade policy and communication on enhancing the enforcement of provisions related to sustainability in new trade agreements. Considerations related to the sustainability of trade were much more exposed than in the former versions of these documents. However, an even more meaningful impact can be expected from the recent legislative initiatives of the Commission.

It is therefore useful to assess in this contribution the potential of these initiatives to allow for the “green turnaround” of the traditional trade policy of the EU. Such a turnaround is a very fragile and up-to-date question in the context of the war in Ukraine and the need to sever economic ties (including import of fossil fuels) of the EU with Russia that was the subject of the European Commission’s communication *REPowerEU*¹. Our paper exposes the CEE perspective on these issues and presents a comprehensive overview of the most relevant legislative initiatives of the European Commission. We aim to show that the effect of these initiatives will be long-lasting and durable, but the success of the “green turnaround” will depend on its longevity. However, already at this moment it is possible to show what consequences this shift will have on the market players, including cross-border businesses and domestic industry companies.

¹ European Commission (2022), *REPowerEU Plan*, COM(2022) 230 final, Brussels, 18 May 2022.

2. Strategic turnaround along the green compass

The EU trade policy is an area that has recently been revisited by the European Commission in order to make it more aligned with the changing circumstances. The COVID-19 pandemic exposed the EU's vulnerability in how dependent it is on the import of strategic goods (mostly active pharmaceutical ingredients). Disturbances in supply chains caused by lockdowns, bans on the export of medical equipment, and bottlenecks in global transport of goods enacted the debate on the EU's need to become more independent in strategic areas related to public health. This debate spilled over to other sectors of the economy and recently focused on the energy sector. The main reasons for this have been Europe's gas price crisis in autumn 2021 and the war in Ukraine. The Commission², supported by the European Council³, proposed a more assertive approach described as an "open strategic autonomy". The most recent developments related to the aggression of Russia provided further arguments to supplement this concept with the adjective "green".

According to the assessment of the Commission, the concept of the "open strategic autonomy" should be guided by three principles: "resilience and competitiveness", "assertiveness and rule-based cooperation", and "sustainability and fairness"⁴. It seems that the third element needs particular strengthening and the war in Ukraine adds new context for the need to follow this objective in a robust and coherent manner. This should translate into an approach that aligns with the "3D principle" in order to achieve the "green strategic autonomy" that would enable the EU to act in a truly independent manner. Or as the Commission puts it, to build "the EU's capacity and freedom to act" based on its values. In short, the EU should follow the path of implementing policy that is oriented toward the 3D principle, which stands for derussification, diversification, and decarbonisation. These objectives should become the core of new EU policies - not a "nice to have" variant. They are particularly relevant for energy policy and the import of Russian fossil fuels (gas, oil, and coal), but other areas of trade with Putin's aggressive regime should be equally important.

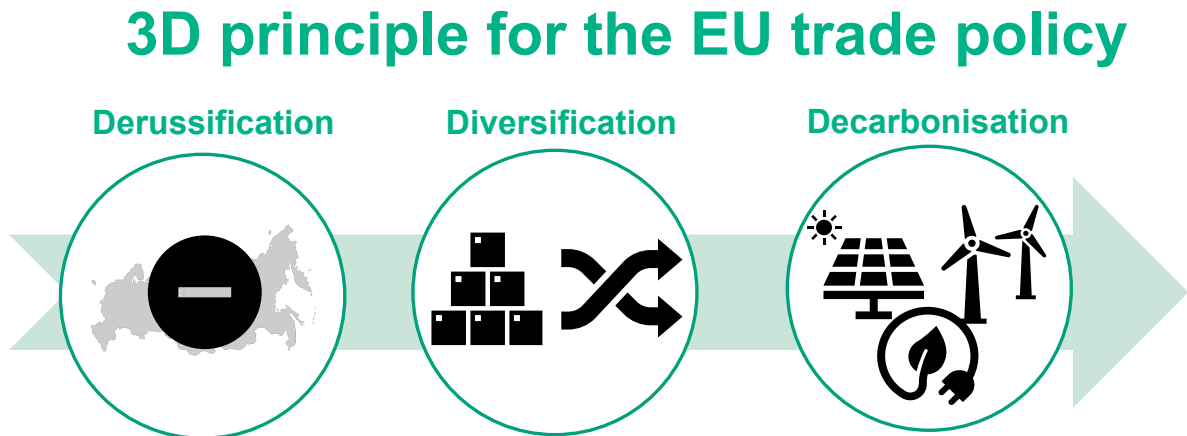
² European Commission (2021), *Trade Policy Review – An Open, Sustainable and Assertive Trade Policy*, COM(2021) 66 final, Brussels, 18 February 2021, p. 1.

³ European Council Conclusions of 1-2 October 2020, EUCO 13/20, p.1.

⁴ European Commission (2021), *Trade Policy Review...*, *op. cit.*, pp. 4-5; European Commission (2021), *2021 Strategic Foresight Report – The EU's capacity and freedom to act*, COM(2021) 750 final, Brussels, 8 September 2021, p.1; see also Vignarelli, M.C. (2021), "The European Commission Trade Policy Review: The Effectiveness of Sustainable Development Chapters in EU FTAs", *European Papers*, Vol. 6, No. 1, pp. 1-2.

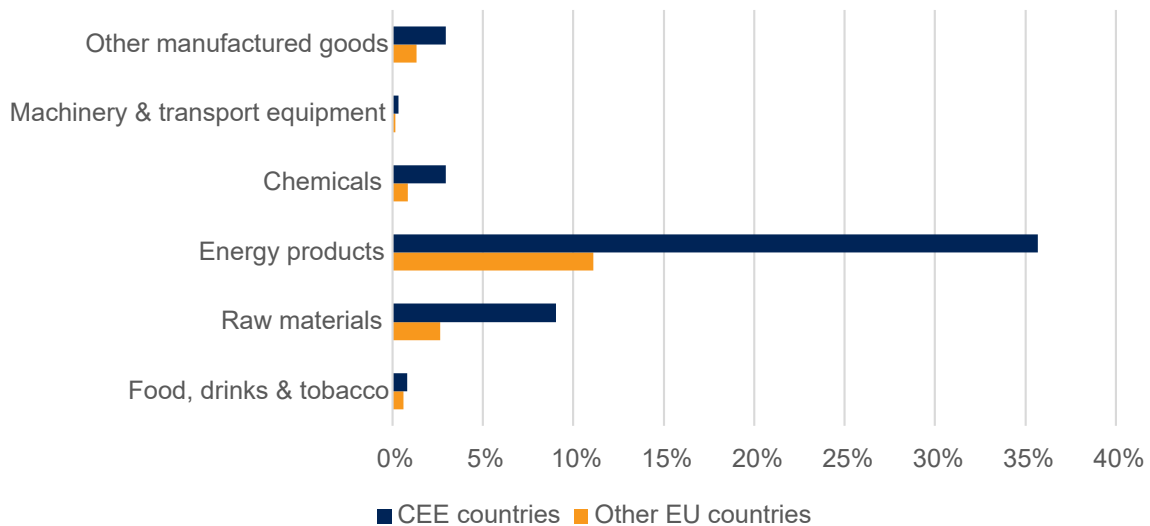


Diagram 1: 3D principle for the EU trade policy



The European Commission presented the plan for actions in the *REPowerEU* communication and increasing the share of renewable energy is among the priorities for the reaction of the EU on the war in Ukraine, as well as replacement of the Russian imports of gas with supplies from Middle East and North America. The International Energy Agency (IEA) has published a *10-Point-Plan to Reduce the European Union’s Reliance on Russian Natural Gas*⁵. According to the IEA, the measures proposed could bring down Russian gas imports by over one-third over the course of 2022. This direction is in particular relevant for the CEE countries that are more dependent on imports from Russia on average than other EU Member States.

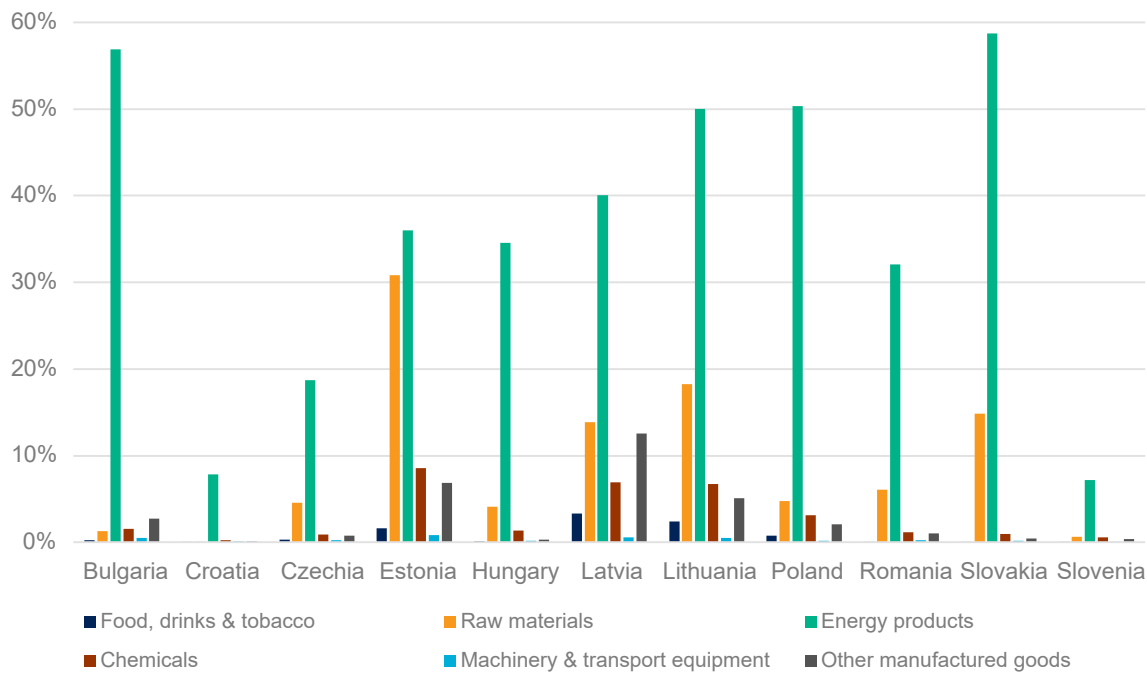
Figure 1: Share of Russian imports in EU countries’ total imports in 2021



Source: WiseEuropa based on Eurostat (EU trade since 1999 by SITC)

⁵ IEA (International Energy Agency) (2022), *A 10-Point Plan to Reduce the European Union’s Reliance on Russian Natural Gas*.

Figure 2: Share of Russian imports in CEE countries' total imports in 2021



Source: WiseEuropa based on Eurostat (EU trade since 1999 by SITC)

Therefore, the need to build the “green strategic autonomy” of the EU is a context against which the Commission’s recent trade-related legislative initiative should be assessed. The growing number of drafts presented by the Commission in recent months suggests that this direction has been recognised at the political level. However, the integrity of the “green turnaround” in the trade policy of the EU will depend on its coherence and implementation. In this context, it is worth stressing that such an approach can be seen as well-grounded in the Treaty provisions. Although the “open” trade policy of the EU is rooted in primary law (preamble and Art. 206 of the TFEU), the environmental protection has a horizontal effect on the other fields of EU activities, according to Art. 11 of the TFEU. The recent attempts of the Commission to substantiate this horizontal dimension can be observed by the fact that the main part of the legislative initiatives with an effect on trade are based on the grounds of the Art. 192 (1) TFEU included in the Title XX “Environment”.

However, this observation applies mainly to the internal initiatives (applying to the entities operating within the EU) – among these the most important are the Carbon Border Adjustment Mechanism (CBAM), the directive on Corporate Sustainability Due Diligence (CSDD) and the regulation on deforestation-free products. Other actions undertaken at the EU level that deserve analysis in the context of their influence on trade are standardisation efforts and the implementation of a Circular Economy Action Plan. Therefore, we present them in the first part of the following paragraph. In the second part we analyse external actions – the inclusion of the Trade and Sustainable Development chapters (TSD chapters) in Free Trade Agreements (FTAs) and climate diplomacy efforts, including initiatives related to establishing climate clubs and the multilateral cooperation of the EU.

Our analysis aims to present the issues related to regulatory actions in the field of greening the EU trade policy through the lens of CEE countries. The most general observation is that the impact of the various initiatives on said countries will be asymmetrical. Therefore, we focus on the actions with potentially the biggest practical implications for the region. Green trade seems to be a relatively distant priority on the agenda of CEE governments. However, as we argue, there are very good reasons to change this approach and to implement a “green turnaround” at the regional scale. These reasons are first and foremost related to these countries’ geographical proximity to Russia, but also to the current economic situation and trade patterns.

3. Implementing the "green turnaround" in practice

THE EU AS A NORMATIVE POWER

After presenting the rationale for pursuing a more ambitious green agenda through EU trade policy, it is worth presenting which tools the EU may use to fulfil its objectives and expand the force of the EU Green Deal beyond its borders. In this context it is observed in academia that traditional approaches to the EU's role as a global regulator through trade are threefold: "1) the normative nature of the EU trade policy (the EU is structurally bound to promote norms and values beyond its borders through trade), 2) the EU's role as a market power: the large size of the EU's market allows it to externalize, intentionally or unintentionally, its domestic regulatory policies, 3) the EU's willingness to export labour and environmental provisions lie in the economic interests of key domestic legislations in the EU"⁶. Thus, the EU trade policy may in many ways contribute to the achievement of the objectives of the EU Green Deal.

Even if acknowledging the fact that the normative powers of the EU are limited⁷ and not always used as part of a consistent approach toward developing countries⁸, the EU may still use its market size to externalize domestic regulatory policies more effectively than any of its Member States could on their own. The large size of the Internal Market of the EU confers it a huge bargaining power, especially toward developing countries and the biggest market players. Therefore, the CEE countries would be more effective in a coordinated approach and cooperation through the EU rather than creating the market conditions solely on their own. This is especially true in relation to the "strategic partners and rivals" of the EU – the USA and China, where the asymmetry of economic power is strongly against their favour.

TOWARDS A NEW TRADE POLICY

The Commission recently acknowledged that emerging internal and external challenges, as well as the new growth model adopted in the EU Green Deal necessitate a new trade policy strategy – "one that will support achieving its domestic and external policy objectives and promote greater sustainability in line with its commitment of fully implementing the UN Sustainable Development Goals"⁹. The Commission outlined the objectives for this strategy, pursuant to the aim to increase the level of ambition among global partners, large emitters, and polluters, and to support social fairness and environmental sustainability, as well as support other policies related to the implementation of the EU Green Deal domestically. Such a strategy was already presented in February 2021 (*Trade Policy Review*) and now the Commission intends to implement it through precise and binding legislative proposals and tools of trade policy. They should "accompany and support a global transition towards a climate neutral economy, including accelerating investments in clean energy, and promote

⁶ Poletti, A., Sicurelli, D. and Yildirim, A.B. (2021), "Promoting sustainable development through trade? EU trade agreements and global value chains", *Italian Political Science Review/Rivista Italiana di Scienza Politica*, Vol. 51, No. 3, p.3.

⁷ van 't Wout, D. (2021), "The enforceability of the trade and sustainable development chapters of the European Union's free trade agreements", *Asia Europe Journal*, Vol. 20, p. 89.

⁸ Poletti, A. et al., *op. cit.*, pp. 2-3.

⁹ European Commission (2021), *Trade Policy Review...*, *op. cit.*, p. 1



value chains that are circular, responsible and sustainable”, as well as promote “responsible business conduct and the respect of environmental, human rights and labour standards” and create the conditions and opportunities for sustainable products and services¹⁰.

The Commission points at the Trade and Sustainable Development chapters (TSD chapters) in free trade agreements (FTAs) as the most prominent existing tool of the trade policy. The vast network of bilateral trade agreements facilitates trade in green technologies, goods, services, and investments, supports the diffusion of clean and more efficient production methods and technologies, creates market access opportunities for green goods and services (in particular on third country markets for renewable energy), ensures undistorted trade and investment in the raw materials and energy goods necessary for the EU’s objectives of climate neutrality, and provides an essential platform to engage with EU partners on climate change, biodiversity, circular economy, pollution, clean energy technologies, energy efficiency and sustainable food systems¹¹.

TSDs have been subject to criticism for being “merely included to have a good appearance worldwide” and for being a “hypocritical” example of greenwashing¹² - the need for making the EU trade policy greener requires a variety of effective and enforceable tools and legislative actions. As it is also observed, the new trade policy of the EU will have to recognise to a greater extent “the need to harness trade for sustainability, not the other way round”¹³. The effects of the communication on strengthening the implementation and enforcement of the TSDs are yet to materialise, since the European Commission has unveiled new approach to trade agreements in late June 2022¹⁴. Therefore, the following part of this policy brief will focus on the potential of the proposed and planned actions for retooling and re-orientating the EU trade policy to facilitate the fulfilment of the EU Green Deal objectives and spill them over beyond the borders of the EU.

¹⁰ Ibid., pp. 10-12.

¹¹ Ibid., p. 12.

¹² van 't Wout, D. (2021), p. 95.

¹³ Ibid., p. 96.

¹⁴ European Commission (2022), *The power of trade partnerships: together for green and just economic growth*, COM (2022) 409 final, Brussels, 22 June 2022.

3.1 Domestic regulatory requirements

The EU influences trade in two ways – through domestically adopted regulatory requirements that will have external implications beyond the borders of the EU, and through external actions that involve some sort of cooperation or coordination (bi- and multilateral) with third parties.

CARBON BORDER ADJUSTMENT MECHANISM

The most significant initiative, and perhaps the one with the biggest potential to implement adequate competitive conditions (regarding carbon pricing) beyond EU borders, is the Carbon Border Adjustment Mechanism (CBAM). The European Commission perceives it mainly as a tool for reducing emissions and avoiding carbon leakage¹⁵. However, in the wider perspective, CBAM will also be an autonomous measure of the EU to ensure a level playing field (at least in terms of costs) between EU-located and external producers in the sectors covered by CBAM – for the initial phase, those are cement, steel, aluminium, fertilisers, and electricity (any changes introduced in the negotiation phase by the European Parliament or the Council will be analysed in a separate paper).

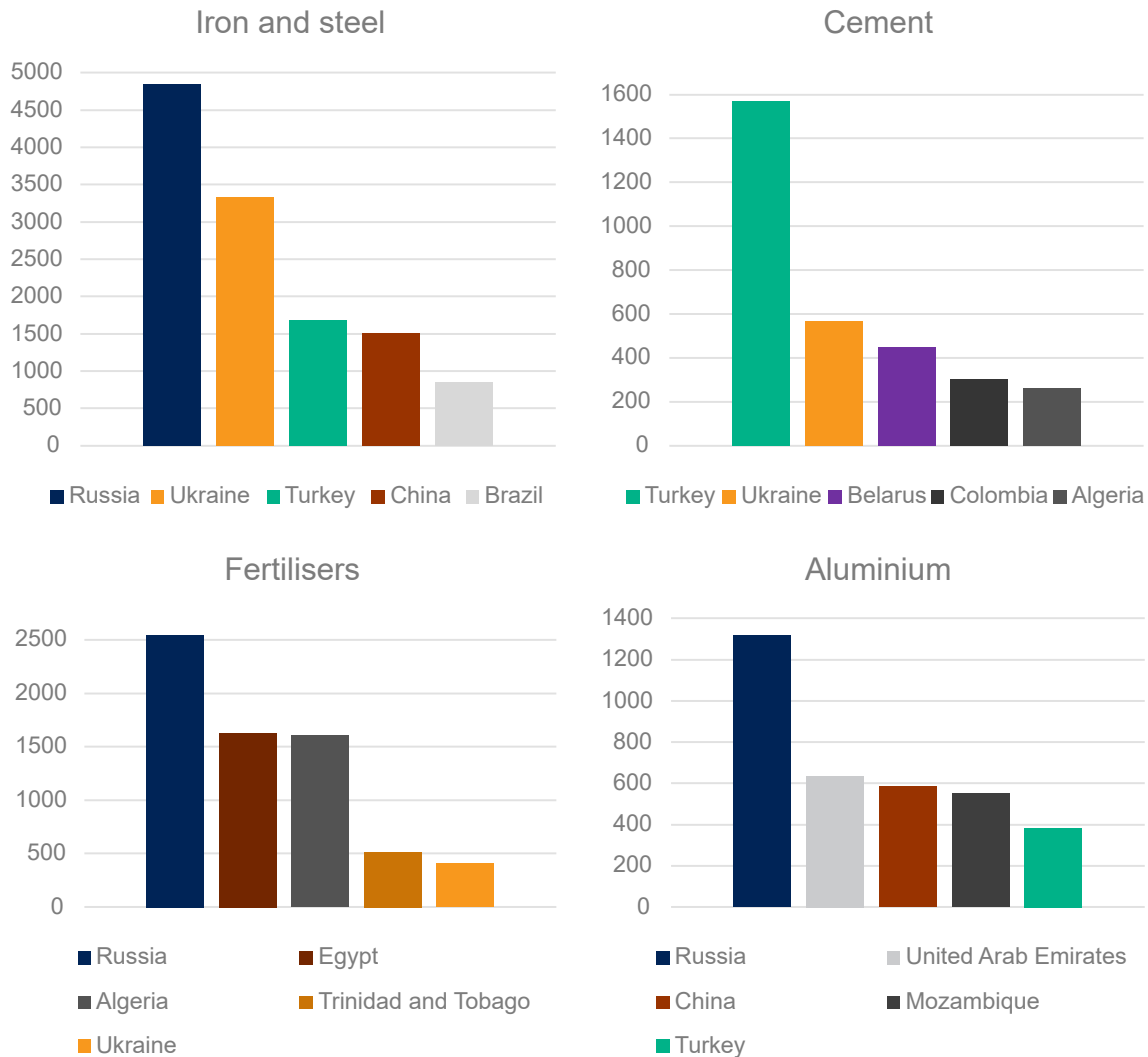
A fee will be levied on these goods at the borders of the European Union in the form of CBAM certificates, which will correspond to the price of allowances paid by domestic producers. The price of the certificates will depend on the embedded emissions, which will be determined in three ways: (i) installation-specific emissions (ii) average emission of the exporting country or (iii) average emission of 10% of the worst-performing EU installations. CBAM will have an introductory period in which certificates will be issued without the need to pay for them. Then in 2025, the fee will be slowly introduced in parallel with the phasing out of free allocation (each year 10% of free allocation for relevant installations will be phased out, while a corresponding number of CBAM certificates will be given without payment, hence full CBAM will be introduced in 2035).

After the first mentions of introducing carbon tax on the borders of the European Union appeared, it became clear that it will be a challenge in terms of administration, reporting, and monitoring. However, its most sensitive repercussions will be of a geopolitical nature and CBAM will potentially operate on the limits of compatibility with WTO rules. Not surprisingly, the official proposal of the European Commission met with mixed, but rather negative, reactions in the international arena. Most vocal opponents are the BRICS countries (Brazil, Russia, India, China, South Africa), led by Russia and China, who point to the protectionist nature of the mechanism and its lack of compliance with WTO rules. On the other hand, the perspective presented by the European Commission envisions CBAM as a tool to level the playing field in the context of carbon pricing of goods and promotes the proposal as specifically designed to comply with WTO rules¹⁶.

¹⁵ European Commission (2021), *Trade Policy Review...*, *op. cit.*, p. 13.

¹⁶ European Commission (2021), *Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism*, COM(2021) 564 final, Brussels, 14 July 2021.

Figure 3: Imports of goods covered by CBAM to the EU (in thousands of tonnes) from top extra-EU exporters



Source: WiseEuropa based on Eurostat

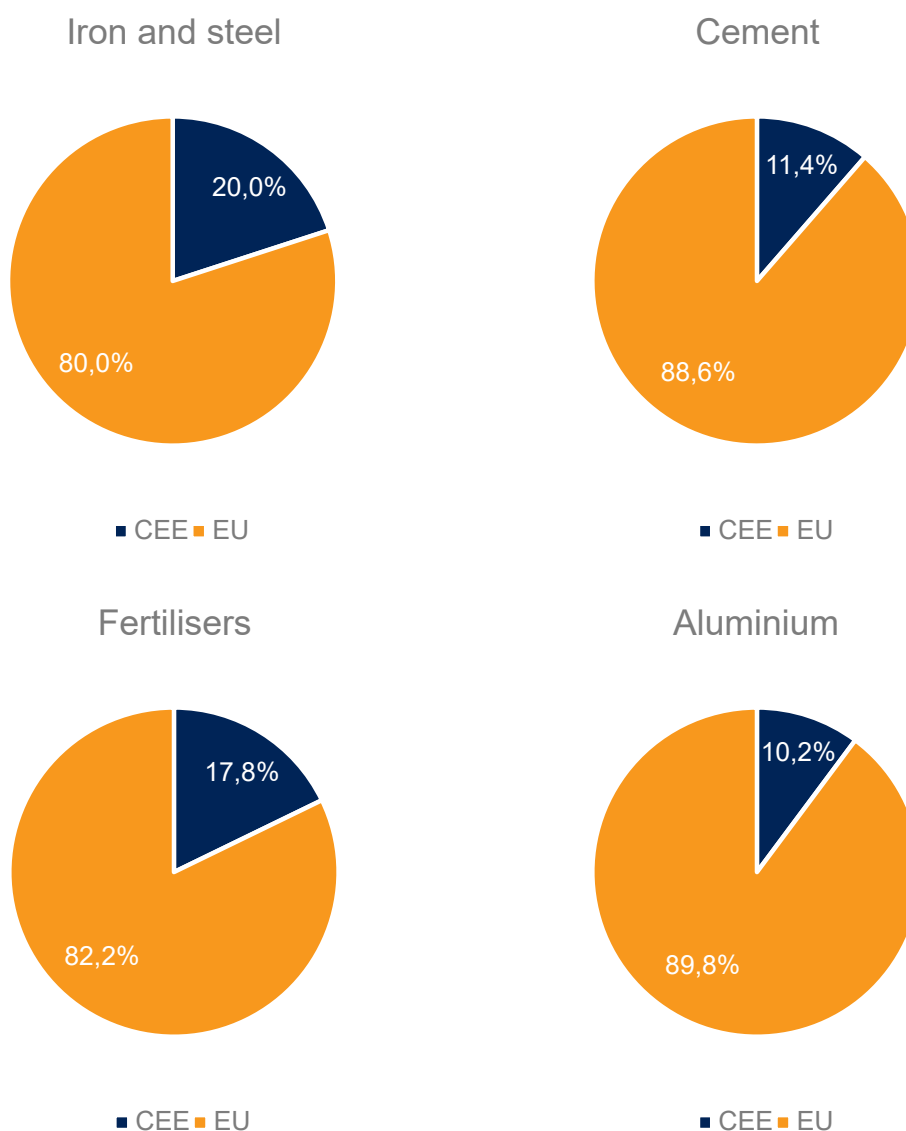
If the current scope of regulation is not extended or narrowed, the countries most affected by CBAM in absolute terms will be Russia, followed by Ukraine, Turkey, and China, which export the largest volumes of commodities falling under the current scope¹⁷. Besides these countries, attention is also focused on countries whose GDP largely depends on the import of goods covered by CBAM to the European Union - this is, for example, Mozambique with a 7% share of aluminium imports to the EU in their GDP¹⁸. Obviously the consequences of the war in Ukraine and embargo on Russian imports of certain goods will affect these developments, but it is not clear yet to what extent.

Simultaneously, CBAM will have asymmetric effects on the importers from various regions. As shown on the graphs below, the biggest share of the imports from the CEE countries among the commodities covered by CBAM is in the case of iron & steel and fertilisers. Therefore, the opportunities arise for domestic producers in these areas to cover the (anticipated) decline in imports with domestic production and expand to the neighbouring markets.

¹⁷ Assous, A., Burns, T., Tsang, B., Vangenechten D. and Schäpe B., Sandbag and E3G (2021), *A storm in a teacup. Impacts and geopolitical risks of the European Carbon Border Adjustment Mechanism*, Energy Foundation China.

¹⁸ European Commission (2021), *Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism...*, op. cit. (the "impact assessment" part).

Figure 4: Share of CEE countries in intra-EU imports of CBAM



Source: WiseEuropa based on Eurostat

SUSTAINABLE CORPORATE GOVERNANCE AND DEFORESTRATION-FREE VALUE CHAINS INITIATIVE

The Commission planned a major revision of the due diligence, reporting, and disclosure requirements for certain actors on the Internal Market of the EU. For this reason, in February 2022 a proposal for a Directive on corporate sustainability due diligence¹⁹ was adopted. The Commission intends for this proposal to be an important element in ensuring sustainability and responsibility within the supply chains of European companies – it should lead to the emergence of sustainable corporate governance models, which will entail “mandatory environmental, human and labour rights due diligence” with the main focus being forced labour²⁰.

¹⁹ European Commission (2022), *Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937*, COM(2022) 71 final, Brussels, 23 February 2022.

²⁰ European Commission (2021), *Trade Policy Review...*, op. cit., p. 13.

Frame 1: Directive on corporate sustainability due diligence – overview

The Directive lays down rules on obligations for companies regarding actual and potential adverse impacts on human rights (including workers' rights) and the environment, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the company has an established business relationship and on liability for violations of these obligations.

The Directive would apply to both EU-based and non-EU-based companies. To fall within the scope of the Directive, they would need to employ more than 250 employees (this is not required for non-EU-based enterprises) and have a yearly net turnover above a fixed value (in the case of non-EU-based companies only the turnover generated in the EU would be counted). EU-based companies with the number of employees not exceeding 500 and non-EU-based companies with a net turnover below a given value should additionally have at least 50% of their net turnover generated in one or more of the following sectors (so called high-impact sectors): the manufacture and wholesale trade of textiles, leather and related products (including footwear), agriculture, forestry, fisheries, the manufacture of food products, the wholesale trade of agricultural commodities, the extraction and wholesale trade of mineral resources, the manufacture of basic metal products, other non-metallic mineral products and fabricated metal products and the wholesale trade of basic and intermediate mineral products.

The enterprises within the scope would be obliged to integrate due diligence into their policies, aimed at identifying actual or potential adverse human rights and environmental impacts, preventing or mitigating potential impacts, and bringing to an end or minimizing those that are already in place. The adverse human rights and environmental impacts that the Directive refers to are listed in the Annex to the Directive.

The most serious measure envisaged by the proposal in order to fulfil the obligations above by the companies is to refrain from entering into new or extending existing relations with the partner in connection with or in the value chain of which the impact has arisen and, where the law governing their relations so entitles them, to temporarily suspend commercial relations with the partner in question, while pursuing efforts to prevent, minimize or bring to an end the extent of the adverse impact or to even terminate the business relationship with respect to the activities concerned if the adverse impact is severe.

The proposal also envisages that the largest EU-based and non-EU-based companies shall adopt a plan to ensure that the business model and strategy of the company are in line with the Paris Agreement. This plan shall, in particular, identify the extent to which climate change is a risk for the company's operations. In case climate change is as a principal risk for the company's operations, the company should include emission reduction objectives in its plan.

The enforcement of the Directive should be secured by sanctions imposed by particular Member States, including fines (based on the company's turnover) and compliance orders. The proposal also requires Member States to adapt their rules on civil liability to cover cases where damage results from failure by a company to comply with due diligence obligations. As a result, the victims of the damage would have a right to get compensation for such damages.

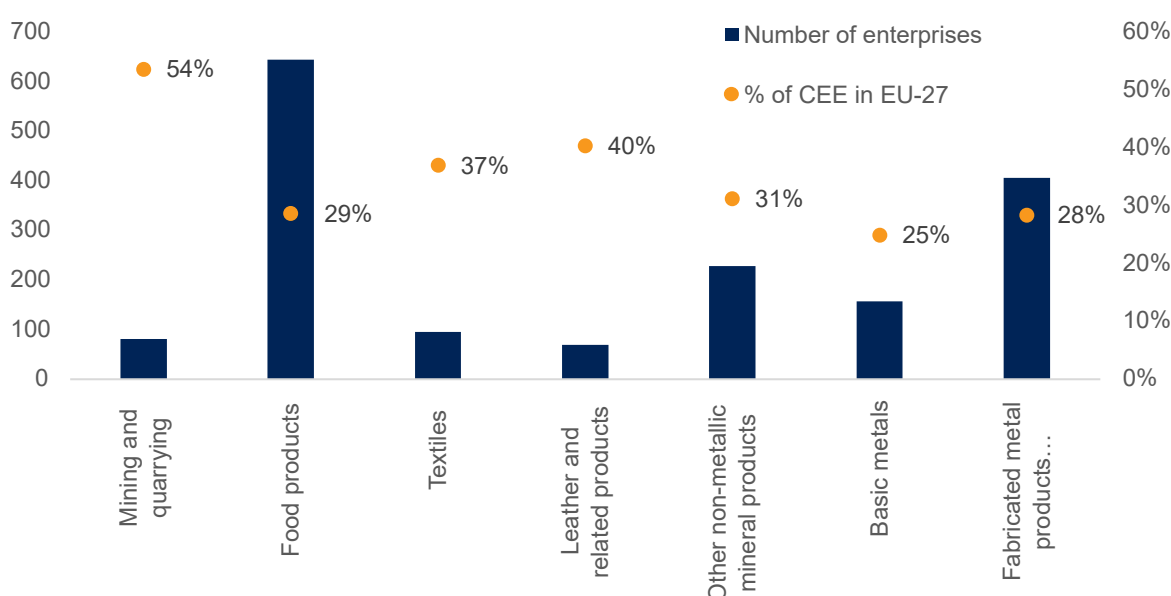
According to the estimates by the Commission, the Directive will apply to around 16 800 companies, both EU and non-EU-based, but the publicly available data has limitations that do not allow to identify an exact number of companies falling within the scope of the Directive. A rough estimate

can only be provided, based on the data on the number of EU enterprises with 250 persons employed or more in particular sectors ²¹.

CEE Perspective

Our analysis of the Eurostat data proves that the proposed Directive might theoretically have a substantial impact on some of the CEE-based enterprises. If we consider high-impact sectors, as they are defined in the proposal, it turns out that 31% of the large EU enterprises (i.e. enterprises with more than 250 employees) from these sectors are located in CEE countries. Mining & quarrying, manufacture of textiles and manufacture of leather and related products are the three branches which stand out, as their share in the total number of EU enterprises in these sectors exceeds 35%.

Figure 5: Large CEE-based enterprises in high-impact sectors



Source: WiseEuropa based on Eurostat (Annual enterprise statistics by size class for special aggregates of activities)

On the other hand, neither the EU nor specifically CEE is the region where adverse human rights and environmental impacts are expected to occur frequently, especially since the EU Member States are already parties to the conventions listed in the Annex to the proposal. Moreover, although EU-based producers fall within the scope of the Directive, the legislative proposal seems to be aimed at non-EU companies exporting goods to the EU and EU companies importing and trading goods from extra-EU countries, where the standards of human (workers') rights and environmental protection might be lower. Therefore, since infringements of the provisions of human rights agreements and environmental conventions listed in the Directive seem to be less expected in the EU (and CEE) itself, the direct impact of Corporate Sustainability Due Diligence Directive on CEE companies will be probably limited to wholesale companies importing goods from the regions where human rights and the environment are less protected than in the EU.

²¹ Eurostat, *Annual enterprise statistics by size class for special aggregates of activities*.

Frame 2: Nearshoring opportunities? Case study of the textiles and leather industry

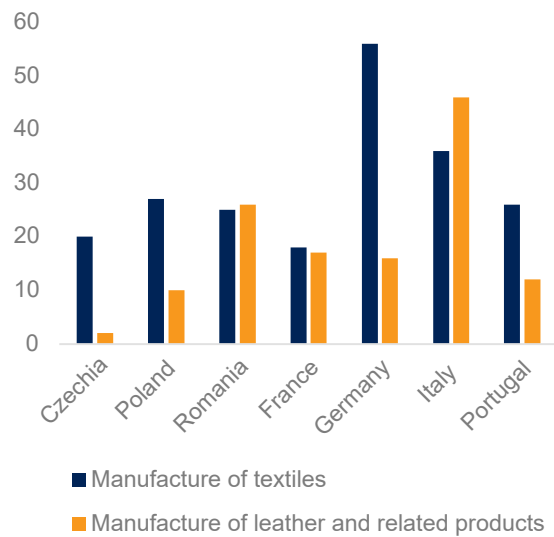
Given that:

- textiles and leather industries are high-impact sectors outlined in the Directive,
- the share of imports from China in these sectors is particularly high (45% in extra-EU imports in 2017-2021 ²²),
- when it comes to large enterprises with more than 250 employees, there is already a robust manufacturing base located in CEE in these branches (especially in Poland, Romania and, as far as only textiles are concerned, Czechia) compared to the rest of the EU states (see: Figure 6),
- labour costs are much lower in CEE than in Western Europe and comparable to those in China (see: Figure 7),

“nearshoring” manufacturing of textiles and leather to the EU (and CEE in particular) might be promising, if the current extra-EU subcontractors will be found to breach the human rights and environmental conventions, which might be expected in the case of China.

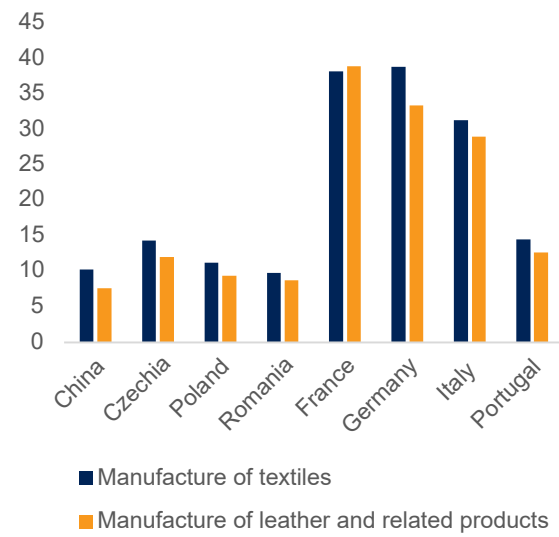
²² Eurostat, *EU trade since 2002 by CPA 2.1.*

Figure 6: Number of large enterprises (with more than 250 employees)



Source: WiseEuropa based on Eurostat (Annual enterprise statistics by size class for special aggregates of activities)

Figure 7: Wages and salaries (USD thousand per employee annually)



Source: WiseEuropa based on the UNIDO database (INDSTAT 2 2022, ISIC Revision 3)

Another example of measures that the EU adopts autonomously is the intention of the Commission to “put forward legislation addressing deforestation and forest degradation” by imposing certain obligations on domestic companies in regard of their suppliers ²³. The Commission’s proposal for a new Regulation to curb EU-driven deforestation and forest degradation ²⁴ was published on 17 November, 2021.

²³ European Commission (2021), *Trade Policy Review...*, op. cit., p. 13.

²⁴ European Commission (2021), *Proposal for a Regulation of the European Parliament and of the Council on the making available on the Union market as well as export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) No 995/2010, COM(2021) 706 final, Brussels, 17 November 2021.*

Frame 3: New EU rules for deforestation-free products – overview

The Commission aims to ensure that only deforestation-free and legal products (according to the laws of the country of origin) are allowed on the EU market. To that end those who place the relevant commodities and products on the market (“operators”) will be required to put in place and implement due diligence systems to prevent the placing on the EU market of products linked to deforestation and forest degradation. The commodities in the scope of the new Regulation are: soy, beef, palm oil, wood, cocoa and coffee and some derived products, such as leather, chocolate and furniture.

To ensure the reinforcement of the Regulation Member States’ competent authorities will carry out inspections of products in the scope of the Regulation and react to substantiated concerns and suspend the placing or making available on the Union market relevant commodities and products with non-negligible deforestation risks. Member States will also lay down rules on penalties applicable to infringements of the provisions of the Regulation by the operators. Penalties shall include, as a minimum: fines proportionate to the environmental damage and the value of the relevant commodities or products concerned, calculating the level of such fines in such way as to make sure that they effectively deprive those responsible of the economic benefits derived from their infringements; confiscation of the relevant commodities; confiscation of revenues.

EU CIRCULAR ECONOMY ACTION PLAN

The Commission also recognises the need to diversify sources of supply of critical materials. For some of them this diversification will mean not only finding new trade partners (which will be increasingly difficult, having taken into account an increased pressure from other countries, dominance of China in the field of the extraction of these materials and the scarcity of supply) but also taking advantage, to the highest possible degree, of the recycling and circular economy within the borders of the EU²⁵. Therefore, implementation of the *Circular Economy Action Plan* might be perceived as the alternative for finding new suppliers in the course of developing trade relationships with third countries.

It can be strongly recommended to all the enterprises and governments within CEE countries to develop greater competences in the field of recycling technologies and urban mining, so they could become significant suppliers of recycled critical materials, such as rare earth metals, lithium, cobalt, photovoltaic panels or steel and aluminium. This is in particular important in the area of the materials necessary for enabling green and digital transition, such as lithium used for batteries for electric vehicles, or cobalt, which is necessary for production of micro-processors. Poland, with emerging strengths in the recycling of electric batteries (also including the state aid funding under the IPCEI scheme) might be one good example of these developments.

Another important factor in this respect might be the announced plan of the Commission to create a legal landscape to increase the rate of repair in the EU. Legislation is underway, with the initiative scheduled for the third quarter of 2022. The legislation is expected to be introduced as amendments to the *Sales of Goods Directive*. The main objective behind the initiative is to “strengthen the rights of consumers to repair products at fair prices”. This should incentivize individuals to do so, rather than turn to purchasing a new product, thereby extending the useful life of goods and contributing to the objectives of a circular economy. CEE countries, with strong technical competencies among society

²⁵ 2020 and 2021 Strategic Foresight Reports by the European Commission.

as a legacy of the former economic and education model, may become a “workshop” for the EU and develop competitive advantages in this area.

STANDARD SETTING

Last but not least, the somehow underestimated field of developing domestic regulatory requirements, which have an (in)direct effect on the EU trade policy, is standard setting and normalization. It follows from the fact that in the view of the Commission “imports to the EU must comply with relevant EU regulation and standards”. The Commission refers to the circumstances defined by WTO rules, which allow for introducing production requirements for imported products. These requirements should be predictable, non-discriminatory, proportionate, avoiding unnecessary disruptions to trade and take into consideration the societal preferences of the EU. Therefore, the Commission sees the application of production requirements to imports as a way to respond to ethical concerns and protect the global environment. The Commission aims also to “pioneer work on developing standards for sustainable growth and shape international standards in line with the European Green Deal, while engaging with its partners to develop and implement rules that are similarly ambitious”²⁶.

This is to be welcomed as part of the pragmatic approach towards setting technical requirements for implementing the objectives of the EU Green Deal and using the abovementioned “Brussels effect” for making European solutions globally impactful. The EU has been a leader on the front of influencing the development of regulations and standards of global significance – both through works within multilateral international standard-setting bodies, sector-specific international fora and domestically (using its position of normative power and its significant market size). However, even in this field the position of the EU is increasingly being challenged given the emergence of new regulatory powers and rapid technological development (often driven from outside the EU). The response of the EU will target a more proactive stance and increasing international cooperation in this field. Therefore, the Commission intends to intensify dialogue and cooperation with EU standard setting bodies and reinforcing its analysis of the external dimension of its regulatory policies in the impact assessments²⁷.

The signs of this approach can be recognised in the sectoral legislation, such as regulations on the supply chain of batteries, where the Commission intends to introduce sustainability requirements through respective technical standards²⁸ – however, it will turn out whether these actions of the EU will prove successful and allow for achieving significant competitive advantage by the exporters from the EU. However, this push shows that the Commission is actively trying to align internal and external policies to identify „strategic areas” on which the focus regarding regulatory requirements will be crucial in the context of the green transition. In this respect, the EU trade policy should support cooperation and make full use of the opportunities for coordinating an approach towards standard setting internationally through trade agreements – especially in developing countries and like-minded partners in Asia-Pacific or Latin America. Moreover, the Commission also intends to increase cooperation with the new administration in the United States, also in an institutionalised way through joint working bodies such as the Trade and Technology Council, in order to ensure “that new regulations are in line with the values of democratic, open and inclusive societies”²⁹. One of the most recent examples of such cooperation is the EU-US steel and aluminium deal, which refers to the elaboration of common standards for the green steel and aluminium production.

²⁶ European Commission (2021), *Trade Policy Review...*, op. cit., pp. 13-14.

²⁷ European Commission (2021), *Trade Policy Review...*, op. cit., p. 16.

²⁸ Bronckers, M. and Gruni, G. (2021), “Retooling the Sustainability Standards in EU Free Trade Agreements”, *Journal of International Economic Law*, Vol. 24, Issue 1, p. 25.

²⁹ European Commission (2021), *Trade Policy Review...*, op. cit., p. 16.

3.2 External actions

The regulatory tools of the EU trade policy in a more traditional sense are orientated around the free trade agreements, especially in the context of TSD chapters. The Commission perceives FTAs as “platforms for enhanced cooperation pursuing values and interests [of the EU]” and openly intends to focus its efforts on “unlocking the benefits of the EU’s trade agreements, coupled with assertive enforcement of both its market access and sustainable development commitments” and ensure that “the EU has the right tools at its disposal to (...) level-up social, labour and environmental standards globally” following the “wave” of new trade agreements concluded in recent years³⁰.

Recently the European Commission issued the communication that outlines how to “further enhance the contribution of trade agreements to sustainable development” and presents the results of an in-depth review with the objective of “strengthening the ability of trade agreements (...) to champion sustainable trade (...) in concert with (...) the European Green Deal”³¹.

This development illustrates the fact that “trade has moved from being free, to being free and fair and subsequently to being free, fair and sustainable”. TSD chapters are a relatively new addition to the traditional field of FTAs, which over the years has become stronger and gained more importance. However, as it is sometimes observed in academia “it could have been expected from the EU to take a much broader role in climate policies” which might change with the Commission’s current focus on green issues³². Therefore the green “tools” of the EU trade policy encompass various instruments with an external dimension that have been presented below with TSD chapters in the spotlight.

ENFORCEABILITY OF THE TRADE AND SUSTAINABLE DEVELOPMENT CHAPTERS IN FREE TRADE AGREEMENTS

The EU has been including TSD chapters in the FTAs since 2009 and the conclusion of the agreement with South Korea. They have been varying among different partners in the amount of commitments and their binding character (see Table 1 provided below), however usually TSD chapters have been used to influence the parties to implement conventions of International Labour Organisation (ILO) and Multilateral Environmental Agreements (MEAs) and not to lower existing environmental and labour standards. Furthermore, TSD chapters create specialized bodies for dispute settlement and monitoring of its implementations, as well as the Domestic Advisory Group (DAG) consisting of the representatives of civil society and European Economic and Social Committee (EESC). The mostly criticized features however are the lacking binding force of the commitments (due to a vague language), unenforceable dispute settlements procedures, lack of mechanisms ensuring transparency and lack of financial sanctions for non-compliance³³. These problems were in the spotlight of the recent pushback of the European Parliament and some of the Member States against the agreement with Mercosur³⁴, which led the Commission to make a statement that an “ongoing dialogue” was pursued to “enhance cooperation on the sustainable development dimension of the agreement, addressing

³⁰ European Commission (2021), *Trade Policy Review...*, *op. cit.*, pp. 9-10 & 19.

³¹ European Commission (2022), *The power of trade partnerships...*, *op. cit.*, p. 1.

³² van 't Wout, D. (2021), *op. cit.*, p. 86.

³³ Vignarelli, M.C. (2021), *op. cit.*, pp. 2-3; Poletti, A. et al. (2021), *op. cit.*, pp. 1-2; van 't Wout, D. (2021), *op. cit.*, pp. 82-3 & 95; Bronckers, M. and Gruni, G. (2021), *op. cit.*, p. 25.

³⁴ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, pp. 28-30.



the implementation of the Paris Agreement and deforestation in particular”³⁵.

The results of the review conducted by the European Commission showed the interplay of the TSD chapters with other trade policy tools, foremost “autonomous instruments” such as CBAM, deforestation-free products regulation, corporate sustainable due diligence directive and a framework supporting the placement of circular and sustainable products on the Internal Market described above³⁶. The communication also presents 6 key areas of action (policy priorities) that would improve the current TSD model:

- 1) The need to be more proactive in cooperation with partners;
- 2) Stepping up the country-specific approach;
- 3) Mainstreaming sustainability beyond the TSD chapter of trade agreements;
- 4) Increasing the monitoring of the implementation of TSD commitments;
- 5) Reinforcing the role of civil society;
- 6) Enhancing enforcement by means of trade sanctions as a measure of last resort.

For each policy priority the Commission envisages a number of concretised action points³⁷. These actions are expected to be implemented in the upcoming trade agreements concluded by the EU, such as recently announced FTA with New Zealand. However, the existing portfolio of FTAs presents a more diverse landscape of TSD provisions.

³⁵ European Commission (2021), *Trade Policy Review...*, *op. cit.*, p. 19.

³⁶ European Commission (2022), *The power of trade partnerships...*, *op. cit.*, pp. 3-4.

³⁷ European Commission (2022), *The power of trade partnerships...*, *op. cit.*, pp. 5-12.

Table 1 part 1/2: Sustainability issues in free trade agreements signed by the EU

Agreement	Signed	Paris agreement referred to?	MEA included?	Provisions referring to sustainable development
EU-South Korea	October 2010	No	2002 Johannesburg Declaration on Sustainable Development; Agenda 21	Chapter 13, e.g. Article 13.6 Trade favouring sustainable development, Article 13.10 Review of sustainability impacts
EU-Japan	July 2018	Yes	Agenda 21; Plan of Implementation on Sustainable Development of 2002	Chapter 16, e.g. Article 16.5 Trade and investment favouring sustainable development, Article 16.7 Sustainable management of forests and trade in timber and timber products, Article 16.8 Trade and sustainable use of fisheries resources and sustainable aquaculture
EU-Vietnam	June 2019	Yes	2002 Johannesburg Declaration on Sustainable Development; Agenda 21; the Outcome Document of the United Nations Conference on Sustainable Development of 2012 (The Future We Want); the Outcome Document of the United Nations Summit on Sustainable Development of 2015 (Transforming Our World: The 2030 Agenda for Sustainable Development)	Chapter 13 Trade and sustainable development
EU-Singapore	October 2018	Yes	Agenda 21; Plan of Implementation on Sustainable Development of 2002	Chapter 12 Trade and sustainable development: Section A Introductory provisions; Section B Labour aspects; Section C Environmental aspects; Section D General provisions (e.g. on investments promoting sustainable development)
EU-Indonesia, EU-Philippines	Talks in progress	Similar measures as in EU-Singapore agreement		
EU-Andean Community	June 2012	No	Rio Declaration on Environment and Development of 1992; Agenda 21; the Millennium Development Goals adopted in September 2000; 2002 Johannesburg Declaration on Sustainable Development; Plan of Implementation on Sustainable Development of 2002	Title IX



Table 1 part 2/2: Sustainability issues in free trade agreements signed by the EU

Agreement	Signed	Paris agreement referred to?	MEA included?	Provisions referring to sustainable development
EU-Mercosur	June 2019	Yes	Ratification in progress, TSD chapter included	
CETA (EU-Canada)	October 2016	No	Rio Declaration on Environment and Development of 1992; Agenda 21; 2002 Johannesburg Declaration on Sustainable Development and the Plan of Implementation on Sustainable Development of 2002; the Ministerial Declaration of the United Nations Economic and Social Council on Creating an environment at the national and international levels conducive to generating full and productive employment and decent work for all, and its impact on sustainable development of 2006	Chapter 22 Trade and sustainable development; Chapter 23 Trade and labour; Chapter 24 Trade and environment
EU-Georgia	June 2014	No	Plan of Implementation on Sustainable Development of 2002	Title V, Chapter 13 Trade and sustainable development; Title VI, Chapter 3 Environment and Chapter 4 Climate action
EU-Ukraine	November 2014	No	Agenda 21; Plan of Implementation on Sustainable Development of 2002	Title IV, Chapter 13 Trade and sustainable development; Title V, Chapter 6 Environment
EU-Moldova	June 2014	No	Agenda 21; Plan of Implementation on Sustainable Development of 2002	Title IV, Chapter 16 Environment and Chapter 17 Climate action; Title V, Chapter 13 Trade and sustainable development
EU-Mexico	Pending approval by both sides	Yes	Agenda 21; Rio Declaration on Environment and Development of 1992; Plan of Implementation on Sustainable Development of 2002; the Declaration on Social Justice for a Fair Globalisation of 2008 of the International Labour Organisation (ILO); the Outcome Document of the UN Conference on Sustainable Development of 2012 (The Future We Want); the document Transforming our World: the 2030 Agenda for Sustainable Development and its Sustainable Development Goals	TSD chapter

The current standards included in TSD in FTAs fall into three different groups: 1) obligations based on existing international agreements, 2) obligations related to existing domestic legislation 3) more aspirational clauses referring to higher levels of protection³⁸. This approach is widely described as “promotional” in opposition to “sanction-based” (pursued mostly by the USA and Canada)³⁹ that is yet to be implemented by the EU. The EU frequently referred in TSD chapters to the “best-effort” obligations and used rather watered-down language (“aim”, “seek to”) instead of stronger and more explicit binding phrases (“shall”, “must”). Additionally, the lacking element is a binding framework to evaluate actual progress, such as specific indicators, targets, and timelines. The lack of binding commitments, institutional mechanisms, and enforcement measures, including sanctions, significantly hampers the enforceability of TSD chapters – according to legal scholars these chapters provide merely relevant ‘context’ to assess the legality of a trade restriction even though the legal nature of TSD chapters does not differ in comparison to other chapters in FTAs. Hence, the majority of scholars recommend including the TSD chapter in the dispute settlement procedure and to establish an effective enforcement mechanism, either economic consequences or sanctions⁴⁰.

The proposed measures to increase the assertiveness of the TSD chapters in FTAs are trade retaliations, financial fines, targeted personal or economic sanctions, making the Paris Agreement an essential element of the trade treaties, but also incentives such as tariff reductions⁴¹. One such attempt to improve the enforceability of TSD chapters, albeit not changing the approach altogether, is the recent initiative of the Commission to reinforce the sustainability dimension and strengthen the enforcement of trade agreements on the basis of the complaints procedure to the Chief Trade Enforcement Officer. Other propositions have been included in a 15-point action plan published by the Commission⁴² and in action points included in the communication of June 2022. The initiative that could have significant practical consequences is the proposition of the Commission to consider the Paris Agreement an essential element in future trade and investment agreements – it would mean that non-compliance with the Paris Agreement clause could lead to the termination of the whole agreement. However, until now, aside from the EU-UK (discussed below) trade agreement, such a clause was not present in the FTAs negotiated by the EU⁴³.

Other policy tools at the disposal of the Commission that are inherent for the promotional approach towards sustainability commitments could be offering technical assistance to promote environmental standards by developing countries, reinforcing joint monitoring, or granting unilateral trade preferences for developing countries under the so-called Generalised System of Preferences (GSP) conditional upon respecting multilateral environmental standards⁴⁴. However, the approach of the EU remains inconsistent (especially towards developing countries) and often not based on binding, enforceable and disputable commitments. Therefore, the opportunities to influence its’ trading partners behaviour are limited⁴⁵.

In contrast to frequently used reference to ILO conventions, no EU FTA included an actual obligation to ratify environmental conventions. Most of the MEAs considered by the WTO to have relevance for international trade are widely ratified, but not all FTAs parties have ratified an entire list

³⁸ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, pp. 26-33.

³⁹ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, p. 25.

⁴⁰ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, pp. 36-50; D. van’t Wout, pp. 6-15.

⁴¹ van’t Wout, D. (2021), *op. cit.*, pp. 14-15.

⁴² European Commission (2021), *Trade Policy Review...*, *op. cit.*, p. 13.

⁴³ European Commission (2021), *Trade Policy Review...*, *op. cit.*, p. 12.

⁴⁴ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, pp. 38-40; European Commission (2021), *Trade Policy Review...*, *op. cit.*, p. 13.

⁴⁵ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, pp. 29-33.

of relevant MEAs. In these cases, the EU should routinely insist on the ratification of all trade-relevant MEAs by its FTA partners⁴⁶. As shown in Table 1, the references to MEAs in FTAs are inconsistent, and the Paris Agreement is mentioned only incidentally⁴⁷.

Finally, one of the methods of increasing the enforceability of TSD chapters that is frequently cited and became one of the policy priorities under the new communication of the European Commission is the inclusion of the civil society groups in the process of negotiations and institutional mechanisms at the international and domestic level⁴⁸. The participation of various stakeholders – trade unions, industry associations, NGOs – should be ensured to allow for the possible fullest representation and intensify cooperation to overcome the ineffectiveness of intergovernmental dialogues⁴⁹. It is also observed that the FTA parties should “make administrative or judicial remedies available to private stakeholders regarding the violations of domestic environmental laws”, as they can indirectly contribute to the effective implementation of international standards – unfortunately the current record of the FTAs containing such provisions is very scarce: they were only included in CETA⁵⁰. Therefore, it remains crucial to hold the Commission accountable for the action points related to DAGs and other elements indicated in the communication of June 2022 in this respect.

THE EU-UK AGREEMENT

A unique example of the TSD chapter has been introduced in the FTA between the EU and the United Kingdom following Brexit. For the EU, it was essential to maintain a level playing field with the UK, given its freedom to adopt diverging standards. Therefore, the EU-UK agreement contains a relatively long list of environmental agreements and quite strict non-regression clauses covering any weakening or reduction in the domestic level of environmental protection. Another difference, compared to regular FTAs, is the presence of far-reaching ‘rebalancing measures’ and investment-related sanctions, which constitute a significant break with a traditionally softer approach of the EU, albeit with a trade effects test included: before imposing these countermeasures the EU would have to demonstrate that the UK’s diverging sustainability levels cause trade effects (i.e. that the sustainability levels of protection are weakened or reduced “in a manner affecting trade or investment”), which is yet to be precised⁵¹.

CLIMATE DIPLOMACY & CLIMATE CLUBS

The Commission also sees the potential of climate diplomacy to make the EU Green Deal more effective outside its borders. It is observed in the literature that to develop and materialize in a substantial manner, the EU Green Deal Diplomacy should build on the actions formulated and implemented since 2011. It is a challenging task of reconciling integrated diplomacies of mutual interests (e.g., promoting renewable energy targets), contrasting interests (e.g., energy security interests versus climate targets) and alignment with the interests of Member States. Although for now the efforts of the Commission are assessed rather critically (EU Green Deal diplomacy is being described as a concept “substantially vague on concrete tools, coordination mechanisms and steps of implementation”), the factors that could make it successful are the inclusion of internal policies in diplomacy efforts,

⁴⁶ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, p. 27.

⁴⁷ van 't Wout, D. (2021), *op. cit.*, p. 8; M Bronckers, M. and Gruni, G. (2021), *op. cit.*, pp. 28-29.

⁴⁸ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, pp. 33-36.

⁴⁹ van 't Wout, D. (2021), *op. cit.*, pp. 9-15; Tröster B. et al. (2019), *Combining trade and sustainability? The Free Trade Agreement between the EU and Vietnam*, “ÖFSE Policy Note”, No. 29, pp. 2-5.

⁵⁰ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, p. 35.

⁵¹ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, pp. 32-33 & 40.

the coordination of potentially conflicting policy components, ensuring high level of Member States support and coordination among EU actors to make tailored-made targets for EU diplomacy. An overarching aim should be to bring various external activities in all policy areas covered by the EU Green Deal together in one comprehensive strategy⁵².

Some efforts are also indicated by the Member States in conclusions of the Council and European Council and are presented below in the box.

Frame 4: EU Climate Diplomacy - guidelines⁵³

Given that EU considers climate change an existential threat to humanity and that global climate action still falls short of what is required to achieve the long-term goals of the Paris Agreement, then the EU's ambition is to accelerate climate action in partner countries, which can be achieved through diplomacy.

Therefore, the Council of the EU adopted guidelines for diplomatic activities pursued by the European Commission and a High Representative of the Union for Foreign Affairs and Security Policy. These guidelines are:

- strengthening bilateral engagement on climate action with partner countries, especially with non-EU G20 countries that account for three quarters of global greenhouse gas emissions and ca. 85% of the total value of EU international trade exchange;
- supporting the uptake of EU energy standards globally;
- promoting as well as supporting the development of socially just economic and energy diversification plans, and providing, where necessary, targeted support to the most affected in order to support the transformation of their economies, with a particular emphasis on supporting the efforts of the EU's immediate neighbours – in the Southern neighbourhood, the Eastern Partnership Countries and the Western Balkans, notably their regions and sectors most affected by the transition;
- urging all countries to institute sustainable and climate sensitive economic recovery policies from the COVID-19 crisis as an important element of a sustainable growth strategy and an immediate investment into a climate-resilient, inclusive and just transition;
- sharing experience of pursuing a socially just and inclusive energy transition leaving no one behind;
- efforts at tackling deforestation, promoting integrated water resources management and preserving biodiversity.

As far as trade is concerned, it emerges as a diplomatic tool to promote safe and sustainable low greenhouse gas emission and climate-resilient development (e.g. through agreements with third countries, see: Enforceability of the trade and sustainable development chapters in free trade agreements). EU will ensure that its trade policy and its trade agreements are consistent with its climate ambition and that the respect of the Paris Agreement is an essential element for all future comprehensive trade agreements. Moreover, the EU will urge all countries to align their trade promotion with their domestic climate pledges and Paris Agreement commitments. The EU will also seek to ensure undistorted trade and investment for EU businesses in third countries, a level playing field, and a fair access to resources and green technologies, noting the important role of industrial alliances. In order to ensure the EU's green technological leadership, EU external action will pursue bilateral strategic research partnerships.

⁵² Petri, F. (2020), *Revisiting EU Climate and Energy Diplomacy: A Starting Point for Green Deal Diplomacy?*, "European Policy Brief" by EGMONT Royal Institute for International Relations, No. 65, pp. 2-3 & 6.

⁵³ Council conclusions on Climate Diplomacy adopted at the meeting of the Council on 20 January 2020; Council conclusions on Climate and Energy Diplomacy - *Delivering on the external dimension of the European Green Deal*, adopted at the meeting of the Council on 25 January 2021.

A specific example of climate diplomacy efforts is the idea of climate clubs. The climate club is understood as a group of countries that willingly and jointly tackle climate and environmental policy issues, creating common framework and targets for emission reduction. Participation in a club would entail the possibility of trading goods without further restrictions other than this common policy, while penalizing (or doing so relatively, by not giving them benefits that members of the club have) countries that do not participate in it. Such a solution would translate into greater commitment both within the club and in third countries which, due to penalties, would like to be part of the club eventually. Lack of such an incentive effect is arguably the biggest weakness of current international climate policy initiatives e.g. the Kyoto Agreement or the subsequent Paris Agreement, and results in free-riding of countries not taking any climate action⁵⁴. In June 2022 G7 countries under Germany presidency issued a joint statement on the “aim to establish a climate club” by the end of 2022. It would cover three policies – climate mitigation and carbon pricing, joint transformation of industry through decarbonisation and partnerships and cooperation with the example of “Just Energy Transition Partnerships”⁵⁵.

More involvement within the club could enhance better cooperation, governance and hence other synergies such as technology diffusion, sharing of knowledge etc. However, the idea also met with some scepticism. The main objection is concern about the exclusivity of this solution, i.e. the organisation of the largest economies imposing a certain level of ambition, unavailable to developing countries, not to mention Least Developed Countries. The club of the biggest emitters⁵⁶ would potentially benefit the global climate action overall, but this cannot be at the expense of other crises such as increasing global inequalities, poverty and exclusion, and if implemented, must be handled with respect for social justice, solidarity and the principle of Common but Differentiated Responsibilities (CBRD).

MULTILATERAL COOPERATION

In addition to the bilateral trade agreements and climate diplomacy actions the EU tries to proliferate the objectives of the EU Green Deal in the fora of multilateral trade cooperation. The most obvious are annual COP conferences, where the EU positions itself as a leading actor enabling the pushing forward of global cooperation on climate change. The international body that is the most relevant for trade is WTO, which is currently in a deep crisis. Trade war initiated by Donald Trump and the incapability of the Appellate Body to effectively resolve disputes (lack of quorum) resulted in the impasse and regress of the multilateral cooperation on trade matters, which led to granting unilateral competences to initiate retaliation and countermeasures to the Commission in a so-called Enforcement Regulation⁵⁷. Furthermore, the EU proposed WTO reform in its Trade Review in February 2021, which should be seen in “a broader context of the EU’s priorities of ensuring that functioning global institutions support (...) sustainable development and the green transition”. The EU strongly advocates improved multilateral framework as a useful method of cooperation to foster green transition to a climate neutral, environmentally friendly and resilient economy. Climate and sustainability considerations should be promoted throughout the various functions of the WTO, including a trade and climate initiative. One such attempt may be the formation of the Coalition of Trade Ministers on Climate forged by the EU, Ecuador, Kenya and New Zealand⁵⁸. The concrete actions should encompass

⁵⁴ <https://climatalk.org/2021/03/14/what-are-climate-clubs-and-why-do-we-need-them/>.

⁵⁵ G7 Statement on Climate Club (<https://www.g7germany.de/resource/blob/974430/2057926/2a7cd9f10213a481924492942dd660a1/2022-06-28-g7-climate-club-data.pdf?download=1>).

⁵⁶ Maj, M., Miniszewski, M. (2022), *The Emitting 7: the time and cost of climate neutrality*, Polish Economic Institute, Warsaw.

⁵⁷ M Bronckers, M. and Gruni, G. (2021), *op. cit.*, p. 40.

⁵⁸ https://policy.trade.ec.europa.eu/news/eu-teams-ecuador-kenya-new-zealand-forge-cooperation-trade-and-climate-2022-06-13_en.



liberalisation in trade of sustainable goods and services, transparency and greening of aid-for-trade and progressive development of disciplines on fossil fuel subsidies. Other form for cooperation indicated by the Commission is building alliances with like-minded countries, including through G7 and G20⁵⁹. One such alliance may be the recent declaration of G7 countries on the climate clubs initiative.

⁵⁹ European Commission (2021), *Trade Policy Review...*, *op. cit.*, pp. 8 & 11-12.

4. Conclusions

In the concluding remarks it should be observed that the green turnaround of the trade policy coincides with a turbulent and uncertain developments in the geopolitical situation that are unprecedented for the current generation of policymakers. Still distorted value chains and supply routes after the Covid-19 pandemic, the war in Ukraine and blockade of grains exports, uncertainty related to the energy prices, inflation, potential migration waves and violent weather incidents create unfavourable conditions for global trade in general. And could pose a threat to the green trade objectives as the undistorted access to markets could once again become more important than the establishment of sustainability conditions and provisions for contracting parties.

Therefore, in order to be genuine, the "green turnaround" presented in this paper needs substantiating. Since many of the described initiatives are in the negotiation phase or included in non-binding policy declarations, their robust implementation will be an essential element of the successful "greening" of the EU trade policy. In this context, it is especially important to elaborate on a coordinated and coherent approach among all the EU institutions, as well as the various policies. The basic role of trade – to enable exchange of goods and services – can become another area of a wider transition from the profit-oriented model to the more value-oriented economy and society. Therefore, an important element of all the initiatives is the avoidance of their watering-down.

This is a very important aspect of the EU trade policy and emerging trade policy tools for the CEE countries and their economic benefits. We argued in the recent paper on "Green Realism" that the rationale for the pragmatic support of the re-orientation of trade policy objectives is related to the place of the domestic producers in value chains. This postulate can now be strengthened with specific examples in which the CEE-located contractors could be better positioned to cover the shares of imports to the EU. Such areas are iron & steel, fertilisers, leather and textiles industries and recycled materials (such as rare earth metals).

However, for this to happen, the CEE producers have to be reliable – they will need to meet the same conditions and obey the same rules as established for the outside contractors. The focus on the impact of their activity on the environment has to increase (taking into consideration the emerging trend of Scope-3 emissions reporting) and access to clean energy becomes one of the crucial elements for competitiveness in international trade.

Therefore, our recommendations for CEE policymakers would be to act simultaneously in two directions – increase the pace of the green transition in the domestic context and advocate for a robust implementation of green trade policy tools. This will ensure the right balance between the short-term and long-term economic interests and climate objectives, as well as contribute to the fulfilment of the EU-wide objectives.



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Energy, Climate and Environment Programme

Poland, Europe and the world are currently facing unprecedented challenges associated with the environment and resources. Avoiding dangerous climate change, improving public health and increasing resource security requires a profound economic transition. Taking advantage of opportunities and avoiding the associated developmental traps requires in-depth evaluation of the short- and long-term impacts of environmental protection and natural resource management policies. Under the Energy, Climate and Environment Programme, we prepare comprehensive sectoral and macroeconomic analyses, focusing on the broadly defined low-emission economic transition in Poland and globally. We are active in areas such as: Polish and EU energy and climate policy, domestic resource policy, improving resource efficiency in the economy, protection of the environment and public health by limiting harmful emissions, sustainable transport policy. This paper is a part of the Energy and Climate Project.



ENERGY, CLIMATE AND ENVIRONMENT

Other publications:

„Inflationomics. Inflation during times of crisis”

M. Bukowski, K. Bocian, Warsaw 2022

“Green reconstruction. Post-war green recovery of Ukraine”

K. Bocian, D. Jędrzejczak, K. Kobyłka, O. Stohnushenko, Warsaw 2022

“Blocked potential. How to use the European Green Deal and the fit for 55 as an opportunity to transform the building and transport sectors at the local level”

P. Chrzanowski, J. Fabiszewska-Solares, W. Lewandowski, K. Marszał, Warsaw 2022

“On the wave(of renovation). Leading role of local authorities in improving energy efficiency: thermal modernisation of municipal buildings”

P. Chrzanowski, J. Fabiszewska-Solares, M. Zaręba, Warsaw 2022

“With the current of change. Electromobility as an opportunity for local development”

P. Chrzanowski, J. Fabiszewska-Solares, D. Kasperek, Warsaw 2022