JUNE 2020

POLICY BRIEFING

ALIGNING THE UK'S TRADE POLICY WITH ITS CLIMATE AND ENVIRONMENTAL GOALS

EXECUTIVE SUMMARY

Alongside fiscal and monetary responses to the COVID-19 crisis, trade will be an important element of global economic recovery. With its departure from the European Union, the UK has the opportunity to develop its own trade policy for the first time in forty years, enabled through the Trade Bill currently going through Parliament. This will have implications for the UK's regulatory regime, the competitiveness of its industries, and crucially the country's ability to meet its domestic climate and environmental targets.

New trading relationships present opportunities for the UK to promote ambitious environmental standards abroad and strengthen its economic competitiveness through exports of low carbon goods and services. This represents an important opportunity, with estimations that by 2030, the market for low carbon goods will be worth more than £1 trillion a year.[1] **Future trade deals can, however, also pose unintended risks.** These include UK environmental and climate standards being diluted by provisions to reduce regulatory barriers, and the competitiveness of some UK industries being undermined by foreign industries not abiding by similar standards.

To respond to these challenges, **UK trade policy must set an ambitious precedent that promotes a race to the top on environmental standards and enables the UK to reach its climate and environmental targets over the next decade.** At a Free Trade Agreement (FTA) level, growing export opportunities for UK businesses in the fast growing low carbon goods and services sector should be at the core of the Department for International Trade's negotiating mandates.

Meeting the UK's net zero and Environment Bill targets and growing its low carbon economy will require the UK government to introduce gradually more ambitious domestic standards and policies over time. **It is therefore crucial that the UK's sovereign right to regulate and tighten standards over time is explicitly protected in future agreements.** Developing low carbon products standards will, for example, be essential to grow the market for low carbon industrial goods whilst also providing a level playing field to businesses and guarding against unintended risk of carbon leakage. **In doing so, the UK can make a global impact on emissions reductions whilst strengthening the competitiveness of its industries in a key area of growth for the world economy.**

This briefing, along with Aldersgate Group's recent publication on COVID-19 economic recovery,[2] argues that **incorporating environmental and climate considerations at the heart of the UK's trade policy is in its economic, social and environmental interests.** It analyses the opportunities for growing UK exports of low carbon goods and services and, in this context, explores what a best practice trade policy should include. This briefing then sets out key policy recommendations to tackle some of the risks that could arise from new trade agreements, such as those relating to the UK's right to regulate to deliver on its environmental goals and risks to the future competitiveness of its industries.

1 CCC (2017) *UK business opportunities of moving to a low carbon economy*

2 https://www.aldersgategroup.org.uk/asset/1666

ALDERSGATE GROUP — LEADERS FOR A SUSTAINABLE ECONOMY

This policy briefing is one of a series published by Aldersgate Group, an alliance of major businesses, academic institutions and civil society organisations that drives action for a competitive and environmentally sustainable economy.

SUMMARY OF POLICY RECOMMENDATIONS

Promoting high environmental standards and maximising opportunities from low carbon trade

1. **Ensure ambitious and enforceable trade and sustainable development provisions form part of any FTA,** including requirements for parties to affirm reciprocal commitments under the Paris Agreement and binding non-regression clauses. This should be reflected in the Trade Bill currently passing through Parliament.

2. **Guarantee adequate parliamentary scrutiny and stakeholder engagement on negotiating mandates** well ahead of ratification, via the Trade Bill. The use of sustainability impact assessments should be mandated, to analyse the expected impact of a trade agreement on the environment prior to ratification and monitor post-implementation impacts.

3. **Remove barriers and lower tariffs to grow trade in low carbon goods and technologies,** for example through joining the Agreement on Climate Change, Trade and Sustainability (ACCTS). Given the importance of services to the UK's economy, the UK Government should ensure that its trade agreements and engagement at the WTO level aim to **minimise barriers to the trade in low carbon and environmental services.**

4. Look beyond FTAs and also **use bilateral trade negotiations and multilateral fora to boost low carbon trade.**

5. **Include provisions on due diligence obligations in FTAs to ensure that businesses have to assess, address and report the environmental and climate impact of their operations,** with an increasing focus over time on capturing whole value chains.

6. **Introduce a declining cap on financial support for international fossil fuel projects through UK Export Finance** and increased transparency requirements for overseas investments in fossil fuel extraction.

Minimising risks to future UK policy making and competitiveness

7. Provide the parties in all future FTAs and investment agreements with a **legally binding right to regulate to increase environmental and climate standards** and put in place a **dispute settlement mechanism which does not threaten the UK government's right to regulate.** This could build on the precedent provided by the Intra-Mercosur agreement as an alternative to the Investor-State Dispute Settlement (ISDS) provision.

8. **Avoid regulatory cooperation mechanisms in FTAs which impose any kind of restrictions on the UK's ability to set new climate and environmental targets** and policies to deliver them.

9. **Develop domestic policy tools which increase the UK's environmental and climate ambitions over time and apply to all businesses selling goods and services on the UK market.** This will help grow the market for low carbon goods and services whilst also providing a level playing field for businesses. Policies could include the development of low carbon product standards for heavy industrial goods such as steel and cement, an update to public procurement rules, and the development of carbon pricing adjustment measures in collaboration with trading partners.

INTRODUCTION

The COVID-19 crisis has resulted in a slowdown of economic activity, exposed the fragility of certain sectors and jobs, and resulted in significant social consequences. The World Trade Organisation (WTO) estimates that world trade will fall by between 13% and 32% in 2020, exceeding the trade slump brought on by the global financial crisis of 2008.[3] Trade in services is likely to be the most directly affected through the imposition of travel restrictions and the closure of many retail and hospitality establishments.

As argued in our recent briefing **'Seize the moment: building a thriving, inclusive and resilient economy in the aftermath of COVID-19'**,[4] beyond protecting the population from the health and economic consequences of the pandemic in the immediate term, government has a crucial role to play in managing the economic recovery and tackling the rising levels of unemployment and regional inequalities. This should involve looking at how to rebuild the economy for the better, rather than simplify facilitating a return to business as usual.

With a net zero emissions target in place and legally binding targets on nature and biodiversity to be developed pursuant to the Environment Bill and a growing number of businesses calling for more environmental policy ambition,[5] accelerating the transition to a low carbon economy provides the key to economic recovery post-COVID-19 as well as to future resilience and long-term competitiveness. Through targeted and ambitious support for innovation, stable regulations and market creation mechanisms, a low carbon recovery package will support industrial competitiveness, local growth and generate significant employment opportunities.

With exports of UK goods and services contributing 30.01% of GDP,[6] the UK's future trade strategy will play a role alongside monetary and fiscal policies in driving economic recovery in the aftermath of the COVID-19 pandemic. In leaving the EU, the UK has an opportunity to develop its own trade policy for the first time in forty years. The implications of this reach far beyond the movement of goods and services across borders. It will impact the UK's regulatory regime, the competitiveness of its industries, the country's ability to meet its domestic climate and environmental targets and its transition towards net zero emissions.

Setting up new Free Trade Agreements (FTAs) presents the UK's environmental, climate and clean growth agenda with a new set of opportunities and risks. On the one hand, they provide the UK with the opportunity of promoting high environmental standards with its trading partners and strengthening its competitive advantage in the provision of low carbon and environmental goods and services which the world economy is increasingly demanding. On the other hand, if not carefully managed, these new trading relationships could potentially undermine both the UK's progress against existing environmental and climate targets and the competitiveness of its industries seeking to innovate in the provision of new low carbon goods and services.

To respond to this challenge, UK trade policy must set an ambitious precedent, which promotes a race to the top for environmental standards. Looking ahead, UK trade policy needs to be aligned and integrated with the most urgent climate and environmental related priorities: reaching its net zero emissions target by 2050, reversing the decline of its natural environment within a generation and supporting the competitiveness of UK businesses during this transition.

UK trade policy must set a truly
ambitious
precedent, which aligns with the UK's most urgent climate and environment priorities

At a multilateral level, the UK has an opportunity in virtue of its new status as an independent nation at the WTO to push for reforms to integrate international trade with climate and environmental policies. The UK should use its diplomatic weight to push for greater coherence between global trade and implementation of the Paris Agreement. Ahead of its presidencies of COP26 and the G7 in 2021, and as a major player in the Convention on Biological Diversity (CBD) in October, the UK could foster increased climate ambition globally by helping to build a multilateral trade policy framework that is truly climate supportive.

3 WWTO Press Release (2020) https://bit.ly/2UVqzd6

4 https://www.aldersgategroup.org.uk/asset/1666

5 Corporate Leaders Group (2020) *More than 200 leading businesses urge UK Government to deliver clean, inclusive and resilient recovery plan*

6 Trading Economics (2020) https://bit.ly/2YcTETh

MAXIMISING OPPORTUNITIES
WHAT WOULD A BEST PRACTICE TRADE POLICY LOOK LIKE?

The UK is a world leader in setting ambitious climate and environmental targets and has made important progress in delivering many of them. Since 1990, the UK has reduced its territorial emissions by over 40% while growing the economy by more than two thirds.[7] Following the adoption of the Climate Change Act in 2008, tighter environmental and climate regulations have boosted sectors such as power, waste management and vehicle manufacturing by raising competitiveness, stimulating innovation, generating export opportunities and creating new jobs.[8]

Through targeted legislation and supportive policies, the UK has grown its low carbon economy significantly. Today, close to half a million people are employed in the UK's low carbon economy, with much of that growth driven by existing environmental standards. **It is estimated that the UK market size for this sector could grow by almost 15% every year to 2030[9] and that by 2030, the global market for low carbon goods will be worth more than £1 trillion a year, representing an increase of 7 to 12 times on today.** As markets for low carbon goods grow, so do low carbon service markets: in the 2020s, it is anticipated that the 50% increase in investment in renewables (on 2012 levels) will likely more than double spending on insurance for the sector.[10] Long term certainty that the UK's trade policy will be coherent with the net zero emissions target will be essential to keep attracting private investment in essential technologies and services.

To facilitate low carbon growth and support continued investment and innovation in this space, a well-designed trade policy should secure a level playing field for businesses and industries. It is essential that UK businesses and sectors investing to improve their environmental and climate footprints are not undermined by competition from foreign markets which don't abide by similar environmental standards. By designing its domestic and trade policy with this in mind, the government will maximise the value of its own investments in emerging low carbon technologies and business models (e.g. Carbon Capture Usage and Storage and hydrogen), provide a stable and predictable investment climate and will put its businesses in the best possible position to become competitive exporters of low carbon and environmental goods and services.

Alongside net zero, trade policy must be considered in the context of the UK's other environmental commitments, including the Agriculture Bill, the landmark Environment Bill – which will contain long-term targets on biodiversity and nature – and the 2018 Resources and Waste Strategy which sets out the UK's intent to move towards a more circular economy. Beyond the environmental benefits that progress in these policy areas could bring, they could also provide important economic growth opportunities following the COVID-19 crisis. For example, it is estimated for example that a more circular economy with higher levels of recycling, remanufacturing, repairing and reusing could create more than 200,000 jobs in the UK.[11]

A well-designed trade policy should secure a level playing field for businesses to facilitate low carbon growth and support continued investment and innovation

Further, investing in improving the state of the UK's natural environment is essential to underpin the future health of the UK's economy and society. The value provided by coastal wetlands in buffering the effects of storms and flood control has been estimated at £1.5bn annually, and the cost of soil degradation in England and Wales has been costed as £1.2bn per year.[12] Excluding flood and water benefits, the total value of UK woodlands was recently estimated at around £270 billion.[13]

In order to deliver its climate and environmental targets, the UK will have to introduce targeted policies and regulations and gradually tighten these over time. The UK's trade policy must provide it with the regulatory freedom and space to do so. Under current precedent, trade agreements can drive a race to the bottom in environmental protections and create obstacles to introducing new standards. **The UK must take a different path and establish a world-leading trade policy, one which underpins trade agreements with the promotion of high environmental standards and contains enforceable provisions that prevent weakening of existing standards.**

7 HM Government (2019) *Leading on Clean Growth*

8 BuroHappold Engineering (2017) *Help or Hindrance? Environmental regulations and competitiveness*

9 Committee on Climate Change (2017) *UK business opportunities of moving to a low carbon economy*

10 Maria Carvalho (2017) *At your service: how exporting more low-carbon services could enhance the UK's future prosperity*

11 Energy & Climate Intelligence Unit: http://bitly url please

12 Aldersgate Group (2015) *Investing in our natural assets; how government can support business action*

13 Woodland Trust and Europe Economics (2017) *The economic benefits of woodland*

To maximise the benefits that trade policy can have on the UK's climate and environmental targets and minimise the risk, we ask government to:

1 Ensure ambitious and enforceable trade and sustainable development provisions form part of any FTA, including requirements for parties to affirm reciprocal commitments under the Paris Agreement and binding non-regression clauses. This should be reflected in the Trade Bill currently passing through Parliament.

Although FTAs increasingly include provisions on trade and sustainable development (TSD), there is considerable doubt about their effective implementation and enforcement. TSD provisions tend to emphasise only domestic enforcement to uphold requirements, and they are usually only enforced through a panel of experts who make non-binding recommendations.[14] For example, the recently implemented Japan-EU Economic Partnership Agreement (JEEPA) contains a TSD chapter with welcome language on environmental and climate goals. However, this chapter is not enforceable in the way that others are, for example through the use of financial penalties when non-compliance occurs.

The UK must maintain its ambitions for environmental governance in the pursuit of FTAs and ensure environmental provisions are as binding as economic ones. FTAs should include a reciprocal affirmation of a commitment to tackle climate change under the Paris Agreement and reciprocal commitments not to weaken or reduce the level of protection afforded by environmental laws in order to encourage trade or investment.

As common practise, FTAs should include reciprocal commitments to non-regression on environmental standards, and commitments to progress climate change mitigation and environmental improvement efforts through trade and investment-related initiatives. Language must go beyond aspirations with sufficient mechanisms to ensure effective implementation domestically, and enforcement and dispute settlement mechanisms for other parties. In the case of England, the creation of the Office for Environmental Protection (OEP) under the Environment Bill could play an important role here due to its functions regarding the monitoring and enforcing environmental objectives.

2 Guarantee adequate parliamentary scrutiny and stakeholder engagement on negotiating mandates well ahead of ratification, via the Trade Bill. The use of sustainability impact assessments should be mandated to analyse the expected impact of a trade agreement on the environment prior to ratification and monitor post-implementation impacts.

The development and ratification of trade deals should be subject to timely and close parliamentary and stakeholder scrutiny as recommended by the House of Commons International Trade Committee.[15] The government should ensure that sustainability impact assessments form a key feature of how all new trade agreements or amendments to existing trade agreements are decided. Following ratification, the sustainability impact assessment process should be complemented by periodic assessments on the impact of the trade terms on the environment, in order to determine whether modifications should be made.

A **comprehensive programme for stakeholder engagement** within and beyond the Strategic Trade Advisory Group (STAG) will be necessary to seriously **consider the risks, opportunities and transition impacts that new trade arrangements can have on big businesses, SMEs, civil society and consumers** – with a fair balance of engagement across these categories.

3 Remove barriers and lower tariffs to grow trade in low carbon goods and technologies, for example through joining the Agreement on Climate Change, Trade and Sustainability (ACCTS). Given the importance of services to the UK's economy, the UK Government should ensure that its trade agreements and engagement at the WTO level aim to minimise barriers to the trade in low carbon and environmental services.

Well-designed FTAs offer the opportunity to reinforce supply chains for low carbon industries. Removing tariffs on low carbon technologies, services or goods from foreign markets will be key for enabling economies of scale and optimising supply chains. The UK should use its new position as an independent nation represented at the WTO to support negotiations under the Environmental Goods Agreement (EGA), seeking to eliminate tariffs on a number of important environment-related products.

14 European Policy Centre (2019) *Ensuring a post-Brexit level playing field*

15 House of Commons International Trade Committee (2018) *UK trade policy transparency and scrutiny*

These include products that can help achieve environmental and climate protection goals, such as generating clean and renewable energy, improving energy and resource efficiency, controlling air pollution, managing waste, treating waste water, monitoring the quality of the environment, and combatting noise pollution.[16]

A good example of new precedent in trade is the Agreement on Climate Change, Trade and Sustainability (ACCTS), a first of its kind initiative launched in 2019 by New Zealand, Costa Rica, Fiji, Iceland and Norway. Negotiations are aiming to eliminate tariffs on environmental goods, use trade disciplines to eliminate fossil fuel subsidies and develop guidelines for voluntary eco-labelling programmes. The ACCTS will be open for other WTO members after the first round of talks, and parties are planning a novel approach to extend their concessions on environmental goods and services to all WTO members.

> Trade deals must not create a framework for cutting domestic emissions by exporting polluting manufacturing chains overseas

Moreover, **removing barriers to the export of low carbon services will be just as important, with four-fifths of the UK GDP coming from services, catering to both global and domestic markets.**[17] Given that the UK already has strong expertise in the provision of low carbon services including green finance, insurance or engineering consultancy, striking trade deals should also be about minimising barriers to services. For example, Aldersgate Group members in the services sector regularly highlight the existence of barriers to service professionals working internationally as a key issue to be addressed.

The Trade in Services Agreement (TiSA), a proposed international trade treaty to liberalise services trade, is one way to resolve this, and the UK should be involved in these negotiations as an independent representative at the WTO. Minimising barriers will be paramount for growing the market for some of the UK's most competitive economic sectors, where its expertise is recognised internationally. For instance, an EU commissioned report shows that improved legal certainty provided by TiSA might lower the cost of trade in services by 3.4 percent in the OECD markets.[18]

4 Look beyond FTAs and also use bilateral trade negotiations and multilateral fora to boost low carbon trade.

Beyond negotiating FTAs, the UK government should not overlook the role of bilateral trade negotiations or multilateral fora like the WTO or the UN to increase trade and grow export opportunities for UK businesses in low carbon goods and services. For instance, bilateral negotiations between India and the UK in 2015 secured more than £9 billion in commercial deals, 1,900 UK jobs have been created or safeguarded, playing on the competitive advantage of UK industries including healthcare, finance or energy.[19] These are often quicker routes to increase trade and offer clear opportunities for exploiting the UK's competitive advantage in sectors of the low carbon economy.

5 Include provisions on due diligence obligations in FTAs to ensure that businesses have to assess, address and report the environmental and climate impact of their operations, with an increasing focus over time on capturing whole value chains.

This provision would **guarantee that domestic environmental and climate gains are not made at the expense of deteriorating international standards,** and would also have positive impacts for businesses; it would level the playing field between British and foreign businesses, improve environmental resilience throughout supply chains and increase board-level literacy of environmental impacts. It is essential that trade deals do not create a framework for cutting domestic emissions by exporting polluting manufacturing chains overseas. We have already seen this happening, with UK territorial emissions from industry falling 52% below 1990 levels. At the same time, UK demand for industrial products increased considerably, with the net value of imports more than doubling for manufactured products - pointing to an increase in consumption emissions, but a decrease in territorial industrial emissions.[20]

In a recent report, WWF argues that **broad mandatory due diligence obligation would provide business with the long-term certainty and confidence they need to invest and adapt and will level the playing field.** They find that such an obligation would also bring reputational and financial benefits to British business and the public purse – including supply chain resilience, social license to operate, improved staff retention and in some cases lower operational costs.[21]

16 WTO (2016) *Environmental Goods Agreement*

17 Maria Carvalho (2017) *At your service: how exporting more low-carbon services could enhance the UK's future prosperity*

18 European Commission https://bit.ly/2YaxlNY

19 HM Government Press release (2015) *"More than £9 billion in commercial deals agreed during Prime Minister Modi visit"*

20 Committee on Climate Change (2018) *Reducing UK emissions: progress report to Parliament*

21 WWF (2020) Environment Second Reading Briefing

6 Introduce a declining cap on financial support for international fossil fuel projects through UK Export Finance and increased transparency requirements for overseas investments in fossil fuel extraction.

The UK should set a positive example in its trade policy by introducing a cap on financial support to international fossil fuel projects. UK Export Finance (UKEF) is the UK's export credit agency, helping companies access export finance that enables international trade to take place. **While there has been an increase in the proportion of support given to renewable projects, the majority is still awarded to fossil fuel projects, with 96% (£2.5 billion) of export finance support going to fossil fuel projects in 2017/18.**[22]

While the initial intention behind fossil fuel subsidy schemes is often positive, such as providing vulnerable communities with access to energy or supporting economic development in least developed economies, they have been shown to be rarely effective in helping the poorest households.[23] Further, research from Carbon Tracker has shown that **UKEF supports upstream projects that are very likely to become stranded in a Paris-compliant world.**[24] **Greater focus of export finance towards clean energy access would reduce long-term financial risks, aid the delivery of developmental goals and further progress towards meeting climate goals.**

The Government has already made welcome commitments on UKEF in its Green Finance Strategy, chiefly that UKEF will make climate-related financial disclosure on its accounts, in line with the Task Force on Climate-related Financial Disclosure's (TCFD) recommendations.[25] As per recommendations by the Environmental Audit Committee in its inquiry into UKEF,[26] government could go further by **capping lending to fossil fuel lending, reporting on the forecast of emissions of its entire portfolio (including scope 3 emissions) and integrating climate change considerations into UKEF's mandate.** In doing so, the UK would send a clear signal to the wider investment market about the importance of the net zero transition, and leverage its position to ensure accelerated multilateral action towards climate neutrality.

22 House of Commons Environmental Audit Committee (2019) *UK Export Finance*

23 World Bank (2017) *The political economy of energy subsidy reform*

24 https://bit.ly/2YPxCoz

25 UK Government (2019) *Green Finance Strategy*

26 House of Commons Environmental Audit Committee (2019) *UK Export Finance*

MINIMISING RISKS
TO FUTURE UK POLICY MAKING AND COMPETITIVENESS

Protecting the UK's right to regulate

Whilst it is widely accepted that trade liberalisation brings economic benefits through greater efficiency, competition and choice, the environmental impacts of trade liberalisation are more complex. Not only can trade liberalisation lead to production moving to areas with lower environmental standards, but regulatory and investment pressures can lead to an unwanted deregulatory impact on domestic standards. It is crucial to ensure that trade agreements do not become barriers to climate ambition, and that the UK's sovereign right to regulate and tighten standards over time is protected.

7 Provide the parties in all future FTAs and investment agreements with a legally binding right to regulate to increase environmental and climate standards and put in place a dispute settlement mechanism which does not threaten the UK government's right to regulate. This could build on the precedent provided by the Intra-Mercosur agreement as an alternative to the Investor-State Dispute Settlement (ISDS) provision.

The role of regulations will be increasingly crucial in the path to meet the UK's net zero and Environment Bill targets over the coming years. There has been increasing convergence between trade and environmental issues as trade and investment regimes confront domestic regulatory measures for environmental protection and climate change mitigation. **The UK must ensure that as a minimum outcome, future FTAs and investment agreements should exclude any provisions that would create obstacles to the UK's sovereign right to regulate in the public interest and to apply regulations to all participants on the UK market (see recommendation 9).**

For example, investment agreements often contain an arbitration mechanism known as the Investor-State Dispute Settlement (ISDS), which has been a source of controversy in the context of environmental regulations. As explored earlier, environmental and sustainability provisions in trade agreements are often lacking in strength of enforceability mechanisms. In contrast, investment protection mechanisms such as ISDS have allowed foreign investors to sue for financial compensation in the event that government action is judged to have harmed their investment.

Opposition has been raised over the use of ISDS claims to undermine government action from regulating in the public interest, with a "chilling effect" on implementing stringent climate regulations.[27] As cases are decided in private arbitration instead of public courts, concerns also exist over the lack of accountability and oversight in ISDS processes that threaten democratic decision making.

> The UK's right to regulate must be protected as it will be increasingly crucial in the path to meet the UK's net zero and Environment Bill targets

A high profile example is TransCanada's US $15 billion claim against the US government for turning down the Keystone XL tar sands pipeline on climate grounds.[28] Claims have also been brought under the Energy Charter Treaty and Bilateral Investment Treaties to which the UK is a party.[29] Disputes at the WTO have also been raised successfully challenging countries efforts to support renewable energy and low carbon production through subsidies, procurement or local content measures.[30] The WTO does aim to provide protection for environmental policies under GATT Article XX,[31] though criticisms have been levied that its scope is in practice too narrow.[32]

27 Corporate Europe Observatory (2019) *Blocking Climate Change Laws with ISDS Threats*

28 Bloomberg (25 June 2016) *"TransCanada Files $15B Nafta Claim on Keystone XL Rejection"*

29 Open letter on the Energy Charter (2019) https://bit.ly/2Nc40fX

30 Office of the United States Trade Representative (6 July 2011) *"China ends wind power equipment subsidies challenged by the United States in WTO dispute"*

31 WTO https://bit.ly/30VXkKL

32 Harvard International Law Journal (2017) *WTO Trade and Environment Jurisprudence: Avoiding Environmental Catastrophe*

The UK should build on the 2017 Intra-Mercosur agreement (between Brazil, Argentina, Uruguay and Paraguay), that provides **an alternative to ISDS provisions, in giving legal certainty to investors without granting expansive and unnecessary powers that threaten the government's right to regulate.**

The agreement significantly departs from standard investment treaty practice, particularly on standards that have enabled investors to challenge regulatory measures. Unlike many bilateral investment treaties, the Intra-Mercosur agreement importantly contains no provisions for ISDS through which investors can sue states directly. Instead, it seeks to avoid disputes arising in the first place, by means of cooperation, mediation and risk mitigation. Investors seek redress by taking complaints to a national Ombudsman and as a last resort, a state-to-state dispute settlement process is available. The agreement **protects governments' right to adopt, maintain and enforce environment, labour or public health legislation** (with the limitation that measures cannot be applied in a way that constitutes a disguised trade restriction). Though this is not a carve-out for public interest legislation and there is scope for going further, the framing makes it harder to challenge legitimate and essential regulation.[33/34]

8 Avoid regulatory cooperation mechanisms in FTAs which impose any kind of restrictions on the UK's ability to set new climate and environmental targets and policies to deliver them.

Trade negotiations will cover means by which to reduce barriers to trade, and for non-EU countries this will chiefly mean reducing non-tariff barriers, i.e. regulations. Regulatory co-operation refers to a system of establishing a shared set of rules which apply to each country's domestic regulations when they have trade impacts. In a transatlantic context this system has been shown to have a "chilling effect" on the introduction of environmental regulations, as its aim is to align regulations to promote trade rather than achieve social or environmental objectives.[35]

There is evidence that regulatory co-operation creates disincentives for the introduction of new regulation. In the Transatlantic Trade and Investment Partnership (TTIP) draft agreement between the EU and US, identified trade barriers included: green or sustainable public procurement policies, energy efficiency labels, fuel efficiency standards for cars, regulation of unconventional fossil fuel extraction including shale gas and tar sands, sustainability standards for bioenergy and the banning of gases in appliances such as refrigerators and freezers.[36]

> Regulatory co-operation can create disincentives for the introduction of new regulation

Due to the difficulties of bridging significant transatlantic regulatory differences in areas such as food or chemicals safety, much of the focus of the TTIP negotiations were on a so-called 'horizontal' regulatory cooperation chapter. Based on proposals under TTIP, the main aim of a horizontal chapter is to cut across all areas of regulation and institutionalise a process of 'regulatory exchange' between both parties. This would have seen the US federal government and the EU having to provide each other with a list of planned legislative acts, to be analysed for their potential impact on transatlantic trade.[37] Concerns were raised that having to subject proposals to such scrutiny – where the principal metric is the extent to which such measures unduly impinge on transatlantic trade rather than broader social, environmental or public health objectives – would undermine the ability of governments to regulate in the public interest.

33 Trade Justice Movement (August 2017) *Stepping Away from ISDS Four alternatives to Investor-State Dispute Settlement*

34 House of Commons International Trade Committee (2019) *Investment liberalisation and investment protection*

35 LSE (9 June 2015) *"Regulatory chill? Why TTIP could inhibit governments from regulating in the public interest"*

36 Trade Justice Movement (February 2016) *Protecting Social, Labour, Environmental and Consumer regulations and standards in EU International Trade Agreements*

37 LSE European Institute (2015) *Regulatory Chill? Why TTIP could inhibit governments from regulating in the public interest*

9 Develop domestic policy tools which increase the UK's environmental and climate ambitions over time and apply to all businesses selling goods and services on the UK market. This will help grow the market for low carbon goods and services whilst also providing a level playing field for businesses. Policies could include the development of low carbon product standards for heavy industrial goods such as steel and cement, an update to public procurement rules, and the development of carbon pricing adjustment measures in collaboration with trading partners.

As the UK takes on more ambitious commitments to cut emissions across the economy, it is important that measures are in place to support industrial competitiveness during the transition and ensure that UK industry is not undermined by competition that does not abide by similar standards. This is known as carbon leakage, i.e. the displacement of emissions to less regulated jurisdictions. The UK faces particular risks here as it is the **biggest net importer of CO_2 emissions per capita in the G7** group as a result of buying goods manufactured abroad, importing around 300m tonnes of CO_2, making up 43% of its total emissions.[38] Research by government on the scale and distribution of UK 'consumption emissions' shows that in the 2000–2008 period, whilst UK territorial greenhouse gas emissions decreased slightly, consumer emissions increased by 15%.[39] **Lack of policy coherence in the transition to net zero emissions could result in unintended consequences such as replacing domestic emissions with imported ones. Robust and innovatively designed solutions are thus required to prevent carbon leakage and make a global impact on emissions reductions.**

The European Commission and other nations are currently **exploring the implementation of a carbon border adjustment mechanism (CBAM) to tackle carbon leakage.** The CBAM could be a customs duty on imported products, or a tax on selected products, and would reflect their carbon content and correspond with domestic carbon pricing. Such an adjustment would protect energy-intensive trade-exposed industries by putting a carbon price on imports of certain goods from outside the EU,[40] with imports of carbon intensive commodities such as cement or steel to be explored first. The expected output is to create a level playing field between domestic and foreign industry and ensure that companies that export carbon intensive products into the EU will be subject to the same level of carbon taxation as European industries.

A WTO compliant border adjustment tax accompanied by auctioning within the EU Emissions Trading Scheme (ETS) could both induce changes in consumption patterns in favour of lower-emitting products and encourage innovative R&D for low carbon emitting technologies. Companies in developing countries would be incentivised to improve the emissions intensity of their exported goods as they would be rewarded by lower adjustments of the border tax.[41] The Government could consider this as a potential policy option and given the interconnected nature of energy policy, could collaborate with the European Commission on this issue. This would align with the government's recently expressed intention to create a UK Emissions Trading System that may be linked to the EU's ETS.[42]

Policy coherence in the transition to net zero emissions is needed to prevent domestic emissions from being replaced with imported emissions

An alternative or additional solution could be the setting of stringent emissions standards on industrial goods that gradually drive down the permissible level of embedded carbon over time. Products standards would apply to all products within an industrial category, e.g. all steel or cement sold on the UK market, regardless of its origin. By targeting domestic and offshore emissions this could help create a level playing field between companies to deliver net zero emissions and a more resource efficient economy. UK businesses investing in low carbon business models and processes would be protected from being undermined by imports which do not meet similar standards. Further, standards can be designed to not only incentivise low carbon production but to also promote greater resource efficiency in the production process, thereby accelerating the transition towards a circular economy.

Whilst this recommendation focuses primarily here on heavy industrial goods, **the concerns highlighted above are applicable to a range of other sectors such as agriculture and farming where an uneven playing field on environmental and food standards could undermine the competitiveness of UK businesses.**

38 ONS (2019) *The decoupling of economic growth from carbon emissions: UK evidence*

39 HM Government BIS & DFID (2012) *Trade and Investment Analytic Papers Topic 14 of 18*

40 European Commission (2020) https://bit.ly/37NHsM4

41 Chatham House (2009) *Trade, Competitiveness and Carbon Leakage: Challenges and Opportunities*

42 UK Government (2020) *The future of UK carbon pricing government response*

The Aldersgate Group is an alliance of major businesses, academic institutions, professional institutes, and civil society organisations driving action for a sustainable and competitive economy. Our corporate members, who have a collective turnover in excess of £550bn, believe that ambitious and stable low carbon and environmental policies make clear economic sense for the UK.

ALDERSGATE GROUP LEADERS FOR A SUSTAINABLE ECONOMY

Email: info@aldersgategroup.org.uk
Tel: +44 (0)20 7841 8966
151 Wardour Street | London W1F 8WE

Aldersgate Ltd is a not-for-profit company
Company No: 6205552