

International Trade Committee: Aldersgate Group written evidence into inquiry on trade and the environment

February 2022

ABOUT ALDERSGATE GROUP

1. 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.¹ They have operations across the UK economy and include companies such as Associated British Ports, Aviva Investors, BT, CEMEX, the John Lewis Partnership, Johnson Matthey, Michelin, Siemens, SUEZ, Tesco and Willmott Dixon.
2. We develop independent policy solutions based on targeted research and the expertise and diversity of our members. Through our broad membership, we advocate change that delivers benefits to an ever-growing spectrum of the economy.

SUMMARY

3. Our response to this inquiry analyses Government's progress to date on aligning climate and trade objectives and sets out recommendations for stronger policy coherence between these areas. We argue that introducing broad due diligence obligations would ensure that domestic environmental gains are not made at the expense of deteriorating international standards.
4. Secondly, we urge Government to carefully consider a range of measures to address carbon leakage, including mandatory product standards on the level of embodied carbon and lifecycle emissions, and a carbon border adjustment mechanism; and a plan to support the financial/technological needs of vulnerable nations.
5. We also caution against the use of Investor-State Dispute Settlement and regulatory co-operation mechanisms that could have a chilling effect on the UK's ability to introduce environmental and climate policies. Finally, we urge the UK to utilise its diplomatic weight and independent status at the WTO to push for reform of global trade frameworks and leverage international climate ambition.

RESPONSE TO THE INQUIRY

Analysing Government progress to date on trade agreements and global frameworks

6. The departure of the UK from the European Union has provided the UK with the opportunity to develop its own trade policy for the first time in forty years, with the potential for a new and ambitious precedent to be set that incorporates climate and environmental considerations at its heart. The UK also has an opportunity as a new independent nation at the WTO to push for reforms to modernise and strengthen the WTO's decision making on environmental issues. Yet the UK Government's progress

¹ Individual recommendations cannot be attributed to any single member and the Aldersgate Group takes full responsibility for the views expressed.

in aligning its free trade agenda with climate and environmental goals has so far been limited. The absence of a concrete trade strategy has fostered a lack of policy coherence and robust governance between the trade and climate agendas, and **we would encourage the Government to produce a strategy specifically on the role of trade in the transition to net zero.** This should address topical issues including consumption emissions and carbon leakage, the right to regulate, due diligence, phasing out fossil fuel subsidies and modernising global trading frameworks.

7. Except for the EU-UK Trade and Cooperation Agreement, which contains a fairly ambitious non-regression principle, trade agreements negotiated by the UK to date contain weak sustainability provisions. Language remains aspirational, with broad objectives and a compliance gap that maximises the potential for environmental degradation to occur. For example, the opportunity to embed climate and environmental provisions into agreements with Australia was missed as references to the temperature goals of the Paris Agreement removed during negotiations.² Given the UK's COP26 Presidency, this deal could have been used to encourage greater climate ambition from Australia – for example putting its net zero commitment into law and enhancing its NDC. Ultimately, **we would like to see environmental provisions in trade agreements mainstreamed and enforced in the same way that other terms are enforced** – e.g. through sanctions.
8. The Government did announce a world-leading change to UK Export Finance by pledging net zero emissions across its financing portfolio by 2050 to move away from fossil fuel projects and increase support for green projects. This has set a clear signal to the wider investment market about the importance of net zero transition, encouraging accelerated multilateral activity. Given this leadership, it is disappointing that the UK has decided not to join 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. Removing barriers to the export of low carbon services will be just as important for enabling economies of scale and optimising supply chains, with four-fifths of the UK GDP coming from services, catering to both global and domestic markets.³ 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.
9. The UK has a strong track record of advocating for global climate initiatives, and there is significant potential for the UK to champion global alignment of trade and climate objectives in other multilateral fora. In particular, we would urge the UK to engage constructively at the Trade and Environmental Sustainability Structured Discussions and Friends of Fossil Fuel Subsidy Reform at the World Trade Organisation (WTO). With a new seat as an independent nation at the WTO, **the UK should push for reform of the WTO system to better integrate climate considerations into its framework** – for example through a 'climate waiver'.⁴ International dialogue will be essential for likely tension areas such as carbon leakage and due diligence provisions

² Sam Coates (2021), *Exclusive: Ministers bowed to pressure to drop key climate commitments for UK trade deal with Australia*

³ Maria Carvalho (2017) *At your service: how exporting more low-carbon services could enhance the UK's future prosperity*

⁴ James Bacchus (2021) *A call for a WTO Climate Waiver*

for deforestation. As identified by Chatham House,⁵ there is currently no anchor for ministerial-level diplomacy and coordination on climate-trade intersections across the full range of international processes. They advocate for a Trade Ministers' Coalition for Cooperation on Climate Action to provide a much needed focal point for constructive international cooperation to ensure trade supports global climate objectives.⁶

10. Beyond considering the opportunities for boosting low carbon trade, the Government has not adequately addressed the unintended but acute risks that agreements pose to global climate goals. These range from trade in goods that drive deforestation, to innovating industries being undermined by lower standard imports, to regulatory and investment provisions that hinder the introduction of new environmental regulations. **The Government should review all trade provisions in future agreements to “stress test” them against climate goals**, in particular measures that impact on industrial strategy, investment protection, regulatory cooperation chapters, and the promotion of environmental technologies, goods, services.
11. **Our members are keen to see policy on broad due diligence obligations to ensure that businesses must assess, address and report the environmental and climate impact of their operations, with an increasing focus over time on capturing whole value chains.** Whilst it is positive to see due diligence requirements in the Environment Act, it will be important that Government builds on this to expand due diligence requirements to all forms of deforestation and other commodities in the future. Introducing legislation on wider due diligence obligations would ensure that domestic environmental gains are not made at the expense of deteriorating international standards. It would also have a positive impact for businesses by levelling the playing field between British and foreign businesses, improving environmental resilience throughout supply chains and increasing board-level literacy of environmental impacts.

Addressing carbon leakage

12. 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 competitors that do not abide by similar standards. The UK faces particular risks here as it is the biggest net importer of CO₂ emissions per capita in the G7 group as a result of buying goods manufactured abroad, with nearly half of the UK's carbon footprint coming from emissions released overseas to satisfy UK-based consumption.⁷ Robust and innovatively designed solutions are thus required to prevent carbon leakage and make a global impact on emissions reductions.
13. Implementing a Carbon Border Adjustment Mechanism (CBAM) alongside competitive trade remedies would place a fair price on carbon for both domestic and foreign producers, while also aligning UK industry with the EU's proposed CBAM when it comes into effect in 2026.⁸ To prevent low cost, high carbon imports from gaining a growing market share at the expense of low carbon goods produced by UK firms, the government should put forward tangible proposals for a CBAM. This would create a

⁵ Chatham House (2021) *Trade ministers must pull their weight on climate action*

⁶ Chatham House (2021) *Trade ministers must pull their weight on climate action*

⁷ WWF & The Sustainability Research Institute at the University of Leeds (2020) *Carbon Footprint: Exploring the UK's contribution to climate change*

⁸ European Commission (2021) *Establishing a Carbon Border Adjustment Mechanism* p.8

level playing field for low carbon domestic firms, by placing a fair price on carbon for both domestic and international producers. Importantly, a CBAM can ensure that the UK is still able to harness and benefit from the best available global technologies for cost-effective decarbonisation, without sacrificing the opportunities for domestic growth. With the introduction of a CBAM, **the Government will need to lay out a robust and clear timeline for phasing out free allowances under the UK ETS to prevent double compensation and significantly reduce the likelihood of a challenge under the WTO.** This will also serve to define a CBAM as an environmental rather than protectionist tool.

14. Alongside the development of a proposal for a CBAM, Government should investigate other options for growing demand for low carbon products. This should include the implementation of mandatory product standards on the embodied carbon, lifecycle emissions and recycled material content of products sold on the UK market. This would directly drive the creation of a market for low carbon products. Careful consideration is needed to understand how a CBAM and product standards can interact with one another. This will ensure that the UK has a range of options at its disposal to drive demand while creating a level playing field between domestic and international producers. It is vital that standards on recycled material content are applied to materials that exist in abundance, are exported, or sent to landfill. This will discourage inefficient waste handling scarce materials. To ensure we can measure lifecycle emissions by the time a target or standard is introduced, it is vital that Government expedite the introduction of mandatory carbon reporting and verification mechanisms. Standards should then be tightened over time, Standards and targets should be tightened over time, as options for decarbonisation become more readily available.
15. When putting forward a proposal for a CBAM, **the UK should develop a strategy for cooperation and encouragement with other countries on its design and implementation** – including offering technical and capacity-building support for developing countries as part of its climate diplomacy. A strategy would address the need for careful design, planning and diplomatic groundwork in advance of the implementation of a CBAM and related policies. Such a package of policies would meet the objective of incentivising companies and countries to adopt greener methods of production, whilst rewarding companies and countries that are already adopting greener practices by making them more competitive. The UK should also seek to comprehensively understand the financial, technological and other support developing countries might need under its proposals – for example by exempting vulnerable nations, such as LDCs and Small Island Developing States (SIDS), or using the revenue generated by the CBAM to accelerate the diffusion and uptake of cleaner production.

Protecting the UK's right to regulate

16. Smart regulations and policies will be increasingly crucial in the path to meet the UK's net zero and environmental 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, **all trade 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.

17. In its approach on investment, the Department for International Trade “note the range of perspectives” on an Investor-State Dispute Settlement (ISDS) arbitration mechanism, suggesting that “if deemed... appropriate...it must reflect modern practise”.⁹ ISDS poses a particular risk in terms of the UK’s climate agenda and has been a source of significant controversy in the context of the Transatlantic Trade and Investment Partnership (TTIP) negotiations between the US and EU. To date, environmental and sustainability provisions in trade agreements have lacked sufficient enforceability mechanisms. In contrast, investment protection mechanisms such as ISDS have allowed foreign investors to sue for financial compensation if 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.**¹⁰ 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. 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.¹¹
18. The former Department for Business, Innovation and Skills commissioned a report from the London School of Economics looking at specific risks of ISDS in the EU-USA investment protection treaty to the UK, with the following conclusion:
- “We suggest that an EU-US investment treaty would impose costs on the UK to the extent that it prevents the UK government from regulating in the public interest... If the UK fully complies with its obligations under an EU-US investment treaty it will not incur any economic costs as a result of adverse arbitral awards. However, it may refrain from regulating in ways that it would otherwise regard as desirable. In contrast, if the UK ignores the risk of claims under an EU-US investment treaty it will not suffer from any reduction in policy space in practice. It would, instead, expose itself to the risk of economic costs associated with adverse arbitral awards... Ultimately, we conclude that an EU-US investment treaty that does contain ISDS is likely to have few or no benefits to the UK, while having meaningful economic and political costs. Removing ISDS from the treaty would be unlikely to have an appreciable impact on the (already negligible) benefits of a treaty with ISDS, while largely removing the costs of the treaty to the UK”¹²
19. Further, as detailed by Columbia Law School’s Sustainable Investment Centre, **studies on determinants of foreign direct investment do not demonstrate that Bilateral Investment Treaties result in higher investment flows, instead confirming that other factors – such as market size and growth, the availability of natural resources, and the quality of hard and soft infrastructure – tend to be far more important to investors than investment treaties when making the decision to invest.**¹³
20. In addition to investment, trade negotiations also cover means by which to reduce barriers to trade, which chiefly means reducing non-tariff barriers, such as regulations.

⁹ Department for International Trade (2019) *UK-US Free Trade Agreement*

¹⁰ Corporate Europe Observatory (2019) *Blocking Climate Change Laws with ISDS Threats*

¹¹ Bloomberg (25 June 2016) “*TransCanada Files \$15B Nafta Claim on Keystone XL Rejection*”

¹² London School of Economics to the Department for Business, Innovation and Skills (2013) *Costs and Benefits of an EU=USA Investment Protection Treaty*

¹³ Columbia Center on Sustainable Investment (2018) *Costs and Benefits of Investment Treaties: Practical Considerations for States*

Regulatory cooperation in a transatlantic context has been known 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.¹⁴ There is evidence that regulatory cooperation can create disincentives for the introduction of new regulation. The 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.¹⁵

21. 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 has been 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.¹⁶ Concerns have been 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.

¹⁴ LSE (9 June 2015) “Regulatory chill? Why TTIP could inhibit governments from regulating in the public interest”

¹⁵ Trade Justice Movement (February 2016) *Protecting Social, Labour, Environmental and Consumer regulations and standards in EU International Trade Agreements*

¹⁶ LSE European Institute (2015) *Regulatory Chill? Why TTIP could inhibit governments from regulating in the public interest*