



HOUSE OF LORDS

# Select Committee on the European Union

## EU International Agreements Sub-Committee

### Oral evidence: Environment, climate and international trade

Wednesday 20 January 2021

4 pm

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Members present: Lord Goldsmith (The Chair); Lord Foster of Bath; Lord Gold; Lord Kerr of Kinlochard; Lord Lansley; Baroness Liddell of Coatdyke; Lord Morris of Aberavon; Lord Oates; Lord Risby; Lord Robathan; The Earl of Sandwich; Lord Watts.

Evidence Session No. 1

Virtual Proceeding

Questions 1 - 18

### Witnesses

[I](#): Dr Emily Lydgate, Deputy Director, UK Trade Policy Observatory, University of Sussex; Susan Stone, Head of Emerging Policy Issues Division, Trade and Agriculture Directorate, OECD; Kate Young, Senior Public Affairs Officer, Aldersgate Group.

## Examination of witnesses

Dr Emily Lydgate, Susan Stone and Kate Young.

Q1 **The Chair:** Good afternoon. This is a meeting of the EU International Agreements Sub-Committee. Today we are looking at environment, climate and international trade. We are very pleased to have with us three witnesses: Dr Emily Lydgate, deputy director of the UK Trade Policy Observatory; Ms Susan Stone, head of the Emerging Policy Issues Division at the Trade and Agricultural Directorate at the OECD; and Kate Young, senior public affairs officer of the Aldersgate Group. Welcome to the three of you. Thank you very much indeed for giving us your time. We look forward very much to hearing what you have to say.

The first question is to all three of you. Could you give us a brief overview of how trade and environment and climate policy currently interact? Are they fundamentally in conflict with each other, or can they work together?

**Dr Emily Lydgate:** Thanks very much for having me. Apologies in advance if you hear any noises of home schooling in the background. Obviously it is a big question with a big answer, but I will very briefly highlight three things. The first is the obvious one. Trade means shipping and aviation, so we can at least partially address the potential conflict between environment and trade by including those emissions in our net zero target, which England currently does not do.

The second element is that just by meeting our domestic environmental goals, the UK impacts upon its trade strategy and trade. We cannot, for example, ban petrol vehicles if we are still importing lots of them. I think we can make our trade policy reflect our environmental goals, but that might involve restricting trade, and it might raise diplomatic challenges at times.

The final element is more outward-facing: our global consumption footprint. According to Defra, about a third of our emissions in the UK are from stuff produced elsewhere that we consume in the UK. To me, this is the trickiest element of getting trade and environment to work together, because of the questions about how much we can or should try to condition our imports on production conditions in other countries.

**The Chair:** Thank you very much indeed. I should have made it clear, by the way—I think you all know this—that this session is being broadcast. There will be a transcript, and you will have an opportunity to look at that before it is finalised.

Would our two other witnesses perhaps like to add or modify in any way what Dr Lydgate has just said?

**Susan Stone:** Thank you very much, Lord Goldsmith, and thank you for inviting me here today. I guess I should make the usual caveat that these are my opinions and they do not necessarily reflect the OECD<sup>1</sup> or our member countries, including the UK.

I would like to talk about three major topics, as Dr Lydgate did, where I see an overlap in trade and environmental concerns: carbon leakage, trade in environmental goods and services, and, finally, technology diffusion. As most of you are aware or have probably have heard about, there is a concern that when a country imposes strict environmental regulations domestically, something called carbon leakage will occur, which means that the so-called dirty production will just move elsewhere, so there will be no net reduction in emissions, despite ambitious policies to address domestic concerns.

Carbon leakage is tied to what has been discussed in the EU. More broadly, it is called a carbon border adjustment mechanism, which is meant to deal with that and potential issues with the WTO. That is a big area where trade and environment overlap.

The second is trade in environmental goods. As you know—or maybe not—the trade in environmental goods agreement has kind of stalled at the WTO. There is lots of discussion about what is included or what is or is not included in that discussion. However, we see ongoing discussions on liberalising trade in environmental goods but also, importantly, in environmental services being pivotal to moving forward in this agenda and balancing these two ideas of making progress in trade as well as making progress on the environment.

Finally, there is the idea of technological diffusion. Here we see really big opportunities. Carbon leakage may be seen as a place where you might have to make some adjustments, and there might be conflicts that need to be addressed between the environmental objectives and the trade objectives. With the trade in environmental goods, we see things working very much in harmony but of course being much more contingent on how that is defined.

We definitely see technological diffusion as also advancing both agendas, because we see trade as being a means of allowing countries access to the needed technology to install environmentally friendly processes and goods that will help to reduce climate emissions but also address a number of other environmental concerns. Where these goods or services require large amounts of investments or economies of scale to make them practical, trade of course is pivotal to meeting those objectives. I will leave it at that.

**The Chair:** That is very helpful. Just before you do, can you help put a little bit more colour on this, perhaps by giving a couple of examples? They could be purely theoretical or actual, as you prefer. It is just so that we, and indeed those watching this, understand the sort of goods and services you are talking about.

**Susan Stone:** For the liberalisation of environmental goods and services, the Environmental Goods Agreement, as it is currently being negotiated in the WTO, mostly consists of environmental goods, which means that it

does not include services yet. In work at the OECD, we have shown definitively that tying services to the liberalisation of environmental goods is pivotal to achieving environmental objectives.

The services underpinning these things are very important. An example is architectural services. If you are going to export a new type of electricity grid that may be more energy efficient, the engineering services that go along with that are pivotal to achieving the environmental objectives that you want, so that is something that needs to go together.

On technology diffusion, we just finished a paper showing that trade plays a significant and important role in displacing resource and fossil-fuel intensive energy sources when wind turbine exports are allowed or increase. The technology embedded in wind turbines and that access to import markets are pivotal and help to replace more “dirty” industries—less climate-friendly sources of energy.

**The Chair:** Would you expect a country negotiating a trade agreement to have these considerations in mind when doing that so they do not just focus on the pure trade aspects but consider the environmental aspects as well in the way you have just been describing?

**Susan Stone:** Right, because there are ways in which you can negotiate types of goods. The whole idea of technology diffusion sometimes raises concerns for countries, whereas technology diffusion does not mean forced technology transfer. There is a big difference there, and you can certainly guard against those in any kinds of negotiations through the types of products that you liberalise and the way you can negotiate market access conditions.

**Kate Young:** To answer the Chair’s original question, trade and climate objectives historically have and still do come into conflict with one another, but there is certainly great potential for reform. I will just give a very brief overview of what we see as the opportunities from trade and key risks to our climate and environmental agenda. I will try to give a business perspective in particular.

Free trade agreements present significant opportunities for countries to promote ambitious environmental standards abroad, to co-operate on delivering key global environment agreements, and to strengthen economic competitiveness through the export of low-carbon goods and services.

The Committee on Climate Change estimates that the UK market size could grow by almost 15% every year up to 2030 for low-carbon goods and services, and that by then the global market will be worth £1 trillion. That is really significant. However, under current precedent, trade deals pose unintended but acute risks. Those include environmental standards being diluted through provisions to reduce regulatory barriers, the introduction of public interest regulations being challenged through investment chapters, and the competitiveness of industries being undermined by imports that do not abide by the same standards.

So although free trade agreements are increasingly including provisions on trade and sustainable development, there is considerable doubt about their effective implementation and enforcement currently.

Looking forward, the time is ripe for a global push to green trade. We have countries taking on increasingly ambitious commitments, the recent EU target for 55% reductions by 2030, net zero targets from the likes of Japan, China, South Korea and Canada, and obviously new dynamics with the incoming US Administration.

**The Chair:** I thank all three of you. This helps us, because when we come to scrutinise new trade agreements which this Government have made, it is obviously important that we have in mind the sort of considerations that you have been talking about. I am therefore grateful to you for that.

As you probably know, different members of the committee will now ask questions in turn. I hope the technology will all work well. It does not always, but we will work through it. I therefore turn to Lord Sandwich, who in principle should be asking the next question.

Q2 **The Earl of Sandwich:** I have had sound problems, but I heard most of what the witnesses have said. I have two questions, for Dr Lydgate especially, on sustainable development. The first is: how can sustainable development chapters in FTAs be improved to be more effective? That is a wide subject, but there is another question to follow.

**Dr Emily Lydgate:** There are two interesting and promising emerging directions for strengthening these chapters, which I think has been widely recognised are not working that well. One of them is using FTAs to commit to targeted environmental goals. A good example is from the EU-UK TCA, where both sides commit to an effective system of carbon pricing. Another is from the ACCTS<sup>2</sup>, which we may come to later, which includes commitments on phasing out fossil fuel subsidies. These are innovative, because they move beyond the traditional FTA focus on product standards and instead establish shared environmental objectives. This is an approach that could be taken up by the UK more broadly going forward.

The second promising area is increasing our understanding of how FTAs impact on specific supply chains. In the past, we have not asked very effectively what is happening with workers or with particular environmental issues. So the USMCA<sup>3</sup>, for example, creates an independent body that can inspect labour practices in particular firms. This can also be done through sustainability impact assessments or domestic efforts: the EU, for example, is introducing a corporate due diligence requirement for human rights and environment.

**The Earl of Sandwich:** Thank you very much. Kate Young, you might say something because of the work that you have done in the Aldersgate

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<sup>2</sup> Agreement on Climate Change, Trade and Sustainability

<sup>3</sup> The United States–Mexico–Canada Agreement

Group.

**Kate Young:** Of course. On the question of improving environmental provisions within free trade agreements, over the last decade there has certainly a clear expansion of environment-related terms appearing in FTAs, but what has not changed is their weak legal status. Language tends to remain soft and aspirational, and provisions focus only on domestic protection, so enforcement is often utilised only through a panel of experts, who can make only non-binding recommendations. The compliance gap of existing trade and sustainable development chapters really limits their impact and minimises the opportunity to raise environmental standards.

An example is the CETA<sup>4</sup> agreement between Canada and the EU, in which the parties really agreed only to promote enhanced co-ordination, to engage in dialogue, and to recognise each other's rights to set environmental priorities. That does not really offer any concrete commitments. There is no monitoring system through which compliance might be identified, and there are no timeframes or sanctions for meeting commitments.

From our perspective, ultimately what we need is for environmental provisions within FTAs to be enforced in the same way that economic terms are enforced in other chapters of the FTA, starting with the introduction of sanction mechanisms for sustainability-related aspects.

Q3 **The Earl of Sandwich:** Dr Lydgate mentioned ACCTS, and I hope we come to that later. If I may, I will now throw it open a little more widely.

The UN definition of sustainable development is quite a lot wider. On the question of developing countries, do sustainable development provisions in FTAs with developing countries need to be adapted, for example to encourage adaptation in those countries and increase resilience to climate change. If so, how?

**Susan Stone:** I can give some ideas. First, I agree with my fellow witnesses about the provisions in free trade agreements being largely aspirational and often not having binding commitments to them that would, of course, increase the ability for them to be enforced or have real impact.

One of the major issues when we are talking about working with developing countries is the expense of some of the more climate friendly or more environmentally friendly technologies and the ability to adapt and to implement those technologies. It has been estimated that the cost of new electrical grids, for example, that are needed in most of the developing world are very high, so we might be able to help them, to entice them, to sign on to some of these commitments through capacity building, and technological aid in that sense—through some kind of an agreement that would help to support them in their efforts to achieve some of the goals in the SDGs, which can be quite daunting.

It is especially ironic that some of the countries that are facing the largest adaptation costs from climate change are also those that are in the least position to do anything about it fiscally. Through the sustainability chapters of trade agreements or through the SDGs<sup>5</sup>, provisions could put forward that could help to support them in these efforts.

**The Chair:** Those could be important themes.

**The Earl of Sandwich:** I am most grateful for that reply, thank you.

Q4 **Lord Kerr of Kinlochard:** Kate, you have been critical in print of the EU's early FTAs, because they did not have chapters on environment, and later FTAs, like the Japanese one, because it had no enforcement mechanism in the chapters. Does your criticism apply to us when we have rolled over EU agreements, and does it apply to our new agreement with the Japanese?

**Kate Young:** We have not looked in great detail at the rollover deals. There are some issues with the Japan deal—I think provisions on data protection changed—but as far as I understand, nothing significant was either introduced or removed on climate or environmental provisions. So would say that our comments still stand: that we have a trade and sustainable development chapter that is kind of siloed from the other chapters, when what we need to be doing is looking at the FTA as a whole and looking at its impact on environment and social objectives.

As you can see with the recent deal reached with the EU, it is great that there is a non-regression clause in there, but it is quite a high threshold of proof that in order for action to be taken on the level playing field provisions, there has to be proof that the environmental degradation has impacted trade. That is notoriously difficult to prove. It is great that non-regression is in there, and we would hope that non-regression clauses feature in all future trade agreements, but they should definitely extend beyond the scope of environmental impact that affects trade.

**Lord Kerr of Kinlochard:** I hear what you are saying about the new UK-EU agreement, but it does go further, does it not, than any of the other FTAs that we have been rolling over with the rest of the world?

**Kate Young:** It definitely does. It is one of the most ambitious out there in terms of its level playing field provisions, even though it could be improved. I would say that most of the risks to our environmental goals come from future agreements, particularly with the US and Australia. I can get to that later, but there are particular provisions, for example, investor-state dispute settlement, ISDS, which did not appear in the rollover Japan deal. I can cover those when that comes up later.

Q5 **Lord Morris of Aberavon:** How important is the failure of the UK's FTAs to be in step with the EU's current approach? What should be done to integrate?

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<sup>5</sup> Sustainable Development Goals

**The Chair:** I do not know whether you want to tackle that, Ms Young, as you have just been talking about the comparison with the EU and the new UK-EU agreement.

**Kate Young:** I do not want to interrupt Emily. Were you just about to come in?

**Dr Emily Lydgate:** I was not quite sure. I wanted to clarify that question. Do you mean that the UK's approach going forward may fall out of step with the EU's?

**Lord Morris of Aberavon:** Yes. In our note, somebody says that we have copied and pasted the EU language on trade and environment and that we are some years out of step with the EU's current approach. How important is it?

**Dr Emily Lydgate:** I should probably jump in there, because I recognise that language and I think I wrote it.

I think that comes from an analysis that we did of the rolled over trade agreements, in which we looked at how the UK had adopted that. We raised the concern, as Lord Kerr did, that it copied and pasted some very outdated language. Some of those FTAs—we have a table that lays it out—have no environment chapter, they are that old, and those that do have an environment chapter have a very outdated one. It struck us that if the UK wants to be world-leading in this area, it is a bit of a casualty, you might say, of being in a great hurry to allow our trade conditions to go forward smoothly. I do think that is worth bookmarking as a concern. I am not sure what the scope is for building upon those commitments, but it does seem to be a lost opportunity, because those cover a lot of our existing trade.

**The Chair:** That is a very important point.

Q6 **Lord Watts:** Can I direct this question to Susan Stone? What are the options for reducing tariffs and non-tariff barriers for environmental goals in FTAs? Can you just touch on what government negotiations should be trying to pursue in trade deals?

**Susan Stone:** Sure, thank you for that. On the tariff side of things, tariffs on environmental goods across most developed countries are very, very small. The gains to be had by further reducing those tariffs might be more limited than if you started to think about other areas such as non-tariff measures.

There are non-tariff barriers and non-tariff measures. Non-tariff measures are a broader concept of different types of standards, regulations and practices that are put in place by Governments for all kinds of policy objective reasons.

Non-tariff barriers are those that are put in place for protectionist measures to protect domestic producers. We have shown that in some cases non-tariff measures help to support trade: measures such as

clarifications on standards; clarifications on some types of labelling; some types of SPS—sanitary and phytosanitary—measures; and TBT—technical barriers to trade—measures help to increase transparency.

Those are things to do with transparency. Things that convey information to producers and consumers, especially on environmental goods, are quite important for trade, so we would want to ensure that any non-tariff measures that were in place were to promote those and not to protect domestic producers. That would be an area where you would want to spend more of your time, I would think, than on the traditional tariff lines.

The other thing I would argue is that combining goods and services is essential to getting the gains across the board. We have shown at the OECD that up to 75% of trade in goods can have services embodied in them, that liberalisation of services can promote significant degrees—anywhere from 20% from 75%—of increase in trade because they underpin the ability for goods to be effective. I would definitely consider goods and services together in any negotiating stance.

**Lord Watts:** Is there much opportunity to negotiate such changes with the United States, even with the change in regime that is taking place as we speak?

**Susan Stone:** That is not something that I would know particularly. The United States has not indicated any kinds of change to us at the OECD. Its policies continue. It is hard to say on any particular matter where it would have room or where it would not have room.

**Lord Watts:** On the non-tariff barriers, the two main institutions would be America and the EU, would they not? The closer they can tie together, the more you could achieve your aims. Would it be unfair to say that?

**Susan Stone:** It is fair to say that the less distance there is between regulatory approaches, the less trade costs are associated to firms and the more trade occurs, that is for sure. But, of course, the devil is in the details. As I said before, some regulations and standards help to promote trade by leading to further transparency and by providing information to consumers about a particular good.

Of course, if we are tying this back to environmental goods and services, we want to ensure that that is done on a non-discriminatory basis. One example is a label that allowed a consumer to understand whether a product contained lead. If paint contained lead, that would directly affect an end product and would be considered something that can be regulated, that can be negotiated.

Certainly it is within the UK's rights to ban or modify such a product, but it becomes a little trickier when the effect on the end product is not obvious, because under the WTO regulations the watchword is non-discrimination. You want to apply the same rules, the same standards, the same regulations to domestic products as well as to any imports that

are coming in. That is fine, but you need to make sure that those are applied consistently.

**Kate Young:** I completely agree. I particularly emphasise the importance of local services, given that the UK's economy is so dependent on them. Four-fifths of GDP comes from services. I agree that DIT, the Department for International Trade, should work to secure a strong plurilateral environmental goods agreement, on which the negotiations stalled a few years ago. The UK, as a major player, could particularly hope to increase ambition, for example by deepening discussion of the relationship between multilateral environment agreements and trade agreements or by seeking to include negotiations on specific provisions such as phasing out harmful investment protection provisions or greening public procurement. I completely agree there.

**Q7 Lord Foster of Bath:** Thank you all for being with us. I think what we have learned from listening to you already is that sustainable development sections in FTAs are limited, are not working very well and, as has been pointed out, have very weak enforcement. Kate Young suggested that we should look at FTAs as a whole. Others have suggested, in a similar vein, that we should ensure that the environmental and climate-related provisions are mainstream throughout the agreements.

I know that Kate Young's organisation, the Aldersgate Group, has suggested one approach, using specific standards for specific goods to help reduce carbon emissions. It would be interesting to hear how you think that could be done in practice and what the challenges of mainstreaming these issues through the agreements would be.

**Kate Young:** Thank you for your question, Lord Foster. I will start with the standards that you mentioned, and touch on what has already been said about carbon leakage.

As the UK takes on more ambitious climate commitments, it will be very important that there are measures in place to support heavy industries innovating in the green transition that are particularly exposed to trade and need to be protected from higher carbon products from abroad. The UK faces a particular risk, as it is the biggest net importer of carbon dioxide emissions per capita in the G7 group, so it is very important that no further offshoring of emissions occurs.

The sort of policy measures that we have been looking at would be in hard to treat sectors such as heavy industry, using product standards which drive down the permissible level of embodied carbon in the production of industrial goods, starting with steel, cement and aluminium. That would ensure that all imports arriving on the UK market have to abide by the same standards, and could provide an effective complement to the carbon border adjustment mechanism that is currently being explored by the UK Government and the European Commission.

To give a non-carbon example, we have a member, Michelin, that innovates in the circular economy by re-treading truck tyres. That offers

significant environmental and economic benefits. Some 95% of truck re-treads that are used in the UK are produced in the UK. So there is that innovation from Michelin. However, the truck re-treading sector in the UK faces significant competition from cheap imports of new tyres from Asia, which cannot be re-treaded due to the design. The surge in imports of single-life tyres has resulted in a significant increase in waste and emissions, as they tend to be exported abroad to be incinerated. It is very important that resource efficiency standards are introduced so that any domestic industry business that is innovating in the green economy is protected and our trade policy provides is a level playing field.

Sustainability impact assessments will be very useful in mainstreaming environmental considerations, especially when they are applied throughout the FTA as a whole to see their impact.

**Lord Foster of Bath:** Thank you. I wonder whether either of the other two witnesses have any further comments.

**Dr Emily Lydgate:** I wanted to highlight the importance of working with others for the UK right now. This ties in with the previous discussion, because market power is very important when we think about the UK's role in setting standards. The example is often given of the California effect, which is where California's higher energy efficiency standards drove up those in the US as a whole because it had such a large market share. The UK has a relatively lower market share than it did as an EU member, which means that if we had standards that are different from the global regulatory powerhouses of the US and the EU, we would then put our producers in a difficult position, because countries would not want to have to go through the bother of retooling their processes to meet our standards.

That underscores the fact that we are not, I think, in a good position to go it alone. I think we can go at it with likeminded partners with the awareness that it might involve making difficult choices if there are times when we want to prioritise an environmental goal over a trade liberalisation goal.

**Lord Foster of Bath:** But, of course, that will create problems when we are developing FTAs with developing countries, which may have difficulty achieving those same high standards. However, I do not want to pre-empt a question from the Lord Chair, who will pick that up a bit later. Thank you very much indeed.

**Susan Stone:** I agree with my fellow witnesses, but I would also take a step back to say that, in the current global environment, there is an acknowledgement that many of the multilateral negotiation platforms, especially on the environment, are not achieving the goals they want to achieve. There is a tendency to move to the plurilateral or even bilateral format that is working right now, which tends to be trade agreements. Trade agreements tend to be the international form right now that is making progress across the area, but advancing these other agendas is not their first best use.

In a practical sense, we do not live in a first-best world, so in a practical sense they are now being used as a means of bringing the likeminded countries together to move the bar forward. That is very important, but we should keep in mind that the first best option is these larger plurilateral, multilateral processes. It is important not to lose sight of the degree to which a country like the United Kingdom, with all its weight and influence, can take part and try to push those forward.

**Lord Foster of Bath:** Thank you. That is very helpful.

**Q8 Baroness Liddell of Coatdyke:** Given that the British economy now has a lot of different sectors that are involved in environmental matters, we are told that trade negotiators have quite a narrow definition of environmental services and perhaps do not take into account that environmental consulting is worth about £1.9 billion to us and has been growing very rapidly over the past five years.

How do we get across the kind of provisions that are necessary in FTAs to facilitate trade in environmental services? I will ask Susan first and then go to Kate, who mentioned some of that. We need to be quite precise about how we get things moving on quite a growing part of our economy. Maybe I am being a bit naïve, but I think there are great opportunities there and we need to seize them.

**Susan Stone:** It is an excellent point. It is very important that this narrow definition be addressed, because there are all kinds of services that promote environmental goods and help to achieve environmental objectives. For example, work we did showed that the liberalisation of computer-related services promoted the export and implementation of environmental goods and services. There is a lot of interplay between different services as well as environmental consulting services.

In the sense of showing and demonstrating, there is lots of evidence out there about the mutually reinforcing interplay between these services and other environmental outcomes that you could bring to the table to show that it is important to take this broader perspective and not only to liberalise environmental consulting services and those going forward but other services that would help to support that process.

**Baroness Liddell of Coatdyke:** Thanks, Susan. Kate, do you have a thought on this?

**Kate Young:** Definitely, and I agree wholeheartedly with the premise of your question. Ultimately, if the world is to remain below 1.5 degrees, the low-carbon economy and the whole economy will be one and the same thing, and the transition is certainly fully under way.

On low-carbon services, the UK already have some very crucial home advantages. We are world leader in law, and we have further strengths in IT, telecommunications services, engineering, consulting and the development of standards, and obviously the City of London is a global hub for climate finance skills.

We released a report recently on building a net zero emissions economy, in which we set out that it is very important that the domestic policy is in place before we think about fulfilling opportunities from low-carbon exports. Ultimately, we need a net zero delivery plan that will send all the right policy signals and stimulate the private investment that is needed to cultivate the scale that is needed.

I will say a little about what can be done in trade. The Department for International Trade and the Foreign, Commonwealth and Development Office could co-ordinate cross-Whitehall initiatives on promoting and identifying low-carbon services. There is, for example, the prosperity fund initiative, which seeks to increase economic growth in developing countries by improving their business environment and supporting institutional reforms. There will certainly have to be a cross-government approach.

**The Chair:** I was delighted by your reference to world leaders in law, given that is what I specialise in. We might come back to that. Before we do, I turn to Lord Morris, who wants to pick up on a point.

Q9 **Lord Morris of Aberavon:** With the UK entering into trade negotiations with countries with higher carbon emissions, or, on the other hand, lower environmental and climate ambitions, is there a risk that the UK's own commitments could be undermined? If so, how can it be avoided?

**Kate Young:** I have already talked quite a bit about carbon leakage, but I would like to say something about protecting the UK's right to regulate. In order to deliver our net zero and Environment Bill targets and grow our low-carbon economy, the UK will have to introduce and tighten, over time, targeted policies and regulations on everything from air quality to resource efficiency to biodiversity. It is absolutely crucial that there is nothing in a future free trade agreement that restricts our regulatory ability.

One of the concerns we have as a group is the investor state dispute settlement. That is an investment provision that has long been a source of controversy in allowing foreign investors to sue for financial compensation in the event that they deem government action to have harmed their investment. A very high-profile example is TransCanada's \$15 billion claim against the US Government for turning down the Keystone tar sands pipeline on climate grounds. In fact, half of all ISDS cases registered at the World Bank up to 2015 related to oil, mining, gas or another energy form.

It is worth mentioning here that a London School of Economics report, commissioned by the former department, BIS, when TTIP was being negotiated, looked at the specific risk to the UK of ISDS provisions in an EU-US deal and found that there would be negligible benefit to investors but significant risk of litigation, even if the UK won court cases, and risk of lost policy space.

It is very important that we avoid any sorts of provisions that would threaten our right to regulate. Another example is regulatory co-

operation, which seeks to harmonise regulations. In a transatlantic context, it has been seen to have a chilling effect on the introduction of public interest regulations. Again, it is very important that the Government consider all provisions in relation to how they might support or hinder our climate objectives.

**Q10 Lord Morris of Aberavon:** We are told that most FTAs have best endeavours and rely on co-operation. They seem to be very worthy tools, but they do not seem to be capable always of accomplishment. What could be effective tools to avoid the situation I have already described?

**Dr Emily Lydgate:** There will be FTA-specific issues, but one thing that I have not seen from the UK Government that would be useful is an overall strategy. If we are to take climate, and integrating ambitions on climate, into our ambitions on trade seriously, we need to have some sort of a policy on how we will do that. There is also a place in that for some red lines. For example, if our trade partners have not signed the Paris Agreement or do not agree to uphold it, we will not negotiate a trade agreement or be willing to suspend a trade agreement.

Again, there are hard choices here, but it is hard to see what the UK Government's strategy is. It seems to be very much on a case by case basis. Having said that, in most of the trade negotiations we are looking into, the trade partner does not have a net zero target, so we do have to be careful about things. I would underscore Kate's points about the risks of investment agreements and about making sure that we are able to uphold our domestic regulations, avoiding, for example, what happened in the CETA negotiation when the EU loosened its restrictions on shale oil as part of a negotiating concession there.

**The Chair:** Thank you. You mentioned non-discrimination in the WTO, and I believe Lord Oates wants to pick up on that.

**Q11 Lord Oates:** Yes. Thank you very much, Lord Chair, and thank you to the witnesses for the excellent papers that were provided to us before this meeting. They were extremely helpful.

I want to ask you about some of the challenges of the WTO non-discrimination rules, particularly in respect of carbon border adjustment measures and what you might say—I would direct this question initially to Dr Lydgate and Susan Stone—about how the UK could best go about avoiding such conflicts with WTO non-discrimination while implementing such measures.

**Dr Emily Lydgate:** That is my favourite topic. The fundamental logic of the WTO, as Kate said earlier, is that UK regulation has to treat products the same regardless of where they are from. If we apply this logic to carbon border adjustment, this will likely mean that, in their desire to comply with WTO non-discrimination requirements, countries that develop these are likely to be quite conservative in their design.

What I mean by that is that they will probably sacrifice some of the potential environmental effectiveness, because if you want a measure to be maximally environmentally effective, you want to charge products with

higher CO<sub>2</sub> embedded emissions more. However, that poses a much greater risk of violating non-discrimination rules in the WTO. The EU will publish its approach to CBAs this summer, so it will put its head above the parapet first, which is an advantage for us. My prediction is that it will be a relatively low tariff that applies to a relatively small number of sectors, and it will have the same charge across products and countries.

**Lord Oates:** Thank you. Susan Stone, do you have anything to add to that?

**Susan Stone:** Yes. Obviously, the potential WTO compatibility of a border carbon adjustment mechanism or process is a big issue. There are a couple of design issues. As you design a border carbon process, you make decisions and, as Dr Lydgate said, there are trade-offs between effectiveness and feasibility, many of them around the ability to measure. To us, this is much of the crux of the matter with the BCA. How do you measure emissions? Is the process of producing, the manufacturing process? Are they similar? The ability to say what is a standard or what should be a base for emissions in any particular production process becomes very, very difficult.

In the Paris Agreement, there is already a built-in mechanism for what we generally call special and differentiated treatment, so that each country has pledged commitments according to its abilities. There is that multilateral process already in place. The idea is that we are saying, "What you have committed to under that process isn't right, so we want you to increase your commitments". The question is what the country can do in what circumstances. Are they able to do that, and are we measuring the same thing?

These issues all come up in the design of a border carbon mechanism. Whether or not they are ultimately WTO compatible will probably come down to what the specific design looks like and how it is stipulated. It may get challenged in the WTO, because the developing world will definitely see this as an exporting of higher standards. Well, not definitely, but there are countries in the developing world that see this as an exporting of standards that are higher than they are able to achieve on their own, and instead of working together under this current Paris Agreement paradigm we are now introducing another paradigm under which they now need to figure out how they will address that. So there are geopolitical implications.

We have looked into this. It is not a matter of discrimination or non-discrimination, as I said before. There are ways to implement a BCA that would pass that bar in the WTO, but there are other issues along those lines as well.

**The Chair:** Of course, our committee is concerned. We do not make the agreements, obviously not, but we do try to look at what role we can play in scrutinising them, and that involves looking at the materials which the Government present. I turn to Lord Kerr to put questions to you that, to my mind, relate to that.

**Q12 Lord Kerr of Kinlochard:** First, I echo what Lord Oates said about the papers we got from our witnesses. I, too, found them extremely useful and interesting. Thank you.

In their scoping assessments published before a trade negotiation starts, the Government say something about environmental impact. I get the impression that our witnesses think that they do not say quite enough. Can you specify the precise criticism? Is it that the documents do not cover the right areas? Is it that they do not use the right methodologies, or is it that they just are, in your view, insufficiently deep and thorough?

**Dr Emily Lydgate:** One of the noble Lords had an excellent amendment to the Trade Bill that addressed some of the issues that I would also raise, one of which is that the methodology does not seem to be specified, and while the Government have released a statement saying that they will do these assessments on forthcoming FTAs, I have not seen this laid out as a legislative requirement. There is another question about independence in sustainability impact assessments; there is, for example, an EU sustainability impact assessment. These assessments are done by independent consultants, so you have a layer of independent government.

**Lord Kerr of Kinlochard:** What would you like to see in the scoping assessment before the whole game starts?

**Dr Emily Lydgate:** I think there need to be some sort of criteria against which we assess. One idea would be to use the concept of sustainability, which has three pillars, so we look at environmental impacts, social impacts and economic impacts.

The issue with a sustainability impact assessment, which is the same issue in the EU, is that it is resource intensive and time-consuming, and is often seen as a sort of existential threat to the FTA negotiation if taken seriously. I do not mean to discount the political issues relating to a sustainability impact assessment. On the other hand, from where I sit, a rigorous sustainability impact assessment would enable a much better trade agreement in terms of actually mainstreaming environmental concerns.

How do you do this? I think it involves having to have an independent assessment that looks at impacts, talks to different stakeholders in the partner country, and tries to be comprehensive. That is very difficult, but that would be ideal.

**Lord Kerr of Kinlochard:** Would that need to reflect some general government integration of trade and environmental policy from which you would derive the principles that would be applied to each negotiation? If you do it bottom-up, negotiation by negotiation, it seems to me that you are unlikely to achieve the integration that you have been calling for in your published work. Is that right?

**Dr Emily Lydgate:** Absolutely. This has been raised in various ways by various parties, but there seems to be an informal approach. Not much

legislation or strategy has been set out for how the UK will address these issues, so I would wholeheartedly agree with your point.

**Kate Young:** I completely agree with what Emily said about the independence of scoping assessments. Our problem with them is that the primary rationale for assessment is to conduct an economic analysis of the FTA while considering some environmental factors. Just having had a look at the US scoping assessment, there is an estimate of emissions impact from a US-UK FTA, but there is no mention, for example, of the consequences of investment provisions, despite the existence of a government-commissioned report into the impacts that I mentioned earlier. Scoping assessments should be stress testing all potential provisions against the Government's climate goals.

There is also a quick point to make about timing. Ideally, the timing of an assessment would come prior to commencement of negotiations, so that MPs and peers have the potential to review the assessment and make recommendations based on them.

Q13 **The Chair:** That is the second time that you have mentioned possible investment protections. I understand that, and your policy paper is quite clear on that, but I just want to see how far you are going. You are saying that the UK's sovereign right to regulate and tighten standards over time should be explicitly protected. In asking this question, I ought to declare that I am a lawyer—I mentioned it earlier because of what you said about world leaders in law—and that this is an area of law in which I practise. Would you see it as acceptable for there to be protection for investors and systems to resolve disputes with investors so long as the right to regulate was protected?

**Kate Young:** To an extent, in the research for our report, I spoke to academics who have expertise in ISDS case law and importantly, they say that there is no evidence that ISDS provides benefits to investors, so there are many more important factors to consider, such as availability for particular skills in the country that the investor is looking at.

A common government response I have heard when I have brought it up with officials is that the UK has not lost an ISDS case yet. But that is not surprising, given that the UK's existing bilateral investment treaties are with capital importing countries, such as former eastern bloc countries, and it would be a step change to have a US agreement, as the US is the biggest single investor in the UK if you do not count Europe as a whole.

There are alternatives that exist. I would point to the Brazil model, which almost gives a full carveout for public interest regulation. But, as you say, we are looking for a much more explicit exception for environmental protections and other important social areas.

**The Chair:** Thank you for that.

Q14 **Lord Risby:** I will add my plaudits for both the papers and the presentations this afternoon.

Could we turn specifically to business, and perhaps most particularly to SMEs? I am involved in an organisation that tries to protect the interests of SMEs, and it is absolutely plain to me that all the people I talk to understand the importance of a green agenda. Of course, our concern, particularly in the present environment, is additional costs, as you would imagine. The DIT has made huge efforts in export promotion in the last few years in order to attract SME's into exports activity, and it has had some success. I would be very interested in how British businesses would be impacted by more ambitious environmental and climate related commitments in trade agreements.

It is quite obvious that, if you are a large organisation, there are huge commercial opportunities out there which are coming onstream all the time all over the world. If you are a smaller organisation, it is another matter; you are talking about organisations dealing with additional costs, labelling and so on. There is a bit of a dichotomy there, but it is a very important thing that we have to get right, so your comments would be much appreciated. Kate first.

**Kate Young:** I should just clarify, first, that while the Aldersgate Group represents a range of businesses across the economy, none of those are SMEs, so I cannot talk specifically about trade policy in relation to SMEs.

On the question of how ambitious environmental provisions would impact UK businesses, given the Government's highly ambitious targets for clean growth and climate it is very clear to us and our members that progressive environmental commitments would create significant market opportunities for the UK rather than have any negative impact.

It is important to look at the Committee on Climate Change's recent sixth carbon budget and the targets that fall under the Environment Bill. The UK will achieve these ambitious goals only through a comprehensive and well joined up delivery plan for net zero, and through halting the loss in biodiversity. Especially in the context of Covid recovery, a net zero delivery plan represents an opportunity for the UK to get its economy going, to invest in innovation, to grow supply chains and to create jobs in areas such as offshore wind, electric vehicle manufacturing, low-carbon industrial goods and building renovation.

We commissioned a recent report to the London School of Economics that showed that a durable economic recovery needs to be closely aligned to the UK's climate and environmental ambitions, so obviously the trade policy must be supportive of this and aligned with the level of ambition while creating a level playing field to protect businesses that might be undermined by imports of lower environmental standards.

**Lord Risby:** Well, thank you. I was interested to hear two words put together twice—particularly by Dr Lydgate, I think: overall strategy. I think this is perhaps what you are suggesting: that there needs to be a greater marriage, a very obvious marriage. As for SMEs—as you say, you have no direct involvement in them—there is a huge effort to involve them in this whole trade process going on. I should just make that

comment. Is there any further comment that anybody wants to make?

**Susan Stone:** I was just going to jump in here, first, to back up what Kate has said about the empirical literature looking beyond the UK and across many OECD countries. It has been shown that large companies tend to innovate, and that significant ambitious environments or climate-related commitments tend not to impact profits or productivity significantly but do spur innovation and expansion.

From our work looking at SMEs directly, we find that, when it comes to compliance costs and understanding the new regulations, information costs are quite large for SMEs and impact on their ability to understand a regulation and how it will be implemented or affect their operations. So, assistance is needed to help them to translate what these are and what it means for them. They do not have departments that look at regulatory structures or government intervention, so these kinds of issues have a big impact on SMEs more broadly.

**Lord Risby:** Yes, I think that is absolutely right. Thank you very much.

**Dr Emily Lydgate:** SMEs struggle with regulatory changes, increased regulation, and complying with customs' regulatory requirements when they change, as we have seen lately.

I do not see free trade agreements as being a huge driver of these things as they relate to environmental commitments. If we think about the scope of things that we have talked about today, I do not think that they entail a huge amount of regulatory change. SMEs will struggle to deal with changing export conditions and to adapt to changing environmental regulation domestically.

There could be elements of integrating a green agenda into our trade that would have implications for SMEs. For example, the introduction of more corporate due diligence requirements might be burdensome for SMEs. Oftentimes I think that a useful policy lever here would be to exempt businesses of a certain size from certain requirements, so hopefully some sense will prevail there.

**Lord Risby:** Thank you.

Q15 **Lord Gold:** Like Lord Risby, I also picked up on Dr Lydgate questioning the Government's overall strategy. It fits neatly into my question, which is: how do you evaluate the UK Government's engagement on environmental and climate-related issues in international trade, in particular with civil society stakeholders and generally across all the sectors? Perhaps Dr Lydgate might start with that.

**Dr Emily Lydgate:** I will defer to Kate on this, as per our previous email correspondence.

**Kate Young:** I am happy to answer this. Thank you. The Government have committed to ensuring that their trade policy is transparent and inclusive. They have promised that Parliament, the devolved

Administrations, the devolved legislatures of local government, businesses and civil society will all get a say in the creation of the UK's trade policy. So far, the UK has not achieved these goals.

One of the most important aspects for us, which was touched on briefly earlier, is that Parliament currently has very little scrutiny over trade negotiations and far fewer powers than the US Congress or the European Parliament. I was disappointed to see yesterday that the amendment to the Trade Bill that would insert robust scrutiny mechanisms was not passed. Obviously, that is outside the remit here, but—

**The Chair:** It is outside the remit of our House, is it not?

**Kate Young:** Yes, although I am hoping for a concession to be found when it goes back to the Lords.

There is definitely an urgent need for greater democratic scrutiny and transparency. On civil society engagement—we represent some NGOs—there are other steps that the Government should be taking. DIT's current model of engagement is quite confusing. There are multiple types of stakeholder groups and channels, and the terms of reference for each group are not always clear, so DIT should look to introduce greater transparency to these groups and to engage with civil society as early as possible in the formation of negotiating mandates.

Lastly, NGOs have raised concerns about the use of non-disclosure agreements, which can be necessary in certain cases but can hinder effective participation, as members of these groups are not able to share any information with their organisations.

**Lord Gold:** You are marking our card a little on what we have to do.

**Kate Young:** Exactly.

**Lord Gold:** Hint taken. Would the others like to comment?

**The Chair:** Do you want to add something on this Dr Lydgate? You defer to Kate Young, do you?

**Dr Emily Lydgate:** I have deferred.

**Kate Young:** Just one more point. It would really benefit UK negotiators if Parliament had a greater say. I think it is called the delicate congressional balance—Emily could probably comment on this—whereby US trade negotiators will turn down a disliked provision in negotiations because they say that it will not pass Congress. It is a surprise that the Government are not willing to find a concession point there, because it would certainly strengthen the hand of UK negotiators.

**Lord Foster of Bath:** Hear, hear.

**The Chair:** There are some people, even on this committee, who share that view, but you have heard at least one of them now express their opinion.

Let me turn to our final questioner, Lord Lansley, picking up on something that has already been raised in this session.

Q16 **Lord Lansley:** Yes, thank you, Lord Chair. I am indeed the back marker on our questions.

Our witnesses may have referred earlier to the agreement on climate change, trade and sustainability, entered into by New Zealand, Norway, Costa Rica, Iceland and Fiji at the end of 2019. Ms Young, can you tell us a bit about what this is and what opportunity this might represent from the United Kingdom's point of view?

**Kate Young:** Yes, of course. On the negotiations, there are three aims. One is to eliminate tariffs on environmental goods. The second is to use trade disciplines to eliminate fossil fuel subsidies. The third is to develop guidelines for voluntary ecolabelling programmes. A particularly novel aspect of the agreement is that the benefits will be open to all WTO members, so the concessions will be extended further than those that have reached the agreement.

We are highly supportive of the UK joining that agreement. It is a welcome initiative. It makes a clear statement of intent to cease from dealing with climate change and trade separately. I just note that the UK has shown recent leadership in committing to phase out international support for fossil fuels through UK Export Finance, which we warmly welcome. We would also recommend that the UK look to join the Friends of Fossil Fuel Subsidy Reform group, which is also going to be important.

**Lord Lansley:** What stage is the agreement at? I know Switzerland joined, but the impression I got from reading about it was that the original signatories wanted to put flesh on the bones of their agreement before the point at which they opened it up for others to join, or do you think that they would be looking for additional members to join now?

**Kate Young:** I could not say definitively. I will go back and check. I am pretty sure that it is open to other members, just by the fact that when I have raised this with the Government they have said that they are actively exploring joining, so I assume it is possible.

Q17 **Lord Lansley:** All right. Could I broaden that a little to the multilateral aspects more generally, and our other two witnesses may like to join in as well? You referred earlier to the environmental goods agreement through the WTO having stalled. I think we are some four years on, but senior officials at the WTO still think they should relaunch it.

How do you regard the relationship? How would the relationship work between the WTO's own initiatives for a plurilateral agreement and other initiatives. There is more than one initiative. The ACCTS is not the only initiative in this area. There are some other plurilateral initiatives around. Now we have the capacity and responsibility to act independently, how should we go about using that? Ms Stone might like to add a bit on that.

**Susan Stone:** Yes, I would like to jump in here, because I see these initiatives out of the WTO—the CTE launched the structure discussion on

trade and sustainability, which is also complementary—as providing impetus to restart the negotiations, as you say, on environmental goods, and hopefully services, and to push that agenda along.

We have quite an active programme examining fossil fuel subsidies. We do the estimations of fossil fuel subsidies, and in 2019 they were almost \$480 billion in terms of costs, so we believe strongly, and have shown, that reducing these subsidies is pivotal in order to make progress. The degree to which like-minded countries can start to make progress, and other countries as they join, we think will help to push the whole agenda forward.

I do not see the WTO process in any way as an either/or. The WTO and the CTE—the Committee on Trade and Environment—at the WTO are very much involved. They are aware of these processes and support them the best that they can, so I see it all as complementary.

**Lord Lansley:** Indeed, the ACCTS might well stimulate the EGA<sup>6</sup> relaunch.

**Susan Stone:** Exactly, especially now under the structured discussions that have just been launched.

**Lord Lansley:** If the United Kingdom takes a position on this, can you observe why the European Union would not, or is the European Union also considering this?

**Susan Stone:** I cannot speak directly to the European Union's position on this initiative. Kate may have more information. In the environment area, we often deal with individual countries. With France, we have some initiatives at the OECD. France, New Zealand and Iceland are very supportive in terms of pushing this agenda, so we tend to deal at that level. In the trade committee, we deal more with the EU in this area, yes.

**Kate Young:** I have heard that negotiations stalled partly because the discussions on defining environmental good had got to the point where environmental might be quite pointless, because the scope had become so broad.

Emily might want to come in here, but I just want to flag a recent report from ClientEarth, the legal experts. This also relates to a question from Lord Oates earlier. It set out that long-held assumptions about the inflexible nature of trade rules can lead to a lack of political will to introduce environmental protection measures. It notes that measures like environmental protection and PPM—process and production measures—can be justified according to environmental protection reasons, and even though they have been controversial under WTO law they are not prohibited per se.

There is definitely a broadening approach that can be seen at WTO level for noting environmental consideration reasons. As is noted in the

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<sup>6</sup> Environmental Goods Agreement

appellate body itself, WTO rules should be interpreted as evolutionary by definition, not static, so I think there is an opportunity for the UK to utilise its new status at the WTO and press for reform.

**Susan Stone:** I could not support that statement any more strongly. There is room within the WTO. It is seen as a barrier, but there is a lot of room there. There are a lot of exceptions under which countries can implement environmental regulations and address these issues. The WTO has a lot of flexibility in those. It comes down to a matter of interpreting them on a discriminatory basis, but there is a lot of room there.

Q18 **The Chair:** That is probably a very good note to end the evidence session on, unless any of our three witnesses want to add anything further to the very clear answers they have given. Dr Lydgate, do you have anything to add?

**Dr Emily Lydgate:** I would say one other thing, which is that obviously we do not have very much information about what will be in the Act. As another example of how these processes are complementary, one of the big issues is how to define fossil fuel subsidies. The OECD, for example, says that the UK has quite a few. The UK says that has none. Therefore, just having a trade agreement and hammering out what the criteria are and categorise them will give a big push to Friends of Fossil Fuel Subsidy Reform and other multilateral efforts.

**The Chair:** That is a very good point. Ms Stone, is there anything you want to add?

**Susan Stone:** I want to go back to the discussion on impact assessments. We are doing some work for some members to look at the effectiveness of impact assessments and where they can be most impactful on the process. As was pointed out, the EU has quite an onerous process and it may not be appropriate in all circumstances, so we are looking into that. To that extent, when it comes to feeding into the negotiation process, timing is very important if you want it to be a live, ongoing effort.

As was mentioned, critical reviews in the UK are often done by independent consultants. One of the problems that we have found in our analysis so far is that these independent consultants do not always apply the same criteria and do not always use the same methods. Often, different impact assessments come out through different processes that have different answers, but it is based more on the methodology than the underlying criteria of the agreement. I just wanted to flag that.

**The Chair:** That is very helpful, Ms Stone. Thank you very much indeed. If, when you have looked at this, you reach any conclusions that you are able to share with this committee, we would be very interested to see what you have to say.

**Kate Young:** There is another recent report, by the Trade Justice Movement, which I will send through to the committee, which is an

excellent, very detailed discussion of fossil fuel subsidy reform and how the WTO has effectively allowed the banning of useful subsidies for environmental goods and services, particularly in renewables.

Secondly, the most important point, which Emily has already made, is that DIT and the Government have a comprehensive strategy. It is so clear from these sorts of discussions that there are so many unintended risks and opportunities that the UK Government need to focus on and capitalise on, and I would just urge the Government not to rush into FTAs but to really think about how they can support our climate agenda.

**The Chair:** I think you have made that overall strategy point very clearly and I thank you very much.

I thank all three of you very much indeed for your engagement, for the clarity of your answers and for the work that you have done on this. We are very appreciative. It gives us a lot to think about.