

INTERNATIONAL TRADE COMMITTEE
INQUIRY INTO TRADE AND THE ENVIRONMENT

Memorandum from the City of London Corporation

Submitted by the Office of the City Remembrancer

Introduction

1. The City of London Corporation welcomes the opportunity to respond to the International Trade Committee's inquiry into trade and the environment. The UK financial and professional services (FPS) industry contributes over 10% of the UK's total economic output and employs more than 2.3 million people, with two thirds of these jobs outside London. It is the largest taxpayer, the biggest exporting industry and generates a trade surplus almost equivalent to all other net exporting industries combined.
2. The City Corporation works closely with a wide range of stakeholders to promote the UK-based FPS sector. These include Department for International Trade, the Treasury, the Foreign, Commonwealth and Development Office and London and Partners. The common goal is to sustain prosperity and stimulate economic growth in London and across the UK through global trade and investment.
3. The City Corporation is dedicated to supporting a vibrant and thriving Square Mile as part of a globally successful and sustainability-focused UK. How the UK develops its approach to international trade will play a major role in this success.
4. Services provide the glue which keeps the international trading system functioning. Without appropriate services - from the ship which transports the goods, to the bank which provides the financing - international trade would not be possible.
5. Environment, social, and governance (ESG) issues are a priority focus area for the City Corporation both in its overarching approach to FPS and in its day-to-day work. As part of this, the City Corporation has engaged in a wide range of stakeholders and its own internal research.
6. In hosting the Green Horizons Summit at COP26 and acting as the secretariat for the ESG workstream of the International Regulatory Strategy Group (IRSG) the City Corporation aims to take a leading role in providing a forum for ESG related discussions and financial and professional services sector policy views. Included in this are reports on international trade in environmental services and UK and EU approaches to carbon pricing which would be of relevance to this inquiry and the work of the committee.
7. In order to achieve net zero and climate goals, the UK will need to take a holistic approach. The City Corporation supports and would encourage continued engagement from across UK Government in initiatives in this space. Whether it be further advancement of WTO definitions of environmental services, development of carbon pricing mechanisms, discussions on ACCTS, or advancement of policies and regulation which support environmental services more widely, the UK has a leading role to play in increasing international awareness of and the policies surrounding environmental concerns.
8. The submission below draws on two recent substantive City Corporation reports which form part of the City Corporation's wider work in the environmental/ESG space. The City Corporation would be happy to provide further information on any aspect of its work to the Committee.

Carbon Pricing Mechanisms

9. Carbon pricing is widely considered an effective instrument for reducing carbon emissions and is a necessary tool for combatting climate change. It has the potential to guarantee reduced emissions and should be at the core of efforts to reach net-zero.
10. Carbon emissions are a global problem, so international collaboration is essential in implementing a global solution. Whilst climate change requires speedy action, policymakers should be mindful of an overload of new instruments, and jurisdictions creating their own potentially incompatible domestic policies. An increase in siloed regulation could risk the success of market participants, particularly where new policies lack alignment with current and future international regulations and norms. As companies increasingly price carbon internally, global standards are necessary to ensure an equal level-playing field across the globe. Policymakers must ensure cooperation on the international stage; this will enable the establishment of consensus around global principle-based standards and transparent approaches to regulation.
11. In light of this, the City Corporation and Norton Rose Fulbright produced a discussion paper, *Discussing EU and UK approaches to carbon pricing as a tool towards net-zero emissions targets: implications for financial markets*, which investigates global climate ambitions and carbon pricing instruments.¹ The report not only describes the global landscape of carbon policies, but also the role of financial services and markets in this.
12. The paper outlines the case for UK policymakers to take global considerations for carbon pricing into account when shaping their own approach. With the EU's CBAM set to start in 2026, exemptions to comply will only be applicable to countries participating in the EU ETS and those having linked their own ETS to the EU's. As the UK ETS is not directly linked to the EU ETS, it cannot currently be exempted from the CBAM and so avoiding vulnerability depends on maintaining similar price levels and market design.
13. For instance, the UK has its own system of free allocation and, if this system is maintained as the EU transitions away from free allocation, UK industries will increasingly face greater exposure to the CBAM since their actual carbon costs will begin to diverge significantly from EU competitors. Given its close trading ties with the EU, the UK risks being among the most exposed trading partners as the CBAM expands to new sectors – exports to the EU account for almost half the value of the UK's total goods exports.
14. The EU currently still is the top trade partner for the UK - given that legislation in the EU is currently considering extending the scope of the CBAM regulation, the UK could end up paying more for exports as more products are likely to be affected in the near future.
15. If the UK fails to coordinate, or keep pace with the leading international ambitions in this regard, important UK exports are likely to be penalised by various CBAM.
16. However, the UK remains ambitious in its plans to reduce its carbon footprint and has also expressed an interest in a CBAM of its own, since it faces similar challenges to the EU with industrial competitiveness in the face of significant carbon prices. This could potentially

¹ City of London Corporation and Norton Rose Fulbright LLP, *Discussing EU and UK approaches to carbon pricing as a tool towards net-zero emissions targets: implications for financial markets*, October 2021. Available here: <https://www.cityoflondon.gov.uk/supporting-businesses/economic-research/research-publications/eu-and-uk-approaches-to-carbon-pricing>

result in two similar systems which would give more ground for coordination and linking between the two.

Role of international trade in environmental services

17. Recent research has illustrated the extensive and growing importance of the UK financial and professional services ecosystem as a vital enabler of international trade. These trends highlight a need for greater understanding of the role and impact of services in the international trading landscape.
18. Trade and sustainability are increasingly overlapping policy areas. Supporting the journey to net zero will require deeper understanding of this interconnectivity.
19. Evidence collected from Eurostat indicates that UK output of “environmental goods and services” (EGS) totalled approximately £87.0 billion in 2018, with exports totalling approximately £11.3 billion. This suggests that the UK is Europe’s third largest producer of EGS (behind Germany and France) and third largest exporter (behind Germany and Austria).
20. Caution should be applied when interpreting such figures, as there is no fixed definition of environmental services. In the UK for example, there has been significant recent growth in both “sustainable finance” services and environmental consulting services, which are not fully reflected in the Eurostat figures. The true scale and economic impact of environmental services may therefore be greater than captured in official statistics
21. To date, national and international efforts at harnessing the power of trade in support of sustainability objectives have focused largely on trade in ‘environmental goods’. This includes lowering tariff barriers for environmentally related products and attempts to expand definitions. Trade in environmental services – services which are in some way environmentally related – is less well understood. Increasing our knowledge of environmental services is crucial to better understanding the international economy.
22. The City Corporation commissioned a report from KPMG, *The international trade in environmental services: barriers to trade and recent approaches to liberalisation*, to provide an overview of the current international structures surrounding environmental services.² As research in this space remains limited, the City Corporation’s ambition for this report is to prompt further thinking into the role of environmental services trade in achieving net zero objectives.
23. The report highlights the important role environmental services play in supporting the trade in environmental goods. The report also outlines the current challenges facing environmental services trade and policymaking in this space. This includes the limited reach of definitions and metrics, stalled multilateral negotiations, and regulatory barriers to trade in services.
24. Defining environmental services is important for measuring the scale and trends in activity over time, for understanding the relevant barriers to trade, and for ensuring that there is a consistent policy dialogue between countries. The “traditional” approach to defining environmental services – used, for example, in negotiating the General Agreement on Trade in Services (“GATS”) in the early 1990s – has been to define environmental services based on

² City of London Corporation and KPMG, *The international trade in environmental services: barriers to trade and recent approaches to liberalisation*, September 2021. Available here: <https://www.cityoflondon.gov.uk/supporting-businesses/economic-research/research-publications/international-trade-in-environmental-services>

a narrow set of activities related to municipal utilities (such as sewage and water treatment) and the reduction of certain industrial emissions.

25. Since the negotiation of the GATS, however, this research indicates that the range of services that are in some way environmentally related has expanded significantly. A range of alternative definitions have therefore been proposed which encompass a broader range of activities, such as engineering, construction and certain business services. However, expanding the set of relevant services within the definition of environmental services raises new questions and issues, and there remains no agreed definition.
26. The City Corporation welcomes and supports HM Government's work on the Trade and Environmental Sustainability Structured Discussions (TESSD) at the WTO. The updated 2022 workplan and the inclusion of trade related climate measures and environmental goods and services as two of the three informal working groups. These discussions will be crucial to updating and advancing the WTO's approach and revitalising discussions surrounding environment and trade at the WTO.
27. The report also examines the evidence on the role of these services in supporting the trade in environmental goods. The evidence suggests that a broad range of services – including engineering, design, and financial consulting – are critical in facilitating the trade of certain environmental goods (such as wind turbines and water filters). This supports the notion that a broad range of activities could be classified as environmental services, and suggests that barriers to trade in these services could have wider implications for the trade in environmental goods.
28. Importantly, however, environmental provisions are much broader than dealing with the promotion of trade in environmental goods and services. They include elements such as commitments to uphold environmental laws and to ensure that trade liberalisation does not damage environmental protection. The research suggests that although environmental provisions have been included, in general, the coverage and extent of commitments to the trade in environmental services are often limited in RTAs.
29. A notable counter-example, however, is the ongoing negotiations over an Agreement on Climate Change, Trade and Sustainable Development (ACCTS) between six WTO members (Costa Rica, Fiji, Iceland, New Zealand, Norway and Switzerland). The ACCTS proposes to substantially reduce barriers to trade in both environmental goods and services, and to extend the agreed concessions to all WTO members on a most favoured nation basis.

International regulatory landscape and coherence

30. Unnecessary barriers distort trade and reduce competitiveness. These also add to costs for businesses, meaning that, in particular, the ability of the strong UK SME sector to engage in cross-border trade is limited.
31. While market access for goods and products mainly involves measures at the border, such as customs duties or quantitative restrictions, market access for services relates more to the application of domestic regulation behind the border.
32. These types of restrictions can include establishment requirements linked to quotas, joint-venture requirements, residency requirements, restrictions relating to the corporate form of a service-supplier, equity caps and nationality obligations. Indeed, a great deal of services regulation is achieved through qualifications and ongoing personal regulation of the service provider, which is often not designed to facilitate cross-border services.

33. The main barriers to high-value services trade are regulatory. FTAs should create the frameworks and establish the principles for ongoing regulatory cooperation, which seeks to identify and reduce barriers. A good example of this is the regulatory cooperation structures included in the UK-Japan CEPA
34. The UK-US Financial Regulatory Working Group (FRWG) as an example of good practice in regulatory cooperation which falls outside an FTA. Learnings from this model could be applied to future regulatory cooperation mechanisms both in terms of transforming trust into meaningful dialogue and engaging with the FPBS community.
35. With regard to global regulatory coherence, the City Corporation, alongside TheCityUK and through the International Regulatory Strategy Group (IRSG) published a report outlining the importance of global regulatory coherence, *Global solutions to global problems: promoting regulatory coherence in financial services for pandemic recovery*.³
36. The report finds that global regulatory coherence and consistent implementation of global standards in a way that fosters cross-border activity encourages fair and open competition, benefiting customers, firms and their regulators alike. It argues the case for a renewed commitment to “global solutions to global problems”, with practical examples on where market fragmentation may give rise to financial instability and other risks. This report also makes recommendations as to how local and international bodies can ensure this principle remains central to their work in the coming months and years. It makes recommendations in three specific areas – to foster operational resilience, to encourage innovation in digital governance and to incentivise sustainable finance.
37. International collaboration over relevant regulations and standards with regards to liberalising the trade in environmental services is of crucial importance. This approach has been a particular focus in the area of sustainable finance. Indeed, various international organisations such as the International Organisation of Securities Commissions (IOSCO) and the International Financial Reporting Standards Foundation (IFRS) are working to establish and encourage global standards and definitions. These approaches represent potentially important developments for the international trade in sustainable finance, and may provide lessons for other environmentally related services.

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³ International Regulatory Strategy Group (IRSG), *Global solutions to global problems: promoting regulatory coherence in financial services for pandemic recovery*, March 2021. Available here: <https://www.irsg.co.uk/resources-and-commentary/irsg-report-global-solutions-to-global-problems-promoting-regulatory-coherence-in-financial-services-for-pandemic-recovery/>