

Written evidence submitted by UK Trade Policy Observatory (NZT0013)

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How can trade help in the pursuit of net zero?

- 1) It is likely impossible to achieve net zero emissions without including trade and trade policy as central elements of domestic strategy. Decarbonizing national economies requires increasing demand for low-carbon goods and services, and decreasing demand for high-carbon goods and services. Trade policy is implicated in numerous elements of this transition, including international trade disciplines on subsidies, both fossil fuel and green; facilitating trade in environmental services; international implications of the introduction of performance standards and labels, and addressing tariff barriers to environmental goods. Stricter climate measures cost more for domestic industries, giving rise to concerns about uneven costs of the low carbon transition. This has led to border carbon adjustment in the EU and (imminently) the UK, to prevent manufacturing emissions from shifting to less regulated locations.
- 2) Even if countries do not foreground climate change as a strategic objective, it is having, and will continue to have, an enormous influence on trade patterns, preferences and supply chains, necessitating strategic thinking. This is due to the effects of climate change (the most obvious example today being water shortages in the Panama Canal), the need to ensure energy security and access to critical raw materials, and the need to continue to compete in a global economy in which low carbon technologies are increasingly attracting public and private investment (the most obvious example being the U.S. Inflation Reduction Act).
- 3) For the reasons set out above, UKTPO has strongly argued for a shift in approach net-zero policymaking, in commissioned work for the Committee on Climate Change¹ and other fora. This shift involves removing the silo between trade and climate policymaking and adopting a more integrated approach. This is particularly important as both most national net zero targets and the Paris Agreement focus largely on commitments to reducing domestic (territorial) emissions.

Is the UK's trade policy consistent with its goals for net zero?

- 4) Whilst the global economy as a whole is interdependent, necessitating an integrated approach to trade and climate policymaking, this issue is particularly pressing in the UK. The UK has the largest domestic emissions reduction among major economies, but as a services-led economy, per-capita imports of emissions account for nearly half of its overall consumption emissions.² This risks the UK simply outsourcing its emissions to other countries.
- 5) Discussion of the relationship between trade and climate in the UK has been limited. Whilst there are pockets of activity, such as the UK's consultation on the introduction of CBAM and its critical minerals strategy, there is no overarching strategy. At the Chatham House Global Trade Conference in March 2024, when asked why climate change isn't included in her 5 priorities for trade,³ Kemi Badenoch stated that 'not everything can be a priority for

¹ <https://www.theccc.org.uk/wp-content/uploads/2022/06/Trade-policies-and-emissions-reduction-establishing-and-assessing-options-UKTPO.pdf>

² See, eg: <https://committees.parliament.uk/publications/9570/documents/162115/default/>

everybody'; and emphasized that she is prioritizing economic growth.⁴ Given the strategic importance of climate change for global trade patterns, however, achieving sustainable economic growth requires foregrounding the low-carbon transition. UK allies have taken this connection seriously, as evidenced by the Biden Administration's emphasis on the low carbon economy as the centrepiece of 'Bidenomics.' The European Green Deal is another example of integrated thinking.

- 6) The UK has positioned itself as world-leading in climate change mitigation but it has not been particularly forward-looking in developing trade and climate policies. It has reacted rather than responded.

How can the UK's trade policy further help with its goals for net zero?

There are ways in which the UK can utilize trade policy more effectively. These include:

Subsidies:

- 7) **Policy consistency.** The UK faces fiscal constraints and cannot compete with, for example, the US in its low carbon incentives. But simply maintaining consistent market signals will make it better able to compete in the low-carbon economy. UK targets and schemes supporting phase out gas boilers, installation of solar panels, heat pumps, insulation, and electric vehicles have been introduced but then withdrawn, redesigned, or communicated unclearly to households and industry. The most recent progress report of the Committee on Climate Change details some of these issues;⁵ Rishi Sunak's moving of the target for phasing out conventional petrol and diesel vehicles from 2030 to 2035 is an immediate example.⁶ With Brexit compounding investor uncertainty, and prospective EV tariffs with the EU in 2026 also chilling investment,⁷ policy uncertainty provided significant headwinds for low carbon investment in the UK. The corrective for this is fairly straightforward: renewable energy incentives that are consistent and communicated clearly, and based in a longer-term strategy.
- 8) **Be careful about local content requirements.** UK low-carbon subsidies can introduce so-called local content requirements that stipulate that the materials have to be manufactured here, as the US has done. However, there is a risk of retaliation or challenge. For example, the EU initiated a WTO challenge against UK local content requirements in the Contract for Difference Scheme at the WTO and dropped the challenge when the scheme was reformed. The UK must assess the short-term and long-term economic implications of such measures. It must assess the legal implications under existing trade rules, and pursue discussions with trading partners accordingly. The UK's broader economic interests are served by open trade and an effective rules-based system. Delinking from a rules-based trading order will not serve its larger interests.

CBAM:

³ <https://www.gov.uk/government/speeches/trade-secretary-my-top-five-priorities-for-trade>

⁴ <https://www.chathamhouse.org/2024/03/role-uk-global-trade-landscape>

⁵ <https://www.theccc.org.uk/publication/2023-progress-report-to-parliament/#key-messages>

⁶ <https://www.fleetnews.co.uk/news/latest-fleet-news/electric-fleet-news/2023/09/20/industry-reacts-to-talk-of-delay-to-2030-new-car-and-van-fossil-fuel-ban>

⁷ <https://www.reuters.com/business/autos-transportation/eu-council-approves-extension-current-rules-electric-vehicle-trade-with-uk-2023-12-21/>

- 9) Due to the UK's trade exposure, including to the EU, we support the UK's introduction of a Carbon Border Adjustment Mechanism. However, CBAM entails a complex set of requirements, and due to the UK's smaller market size, introducing an approach to CBAM that differs from the EU's approach risks creating significant burdens for industry, as well as complexities in Northern Ireland.⁸ Without the EU's regulatory design to shelter behind, the UK is also more exposed to diplomatic pressure and potential trade disputes and retaliation.

Thus we recommend:

- Linking the UK and EU ETS will prevent the UK from bearing both costs and administrative requirements of CBAM. This will also resolve problems with CBAM administration in Northern Ireland.
 - The UK should introduce a phase-in reporting period for its CBAM starting in 2026, to bring it closer in line with the EU timescale.
 - Consider the position of the UK Emission trading scheme free allowances with the introduction of the CBAM. The UK could do the same as the EU planned – phase out the free allowances gradually with phase-in CBAM.
 - The UK should adopt the same methods for calculating emissions and sectoral coverage as the EU.
 - The UK will need to operate a separate system of conformity assessment. However, it should seek to 'piggyback' on EU enforcement systems where possible. For example, the EU requires third-party certification. The UK system should be similar enough so that the same certifiers can assess compliance with UK CBAM requirements.
- 10) There is one area, however, where we recommend that the UK should depart from EU CBAM, and that is the exemption of charges to Least Developed Countries. This would not undermine the UK's climate-related goals as the proportion of imports of CBAM'ed goods is very small. However it would address some of the concerns about economic impacts of CBAM on poor countries.⁹
- 11) The UK should also leverage its position as a knowledge economy or mainly comprising services-based industries, in order to provide necessary technical and technological support to poorer countries to comply with CBAM requirements. Doing so will help the UK manage future risks of legal challenges to the measure.

Critical Minerals:

- 12) The UK's trade policy relating to critical minerals is important to climate change, as critical minerals are inputs to several industries that manufacture goods necessary for the green transitions, for instance, the EV industry. However, trade in critical minerals, climate change and sustainability are not yet integrated in UK trade policy tools. An approach along the lines of the EU's approach to critical minerals and chapters specific to energy and critical minerals should be considered. Moreover, the UK should analyse whether it has the industries that require critical mineral imports or the capacity to build them or even the need to build them. In accordance to the outcome of this inquiry, the UK should adopt a targeted approach to securing critical minerals or their downstream products, using its trade policy.

⁸ <https://citp.ac.uk/publications/where-technical-meets-political-the-complexity-of-the-eu-cbam-in-northern-ireland>

⁹ <https://citp.ac.uk/publications/exempting-least-developed-countries-from-carbon-border-adjustments-a-legal-and-economic-analysis>

Diplomacy:

- 13) Underpinning many of the recommendations above is the need to work closely with allies, primarily the EU, in order to build low carbon supply chains.
- 14) The UK should continue to play an active role in TESSD negotiations at the WTO. It should also try to leverage its soft power to call for, and support, discussion and cooperation on standards (for example, through the International Deep Decarbonization Initiative, at the OECD, through the BSI, ISO and CEN/CENELAC processes).
- 15) The UK should leverage its technological, green finance and environmental services-based expertise to support trading partners to adopt necessary climate measures.

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