CBI RESPONSE TO THE INTERNATIONAL TRADE COMMITTEE INQUIRY INTO COP-26 AND INTERNATIONAL TRADE

A. *The CBI welcomes the opportunity to respond to the International Trade Committee's inquiry into COP-26 and International Trade. The CBI is the UK's leading business organisation, speaking for some 190,000 businesses of all sizes, sectors, and regions, that together employ around a third of the UK private sector workforce. The inquiry is timely given the upcoming opportunities to commit further to trade and climate goals as part of COP-26 in Glasgow and position the UK as a global leader in Green Trade.*

Introduction

1. Tackling climate change is a global challenge that requires unprecedented cooperation between governments and business. With COP-26 imminent, the UK should set the bar high by incorporating climate into trade policy and contributing towards carbon neutrality. As the world recovers from the pandemic and accelerates towards an economic recovery, we need to ensure that trade becomes more sustainable and decreases carbon emissions.

2. For this to happen, there needs to be a shift in the narrative on climate and trade to emphasise that environmental sustainability is at the heart of enterprise competitiveness and not a hinderance to economic prosperity. International cooperation will be key to meeting goals for climate action and the UK government must highlight that a sustainable business can, and indeed should, aim to be successful and profitable. According to the World Bank, the world will need to make significant investment in infrastructure over the next 15 years –around £65 trillion by 2030 to meet economic demand globally. These investments can only be made in an environment which is commercially viable. Transitioning to a green economy can unlock new economic opportunities and jobs. An investment of approximately 72p, on average, yields £3 in benefits globally.[1] A greener economy is also more profitable over the long term – this needs to be emphasised by the government multilaterally as well as domestically.

3. The Environmental, Social and Governance (ESG) framework offers a strong value proposition for firms. Those ahead of the game with their climate credentials often increase market share, attract, and retain talent and are seen favourably by investors. This is a growing global market. So, there are big prizes for those sectors and types of firms that operate in the low-carbon space. The UK has a genuine chance of being a world leader in areas like carbon capture and offshore wind as well as a significant player in electric vehicles. We have a real opportunity to become a significant exporter of high value, high innovation green products and services.

4. In November 2020, the CBI welcomed the announcement of the Prime Minister's Ten Point Plan for a Green Industrial Revolution, seeing it as a starting point to unlocking the significant opportunities for UK-wide low-carbon investment and green jobs that a net-zero economy can bring. However, to realise these opportunities requires government to move beyond climate ambition to climate action, urgently filling the gaps across the 10-Point Plan to provide the confidence to unleash new waves of global investment to deliver net zero. Government must also unlock opportunities internationally through developing a holistic UK green trade policy which promotes green trade, reduces tariffs on green goods, mitigates carbon emissions and sets standards to boost clean technology and finance and support a green recovery.

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[1] UN, https://www.un.org/en/climatechange/raising-ambition/climate-finance, Financing Climate Action, 2021.

5. CBI members support the UK government's progress so far on climate and trade and see it as a step in the right direction, whether it be eliminating tariffs on certain environmental goods as part of the new UK Global Tariff (UKGT), which goes beyond the EU's Common External Tariff (CET), incorporating sustainability provisions into UK FTAs or using FCDO led aid capacity building programs – to support developing countries transition to net zero. There is still scope for the UK to go further by using COP-26 to highlight the importance of increasing the number of countries liberalising their trade in environmental goods, emphasising climate to be at the core of WTO modernisation through promoting environmental services and creating international alignment in developing sustainable finance taxonomies, regulations, and policy frameworks to support climate risk mitigation.

6. **The UK should lead the conversation on WTO reform as the current trading system is not fit to meet modern challenges of climate change. To be successful it will require better integration and redesign of the WTO institutions and mechanisms.** For example, redesigning the trade policy review mechanism to include climate.

7. COP26 should set the tone, ahead of MC12, by highlighting the role of trade as an accelerator in the race to net zero. A powerful signal at this years' MC12 should therefore be to restart negotiations on the Environmental Goods Agreement (EGA), generating momentum in the stalled negotiations from the increasing political impetus behind efforts to tackle climate change and the growing economic benefits from environmental trade.

8. The WTO should go beyond liberalising tariffs on environmental goods and lean into discussions on regulatory harmonisation to promote international standards of environmental goods. Services also need to be a greater part of the green agenda as a critical enabler of the shift to low-carbon. The Structured Discussions on Trade and Environment Sustainability are a welcome start, but concrete actions must follow. Accelerated talks are needed in the normal negotiating committees on trade in services. An example where modernisation is needed is how the traditional trade categorisations of environmental services (e.g., waste management) do not encompass the modern business experience of architects designing energy efficient buildings or environmental consultants advising businesses on how to cut their carbon expenditure. If a revamped Environmental Goods Agreement proves possible, a fully-fledged Environmental Services Agreement should be the next step.

9. **The UK should consider joining negotiations on the Agreement on Climate Change, Trade and Sustainability (ACCTS) ahead of COP-26 to signal commitment to multilateral progress on trade, environment, and climate change.**

10. ACCTS was launched in the margins of the United Nations General Assembly (UNGA) in September 2019**.** It builds on the principles of the Paris Agreement and the Sustainable Development Goals and covers four key areas: removal of tariffs on environmental goods; establishment of new and binding commitments to facilitate trade in environmental services; establishment of disciplines to eliminate harmful fossil fuel subsidies and guidelines to inform the development and implementation of voluntary eco-labelling programmes and mechanisms. This makes the agreement the most forward leaning agreement on climate and trade and demonstrates what WTO reform in this area should look like.

11. **The UK must create alignment in its approach to carbon pricing with the EU and ensure it establishes an approach which fits in with the wider developments on carbon pricing globally.**

12. Carbon pricing is an international issue and, if the EU adopts a carbon border adjustment mechanism, there could be significant distortion of trade if the UK did not follow suit, e.g., diversion of cheap goods into the UK from low carbon price territories undermining the competitiveness of UK business. The UK government will need to consider the potential impacts if the EU adopts a carbon border adjustment mechanism and any measures required to address those impacts. While many businesses acknowledge the benefits of carbon border adjustments in principle, the detail and implementation will be critical for ensuring these operate as intended to support investment in low-carbon products and processes.

13. ***Emissions Trading System (ETS):*** CBI welcomes the commitment to 'serious consideration' of linkage of EU and UK ETS schemes under the TCA and call on both sides to start the process of linking the new UK Emissions Trading System (UK ETS) with the EU's Emissions Trading System (EU ETS) as soon as practicable. Given the similarities in systems, linkage should be straightforward. Making meaningful progress on the linkage between the UK and EU ETS would reaffirm the UK and the EU as climate leaders, ahead of COP26. A linkage would demonstrate commitment to Article 6 of the Paris Agreement, with the UK hoping to finalise the Article 6 framework as a key outcome of COP26. The linkage would also align decarbonisation pathways and create a stable environment for investment into low-carbon technologies. It would create a level playing field in terms of carbon pricing, avoiding competitive distortions, and leading to aligned cost implications for industry across the UK and the European Economic Area (EEA). This would minimise the risk of carbon leakage, and lower the costs of achieving Net Zero, facilitating trade and investment between the Parties as per the objective of the Chapter on energy in the TCA. The revenue obtained through the UK-ETS should be hypothecated where practicable to green technology.

14. ***Carbon Border Adjustment Mechanism (CBAM)*:** It will be important to understand how ETS linkage will work with the EU's CBAM. With the European Commission having published a package of legislative initiatives with the aim of reducing net greenhouse gas emissions by at least 55% by 2030, compared to 1990 levels, there is a real opportunity for the EU and UK to work together to tackle climate change and drive a more resilient, competitive, net-zero future. The CBI will be working with BusinessEurope on the detail of the proposals to find the right balance between climate ambition and ensuring industry's competitiveness. Included in this package is a proposal for a Carbon Border Adjustment Mechanism which will put a carbon price on imports of a targeted selection of 'high risk' goods, to avoid 'carbon leakage'. When it comes to carbon border taxes, we risk seeing a patchwork of measures being introduced across the world. We are therefore calling for the development of coordinated market-based mechanisms.

15. Carbon Border Adjustment Mechanisms are one such tool, which in principle could support domestic low-carbon manufacturing and production; however, the implementation of such measures comes with significant risks, including the creation of multiple carbon borders that could entrench disparities between areas of high and low emission activities.

16. The IMF estimates a carbon price of around $75 per tonne of CO2 will need to be in place by 2030 if the rise in global temperatures is to remain below 2 degrees. That will require carbon price in the EU to almost triple, implying an average applied CBAM tariff of approx. 6 per cent on

the countries without a similar carbon pricing regime. Without an equivalent mechanism, this could affect, either directly or indirectly, all UK sectors that depend on imports of the goods concerned into the EU. This may in turn have an impact on global trade flows and purchasing decisions.

17. CBAMs depending on the way they are designed may also risk being incompatible with WTO rules, and therefore could become undesirable to be adopted globally. Additionally, there has been reoccurring criticism that the CBAM masks protectionist measures to protect domestic producers from competitive imports. Therefore, a global approach to carbon pricing needs to be initiated in the longer term by the WTO.

18. **New UK trade agreements should include provisions that facilitate trade in green goods and services.**

19. As the UK continues to deliver on its ambitious schedule to sign new trade agreements, there is scope for the first time to be innovative in how we incorporate climate provisions into Free Trade Agreements (FTAs) that would help meet climate goals. An important aspect of achieving these goals is to address barriers to trade on green goods and services and coordinate carbon pricing mechanisms.

20. The UK government has made progress in incorporating climate goals with FTAs for example, through the commitments in the UK-EU TCA. These bilateral agreements not only provide a clear signal to industry on the importance of green trade but, where they can be agreed, can also provide the building blocks for new green rules and standards which will underpin future sustainable trade growth and the climate benefits that delivers.

21. The UK government should also consider revising Sustainability Impact Assessments, so that more equal weighting is given to assessing the economic, environmental, and social impacts of trade agreements.

22. **COP26 will be an important platform to agree the rules and standards which will support further growth in international green investment.**

23. The UK is already a leading light in green finance and this needs to be developed alongside industry, not just those in financial services but also those in industries where there could be a knock-on impact for instance carbon intensive industries and those with existing investment portfolios who will need to limit their exposure.

24. **At a global level, the UK government's priority should be to increase international alignment in developing sustainable finance taxonomies, disclosures, regulations, and policy frameworks**, as recommended in the B7 Joint Statement on Climate and Biodiversity. Otherwise, it will be impossible to scale up sustainable financing internationally.

25. If we are serious about solving environmental problems on a global scale, rather than just shifting them around the world, the move towards commons sustainable finance standards and policies is a "must-have". From the perspective of UK businesses specifically, without global cooperation and alignment, it will be much more difficult to promote the British financial services industry as a centre of excellence and to sell services into other markets. Where policy

and standards diverge, we see local markets more dependent on local resources and local expertise instead, which limit the exchange of knowledge and the expansion of business opportunities.

26. **The CBI is looking forward to the establishment of the International Sustainability Standards Board (ISSB), under the IFRS Foundation, which has the unique opportunity to standardise global sustainability reporting and limit reporting burdens across borders.**

27. We welcome the IFRS Foundation's intention to focus on climate-related metrics first and rely on the TCFD-framework to ensure a broad application of their standards. The work on the TNFD is progressing at pace, hence, we recommend that the ISSB looks at standardising biodiversity-related metrics in due course to avoid the proliferation of regional standards. The UK government needs to make sure that all domestic regulations take these international developments into account and are fit for cross-border alignment according to the "building blocks" approach proposed by the IFRS Foundation. It will be difficult to transition the global economy to a sustainable model, without establishing initiatives such as global carbon markets that put a price on emissions and prevent carbon leakage to different parts of our planet. For example, now, national carbon markets are not properly linked, or, in many regions, they do not exist at all. Hence, jurisdictions such as the EU resort to introducing suboptimal legislative solutions to prevent carbon leakage, such as the Carbon Border Adjustment Mechanism.

September 2021