The UK must develop a cross-cutting strategy for trade and climate policy in order to become a world leader in both


Chloe Anthony *and* ***Emily Lydgate*** *write that, while the potential for conflict between trade and climate policy is high, the UK could create coherence between the two. They explain how.*

Due to differences in underlying logic, there is much potential for trade and climate policy to conflict. Fundamentally, world trade rules and agreements aim to facilitate the free movement of goods and services, and restrict subsidies that distort trade. Climate policy, on the other hand, aims to support the low-carbon economy and restrict trade in high-carbon goods and services. The UK was the first country to put its climate target into law in 2008; it has met its first two interim targets for emissions reduction and is on course to meet the third in 2022. Yet analysis has shown that the first two emissions targets were met due to changes in accounting methods and the financial crisis, rather than due to effective policymaking.

The COVID-19 pandemic has led to an unprecedented reduction in global carbon emissions coupled with a fall in economic output. But net zero targets set out in international and UK climate law require substantial emissions cuts year-on-year. It is likely that the UK will need to increase green subsidies and restrict high-carbon goods and services. This does not sit well with the current lacuna in climate policy that has occurred as a result of Brexit and the imperative to negotiate free trade agreements the world over.

The UK should include trade-related emissions to its domestic targets

The UK Climate Change Act commits the UK to achieving net zero emissions by 2050, but this target does not include emissions from trade, including from aviation, shipping, and international production and consumption. This is in line with the approach of the UNFCCC and Paris Agreement, but these emissions are significant. If included, the UK's emissions would be 50% higher and the UK's independent Committee on Climate Change continues to recommend they are.

Because the Paris Agreement does not determine which policy tools are acceptable for achieving the climate target, the WTO has been a primary international forum regulating climate measures. WTO rules allow countries to retaliate against subsidies that are aimed a specific industries, sectors or regions, provide a financial benefit that improves on market conditions and injure their domestic industries. In practice, it is green and not black subsidies that have provoked action in the WTO arena, and these disputes have left key questions unanswered, notably the WTO-compatibility of government-sponsored green investment and innovation funds on which much UK climate action relies.

The introduction of the more ambitious net zero target also dovetails with a period in which COVID-driven economic disruption suggests a longer trend of increased state support and investment. Against this backdrop of increasing subsidisation, countries are reluctant to notify the WTO as required, making it difficult to assess how subsidies are being used, and WTO oversight has been ineffective. Whilst this might suggest that the compliance of UK climate policies with WTO rules is not of major concern, it also increases the volatility of the world trading system and the likelihood of countries taking retaliation into their own hands (as the EU's recent trade enforcement reform showcases).

Green subsidies need firming up and greater ambition

The UK has been a leader in market-based climate policy, but the Climate Change Committee and others highlight that slow policy development and frequent changes to schemes have hindered the path to a green economy – a current example being the Green Homes Grant, a £2bn programme suffering from a 95% underspend that is not being rolled over to the next financial year. Despite recent policy announcements – the Ten Point Plan and the Energy White Paper – government climate policy remains very much in development with frequent reference to future strategies, consultations, and plans.

The Climate Change Committee published the Sixth Carbon Budget for the period 2033-37 in December 2020, the first budget in line with the new net zero target. The government is required to legislate on this by the end of June 2021 and the Committee's preferred pathway relies on very significant drops in high-carbon technologies. But, on the government's own estimates, new policy measures will only make up 69% of the shortfall on interim targets. And some headline measures, like green investment funds or energy efficiency standards in vehicles, are legally uncertain. Compliance with WTO rules for green investment funds centres on whether it provides a benefit better than market rates and product bans can be controversial. There is clearly a need for a firming up of policy and ensuring coherence with trade rules.

Subsidies for fossil fuels should be transparent and reduced

The G20, G7, and European Commission have all pledged to phase out fossil fuel subsidies. Such action would be a win-win for trade liberalisation and reaching net zero targets, but countries have made limited progress on achieving this goal – one tracker found the UK top of the G7 in pledges, but bottom in transparency. The UK claims it does not provide any subsidies for fossil fuels, but analyses by the European Commission and the OECD suggest it does. This is due to different approaches to calculating subsidies. The Commission, for example, found the UK to be the largest provider of support for fossil fuels in the EU at €11.6 billion per year (in contrast to €7.76 billion for renewables), highlighting tax reliefs for energy-intensive industry and UK households.

The government also continues to support a strategy of a 'secure and resilient supply of fossil fuels during the transition to net zero' and has recently approved a new deep coal mine after the last was closed in 2015, despite the voicing of concern by the Climate Change Committee and others. Reducing fossil fuel subsidies would improve compliance with WTO rules and is coherent with climate policy. The UK should reform its approach to fossil fuel subsidies by improving transparency of its subsidies in line with WTO rules, by providing more detail on how it will achieve a 'net-zero continental shelf by 2050' and by increasing coherence between climate policy and fossil fuel policy.

As a member of the EU, the UK participated in the EU emissions trading scheme (ETS) and operated a domestic carbon tax, the Carbon Price Floor. On leaving the EU, the UK established a UK ETS. Carbon pricing schemes differ greatly around the world leading to industries in countries with high carbon taxes facing pressure from imports from countries with lower tax burdens. Raising or broadening carbon taxes is necessary – the Grantham Institute estimates the price per tonne of CO_2 will need to triple by 2030 to achieve the net zero target – but this risks increasing the asymmetry between the UK and other countries.

The EU-UK Trade Agreement saw unprecedented commitments on climate policy, but it's uncertain precisely how they will cooperate in the future with the linking of their carbon pricing systems only to be given 'serious consideration'. The UK, in line with the EU's approach, has offered free ETS allowances to energy intensive industries. Although never challenged at the WTO, this may be interpreted as an actionable subsidy. The balance between an effective carbon tax and its impact on trade is not easy to achieve and international cooperation is required.

New trade agreements should include climate commitments and facilitate trade in low-carbon goods and services

One solution to carbon pricing problem is border carbon adjustment (BCA): import fees for countries with low or no carbon pricing mechanism. BCA has long been discussed in the EU and the Commission is poised to introduce a detailed proposal this summer. Compliance with WTO rules rests on how they are designed, but compliance risks lowering the effectiveness of BCA in incentivising a reduction in emissions both domestically and internationally. In this sense, WTO compliance may indeed conflict with achieving the net zero target. This friction would be removed, however, if there was international agreement on a global or regional carbon pricing mechanism.

Barring global agreement and action driving the transition to a low-carbon economy, possibly the most significant solution to integrating trade and climate policy is through trade agreements themselves. Free trade agreements (FTAs) have the potential to remove trade barriers on energy efficient goods and services, align commitments to green subsidies and reduce fossil fuel subsidies, and coordinate carbon pricing mechanisms, all reinforcing action towards to net zero targets. There has been some recent progress in tying in climate ambition with FTAs, most notably the EU-UK TCA. The EU FTAs with Singapore, Japan, and Canada have also included climate-friendly provisions, although they are generally non-binding. Countries may also wish to use FTAs to secure favourable terms for their high-carbon exports. The UK could aim for climate-friendly FTAs by including 'climate red lines' in its negotiations, but when potential partners are not willing to integrate trade and climate policy, this will be an area of hard choices for the UK government.

Note: *the above draws on the authors' recent briefing paper and article in Environmental Law Review.*

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