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Joint Briefing

Leveraging trade policy and carbon border mechanisms to tackle consumption emissions and carbon leakage

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Introduction

Significant work is needed to align UK trade policy with the government’s net zero commitments. This applies to trade policy in the round, and a suite of policy mechanisms will be required to comprehensively tackle the interconnected and complex challenges of consumption emissions and carbon leakage.

It is worth noting that the first and best way to tackle both consumption emissions and carbon leakage is increased climate action at home and abroad. While the UK has made good progress domestically in tackling territorial emissions, this is not the whole story.

UK consumption emissions, those associated with the goods and services we use, are 50 per cent higher than territorial emissions and have fallen much less dramatically. About 43 per cent of these emissions are generated outside the UK’s borders, in the production of products we import.¹ This is a significant source of carbon emissions which the government is now incorporating into its emissions calculations, and which trade policy should play a central role in addressing.

Benefits to the UK economy

There are strong domestic economic arguments for the UK to take more ambitious action to tackle consumption emissions and carbon leakage and to leverage its position as a convener to speed up climate action across the world. The UK is well placed to position itself at the forefront of global low carbon markets.

Trade policy is a key tool to deliver a net zero economy and should be designed to accelerate action on climate change and reduce UK consumption emissions. This would foster demand for innovative low carbon and resource efficient goods and services, create well-paying green jobs, increase productivity and spur greater domestic and international investment in UK industries.

Research from CBI and Aldersgate Group shows the extent of the opportunity and what is being left on the table in the absence of policy mechanisms to drive green growth.^{2,3} If the UK creates attractive conditions to pull global investment into domestic green industries, it can further establish these sectors, capture greater market share, and use our strong R&D base to produce the technologies, services, and innovation needed to scale up and drive decarbonisation across the UK economy. This also creates more opportunities to increase exports of UK based green goods and services to accelerate decarbonisation globally.

Supporting the delivery of net zero

Action to cut consumption emissions would also have a positive impact on territorial emissions, through greater emphasis on resource efficiency across the board. Approaching UK trade policy through this lens would build on a growing number of corporate commitments and increasing efforts by UK based businesses to reduce their supply chain emissions and ensure UK industries remain competitive and capitalise on the opportunities presented from leading the way in a rapidly decarbonising world.

A range of policy tools are available to realise these opportunities. This could include measures such as carbon border adjustments, product standards and incentives to support faster domestic industrial decarbonisation. Ultimately, a variety of measures will be needed, each designed to work in concert to comprehensively tackle consumption emissions and carbon leakage. Swift action from the UK is essential, as the US, EU and other large economies are moving quickly to take advantage of the economic gains offered by leading the way on decarbonisation.

Design and implementation principles

Whatever policy mechanisms the government decides to pursue, these should be underpinned by the guiding principles and specific design considerations set out below.

Guiding principles

- 1. Trade policy must be designed with emissions reductions in mind.** Policies to tackle carbon leakage and consumption emissions should first and foremost be seen as being about climate action, and the imperative to increase sustainability and reduce emissions across every facet of the global economy.
- 2. The UK's efforts to tackle consumption emissions and carbon leakage must be driven by the principles of Common but Differentiated Responsibilities (CBDR) and Special and Differential Treatment (S&DT).** The UK has historically benefited from globalisation. Policies must account for the UK's legacy of contributing to climate change and address the fact that developing countries are today bearing the brunt of climate impacts. UK policy must seek to avoid negative impacts for developing countries or put in place clear mitigation strategies. The UK must engage in ongoing dialogue with those countries to identify the best ways of doing this. This includes assessments of the impact on those countries, across key sectors. Based on these assessments, the UK must be prepared to exempt countries altogether and/or provide qualified exemptions and limit sectoral coverage of policy mechanisms.
- 3. Policies must be built upon a foundation of transparency, robust stakeholder engagement, parliamentary oversight and independent governance.** To ensure their effectiveness, the development and implementation of policies and the adjudication of disputes under them must be beyond reproach. This means decisions taken must be evidence based, consistent and transparent. Parliamentarians, businesses, NGOs and external stakeholders should have a meaningful role in contributing to policy design, implementation and oversight. The organisational and institutional capacity required to support proper governance and dispute resolution needs to be adequately resourced, independent from government and held accountable by effective and trusted appeal mechanisms. It is also important to emphasise the centrality of non-regression in decision making at the outset.
- 4. Consumption emissions and carbon leakage policies must be designed to apply equally to both domestic and international trading partners, in line with principle two, so they are not seen as protectionist.** It is essential to ensure that policies are applied fairly across the board to strengthen their

perceived legitimacy and ensure they remain resilient to potential challenges. A CBAM, for example, needs to be designed to ensure it is principally seen as an environmental measure amongst trading partners, rather than a barrier.

5. Policies should be paired with greater international climate diplomacy efforts.

There is a need for greater climate action across the board, and any policies pursued should not be seen as an alternative to continued engagement and dialogue with trading partners. Instead, they should be viewed as important tools to increase climate ambition amongst partners and, if designed following the principles set out in this briefing, can be used to build trust amongst trading partners and accelerate international decarbonisation efforts.

Design considerations

- 1. Any carbon border mechanism should include a rapid phase out free allowances under the UK Emissions Trading Scheme (ETS).** Keeping free allowances while introducing a carbon border adjustment mechanism (CBAM) would be duplicative and reduce its effectiveness. The allocation of free allowances as it stands is a major market failure and creates little to no incentive to decarbonise industrial operations.
- 2. The scope of any policy mechanisms should cover all high carbon intensity industrial sectors.** All sectors which contribute significantly to climate change and any products, components or raw materials that are highly internationally traded should be covered by a CBAM, product standards and support mechanisms for decarbonising industrial processes.
- 3. Revenue generated by policies to address carbon leakage and consumption emissions should be targeted to supporting investments in decarbonisation of developing economies.** It is essential to ensure developing economies are not stranded with high carbon production methods and industries. In addition to recognising the right of developing countries to continue to develop, policies should also be targeted to supporting these countries to transition to sustainable renewable technologies as quickly as possible. This could also take the form of technical assistance to support compliance and alignment of domestic policy frameworks. Any financial or technical assistance provided should be additional to Overseas Development Assistance already committed.

4. **Export rebates should not be included for domestic industries.** While there has not been a World Trade Organization (WTO) ruling on this, various legal and trade experts have concluded that export rebates are likely to be incompatible with WTO rules.⁴ Offering export rebates for products sold to international markets would create perverse incentives for high carbon industries and products to pivot to increasing export volumes and thereby undermine the effectiveness and credibility of domestic carbon pricing. Climate change does not recognise international borders, and a carbon price should apply to products equally regardless of where they are bought and sold.

5. **Any policies should be designed with a focus on compatibility and alignment with comparable EU regulation.** UK exposure to EU carbon pricing mechanisms and the Emissions Trading Scheme (ETS) necessitates designing UK mechanisms with compatibility in mind. Linking the UK and EU ETS will be important to improve the effectiveness of both systems, and any carbon border mechanism should also be designed to be compatible with the EU system to the greatest extent possible.

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Endnotes

¹ Defra, [Carbon footprint for the UK and England to 2019](#), November 2022

² CBI, [Green Growth, The UK is Falling Behind](#), January 2023

³ Aldersgate Group, [How Product Standards Can Grow the Market for Low Carbon Industrial Products](#), December 2022

⁴ University of London, [Border Tax Adjustments and the WTO Law Compatibility of ETS/CBAM Export Rebates](#), July 2022