From Trade Wars to Sustainable Trade

*By **Dr. Rebecca Harding**, CEO at Coriolis Technologies Limited*

Over the last few years, we have become inured to weaponised language in trade. So when President Biden renewed US tariffs on solar panel imports at the beginning of February,[1] a weary, "here we go again", sigh of exasperation was forgivable. Nominally the extension of the tariff regime was to boost the US solar panels sector so that it can serve America's sustainable energy needs in the future, but this was only a part of the point and highlights a much bigger sustainability challenge.

China exported around $12bn in solar panels in 2021. This is more than twice as much as the G7 exports in solar panels combined. Renewing the tariffs will not go far towards closing the US trade deficit of US$8bn in solar panels: it will take too long and as a result the US will find it more difficult to achieve its climate targets by 2035.

The problem is this: if China is excluded from the global trade system then the process of transition to lower carbon emissions and net zero will take longer. The goals of the Paris Climate Accord and more recently of COP26 will not be met by 2035 and the impact on the planet in terms of species depletion, biodiversity, flooding, droughts and consequent human suffering will be immeasurable.

Tariffs are a blunt instrument and best in a "winner takes all" world: if the price of imports go up, this catalyses domestic producers into producing more. You export less, I export more – you lose and I win. But if the world's lofty climate and sustainability targets are to be met, the approach has to be more nuanced for two reasons.

First, supply does not shift that quickly. It is really difficult to scale up the production of solar panels, or anything else for that matter, if the domestic supply chain infrastructure or expertise is under-developed or simply not there. During the transition, imports continue but at a higher price. This is inflationary and something which, particularly in the current macroeconomic climate, may in itself be a deterrent to adopting renewables or shifting the manufacturing base.

Second, managing sustainability is itself fraught with conflict. For example, if we stop funding fossil fuels, then we render billions of dollars worth of business activity unsustainable in an economic sense with obvious consequences for the livelihoods of communities and individuals associated with those supply chains. Managing transition is inherently about mitigating these conflicts.

Everyone, from policy makers and regulators through to banks and investors will need to understand the symbiosis between the planet, economic activity and economic development. This is an age-old geopolitical problem in the true sense of the word – a conflict over resources between nations, social groups and individuals, and the failure to resolve it is perhaps because of its intractible and universal nature.

In essence, any resolution to the problem means moving from punitive solutions towards ones that "nudge" behaviours. The use of tariffs to incentivise change is almost by definition too blunt an instrument because it focuses on a mercantilist world in which trade was zero-sum.
But now that trade has to be zero carbon rather than zero sum, we need to be more strategic in our approach. This means taking our aspirations and goals to deliverable and measurable actions.

[1] https://www.ft.com/content/07838d2c-4536-4afd-aba3-0bcbe610de85

However, strategic thinking is currently long on aspirations and short on deliverables and this is creating huge problems for the commercial sector. Take Sustainable Development Goals as an example. 193 countries signed up to the Unitied Nations Sustainable Development Goals (SDGs) and the 2030 Agenda for Sustainable Development.[2] There have been 169 targets, 3,120 events, 1,318 publications and 5,503 actions associated with achieving these goals and they are accepted across the world as a guiding principle for sustainability in every sense of the word.[3] But just how do you go about eliminating povery or achieving zero hunger, or creating affordable and clean energy if there are no specific mechanisms or metrics against which incentives as well as regulations can be constructed?

There are regulatory sticks being imposed. The Sustainability Disclosures in the Financial Services Sector Regulations (SFDR), for example, require financial product providers to report on sustainability in their portfolios and their exposure to adverse impacts through provision of financial services from March 10th 2021.[4] The SFDR is based in the SDGs, so effectively banks and investors are being asked to report on their progress towards achieving them. The SDGs are themselves imprecise in delivery and their measurement prone to the vagaries of self-reporting against “principle adverse indicators” (PAIs)[5] that are themselves aspirational rather than measurable. Yet failure to comply could affect a bank’s license to operate.

Other actual or pending regulations will have similar impact on banks. For example, the EU Taxonomy Regulations have been in place since July last year and require “qualifying businesses” to report activity against climate change, climate mitigation, sustainable use and protection of water and the marine environment, transition to the circular economy, pollution and biodiversity.[6] Germany’s and the EU’s supply chain laws require mandatory reporting on Human Rights Abuses; and this is before the EU taxonomy’s social chapter has been introduced.

Compliance is non-negotiable, so exactly ***how*** do financial services organisations and their clients go about it?

A solution is to make the SDGs, the various taxonomies and the Principal Adverse Indicators (PAIs) measurable. The only objective way of doing this to avoid self-reporting is to match products or services themselves against the SDGs, the taxonomy and the PAIs. In goods trade alone there are around 8,500 products that can be matched like this and the results do not make pretty reading for policy makers and regulators around the world:

- Only 1/5th of all products that are trading can be classified as contributing positively to SDGs.
- On a scale of minus 1 to plus 1 (where minus 1 is all trade is contributing negatively to SDGs and plus 1 is where all trade is contributing positively), world trade as a whole scores -0.54. In other words, just under 25% of it is positive against SDGs.
- Developed economies score worse on this scale than emerging economies because they import less of the products that are associated with negative SDGs in relation to consumption.

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[2] http://www.un.org.cn/info/6/620.html
[3] https://sdgs.un.org/goals
[4] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en
[5] https://www.robeco.com/uk/key-strengths/sustainable-investing/glossary/eu-sustainable-finance-disclosure-regulation.html#:~:text=The%20EU%20Sustainable%20Finance%20Disclosure,better%20understood%20by%20end%2Dinvestors.&text=The%20SFDR%20and%20other%20regulations,EU%20carbon%20neutral%20by%202050
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[6] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en

The fact that world trade scores so low against SDGs serves to highlight the need to shift the dial from the negative territory that it is now in, at least to neutral.

Regulations are a good start because they compel the commercial sector to change. New US supply chain regulations in “critical” supply chains exclude trade with companies associated with human rights abuses but are targetted at sectors like electric vehicles and batteries as well as critical minerals which could lead the way towards more sustainable solutions. This highlights the downside of a regulatory approach in that it is asymmetric in its suitability across the world and entrenches financial services providers as the footsoldiers in what is both a global challenge and a global conflict.

Aspirations are a fine thing, but the targets and the steps along the way need to be measurable if banks and businesses are to be provided with, and to provide, the regulatory and price incentives to make trade more sustainable. This is where campaigners, policy makers and regulators have failed. The result is inevitable conflict, misinformation and ultimately greenwash. The solution is to resolve conflicts through agreed and standardised metrics; matching products to SDGs and taxonomies has to be a useful starting point in managing the transition from trade wars to sustainable trade.