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# *Great Insights*



## **Square pegs in round holes?**

**Using trade policy for non-trade objectives**

**Non-paper from the Netherlands and France on trade, social economic effects and sustainable development**

**Making EU trade and development policy 'smarter'**  
Magntorn, Holmes & Rollo,  
UK Trade Policy Observatory,  
University of Sussex

**Trade & COVID-19: External policy coherence?**  
Hoekman & Fiorini,  
European University Institute

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# Editorial

COVID-19 has accentuated international tensions and a shift in global world order. In a more polarised world, Europe strives to assert itself as a geopolitical power. This is a major challenge with 27 member states and complex decision-making processes. Global Europe brands itself as both self-interest and value-driven. It has a toolbox at its disposal to interact with the rest of the world. One of the most essential tools in the kit is trade policy. But is this the most effective tool to export these values or rather a square peg for round holes?

ECDPM together with a group of well-respected academics from across Europe, under the leadership of Bernard Hoekman at the European University Institute, embarked on a 3 year research project financed by Horizon 2020 entitled: 'Realising Europe's Soft Power in External Cooperation and Trade' (RESPECT). This magazine presents some of the 'Great Insights' of the research produced so far.

Lisa Lechner describes how non-trade objectives have become an essential pillar in EU trade agreements, and that over time the agreements might get more teeth to enforce these values. The non-paper published by the Dutch and French Ministry of Foreign Affairs is a case in point. It calls for the EU to step up its ambition in linking trade and sustainable development in all its dimensions.

Basedow, Fiorini, Hoekman and Yildirim summarise the results of an extensive stakeholder survey on the perceptions and preferences regarding the effectiveness of policy linkages to attain non trade policy objectives (NTPOs).

Paola Conconi and her team find that there are serious limitations to use both positive and negative conditionality in trade agreements to convince partner countries of the EU to make commitments in policy areas such as human rights or labour and environmental standards.

Ubaldi & Borchert argue that uncertainty linked to the conditionality on NTPOs embedded in the EU preferential market access schemes can actually discourage trade and have the opposite effect of what Europe seeks in terms of development.

Magntorn, Holmes and Rollo focus on what it takes for Europe to exert 'smart' power.

Pelkmans observes some convergence in terms of environmental standards between Europe and China, that cannot necessarily be ascribed to Europe's influence.

Hoekman and Fiorini draw six lessons in terms of policy coherence from the COVID-19 crisis and the trade policy reactions that ensued highlighting the significant negative spill-over effects on EU's trading partners, particularly developing countries.

Van Seters and Bilal identify how existing trade and investment tools, like the European Enterprise Network, can contribute to make better use of trade policies to deliver results for consumers, workers and business, with respect for the planet and human rights.

Rojas-Romagosa finds that not only preferential trade agreements increase bilateral FDI, but the inclusion of civil and political rights provisions has an additional positive effect on investment.

The tenuous link between export promotion and unemployment is the focus of Olarreaga and Ugarte's research. And finally, Kamala Dawar argues that the COVID-19 crisis has accentuated the urgent need for a clear regulatory framework for official export credit support.

These articles illustrate how the EU considers its trade policy as an instrument of external relations. The jury is out on whether these are the most effective means of achieving its broader objectives. Trade policy in conjunction with other interventions holds more promise.

*Guest editor*

**Kathleen van Hove**  
Senior Policy Officer  
Economic and Agricultural  
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# Europe: Leader on non-trade objectives in trade agreements

The European Union has long been a leader in using trade agreements to pursue non-trade objectives, such as social and political rights, security, and environmental protection. Where Europe has lagged is in adding enforceability to these provisions and anchoring commitments in the international legal framework on sustainability. That, however, might be changing.

By [Lisa Lechner](#)

With Brexit under negotiation and ambitious plans for future trade agreements ahead, the EU faces pivotal questions on its trade policy. Crucially, what form should future trade agreements take? It is important to realise that not only the number of preferential trade agreements (PTAs) is expected to rise, but their scope and depth are increasing as well. Trade agreements covering only import and export duties are a thing of the past. Modern agreements contain provisions on investment, taxation, public procurement, and even entire chapters on non-trade objectives.

## Leadership on non-trade objectives

In the 1970s, just 4% of EU trade agreements covered civil and political rights – mainly provisions on human dignity, the right to political participation, minority protection, and women’s and children’s rights. Among the EU trade agreements signed since 2010, 93% include at least one of these clauses. While 8% of early EU agreements mention security issues, such as combatting drug trafficking, money laundering and terrorism, half of recent agreements emphasise these aspects. The same is true for economic and social rights provisions and environmental

provisions. All modern EU trade agreements cover these aspects, compared to, respectively, 69% and 19% of agreements in the 1970s. Economic and social rights provisions pool the right to work, rights at work, the right to education, the right to development and the right to health. Environmental provisions address natural resources conservation, waste and air pollution, and wildlife and game protection.

Figure 1 charts the rise of these non-trade objectives in EU trade agreements over time. Compared to others, including developed countries, the EU has taken and still holds a leading role in regulating non-trade objectives via trade agreements (Lechner 2019).

### Room for improvement

Despite this leadership, many would like to see an even stronger EU stance on non-trade objectives. Calls for a harder line are especially heard vis-à-vis trading partners with low standards and highly competitive imports. Stakeholders such as trade unions, firms facing competition from abroad and non-governmental organisations want the EU to increase the enforceability of the non-trade provisions in its trade agreements (Lechner 2016). The EU institutions have exerted pressure for fairer trade. For instance, the European Parliament took a strong stance on human rights conditionality during negotiation of the EU-Canada free trade agreement (FTA) (Meissner and McKenzie 2019). Individual member states have raised their voices for more and stricter non-trade objectives. France and the Netherlands, for example, recently pushed for tougher labour and environmental standards (see article

in this Great Insights). As part of the European Green Deal they advocated a mechanism for the EU to charge levies on imports from non-EU countries based on their carbon footprint (Brunsden and Mallet 2020). Finally as the global climate change crises intensifies, international calls for stronger commitments to sustainability via trade relations will almost certainly rise.

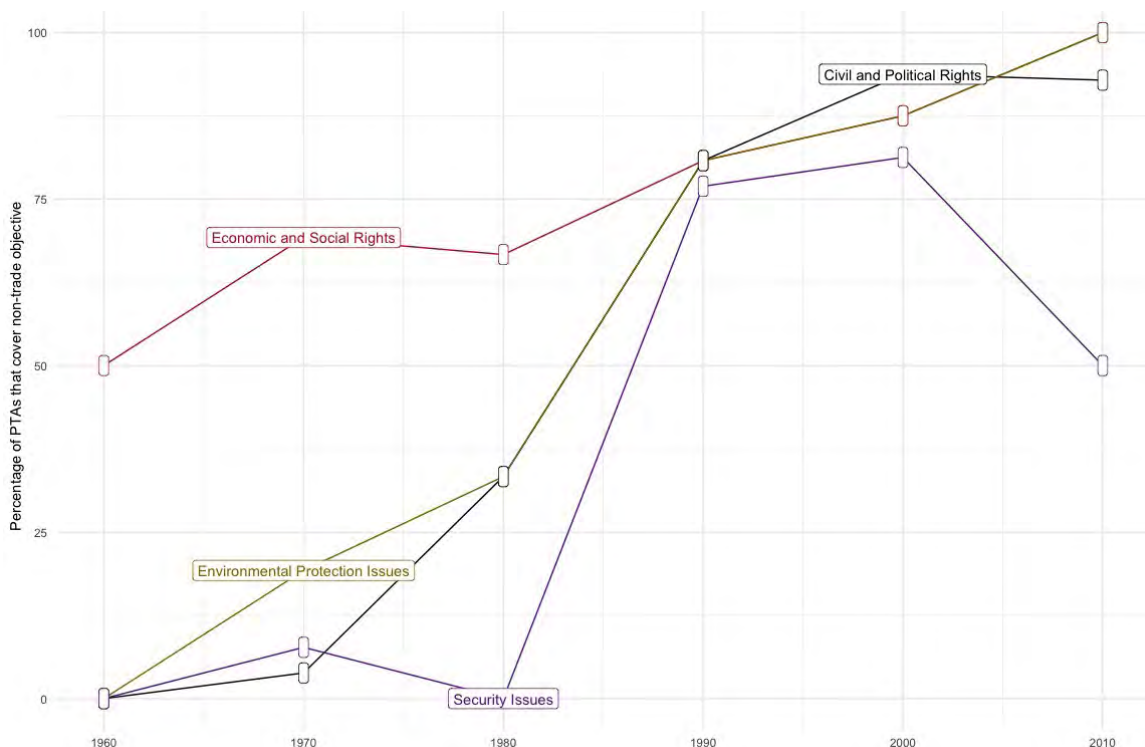
The current dissatisfaction boils down to two main shortcomings of non-trade objectives in EU PTAs. First, past agreements lack enforceability of sustainability clauses. Second, few EU PTAs reach beyond the EU legal framework, so the commitments they contain lack anchoring in the international legal framework on sustainability. This, however, might be changing.

### Adding teeth to sustainability clauses

The EU is well known for its ex ante conditionality clauses. These feature in a wide range of its accession agreements. The EU overall has not been shy about asking partners to demonstrate progress on non-trade objectives in exchange for signing an agreement granting access to the EU market. The risk of this approach is that countries may backtrack after an agreement's entry into force. Recognising this shortcoming the EU has begun adding ex post conditionality; that is language specifying sanctions, or at least a legal process, for violations on non-trade objectives after a treaty has been signed.

EU negotiators pursued ex post conditionalities when negotiating trade agreements with South American countries. Hence, the agreements with Central America and with Colombia

**Figure 1 Non-trade objectives in EU preferential trade agreements over time**



Source: Data from Lechner (2016, 2018).

and Peru, both signed in 2012, include ex post conditionality. In specifying legal consequences for later violations of labour rights or environmental regulations, these agreements mark the start of a new era for the EU in non-trade objective conditionality.

Exceptions can still be found, such as economic partnership agreements (EPAs) with various African countries and regions, where the parties rely on cooperation and dialogue instead of enforcement. Also, the Stabilisation and Association Agreement between the EU and Kosovo, signed in 2015, followed the traditional approach of ex ante conditionality without ex post conditionality.

### **Anchoring in international treaties on sustainability**

In the past, the EU has preferred to reference only its own legal framework in trade agreements. On sustainability aspects, it refers to the EU acquis or specific regulations or past decisions on the matter. Other developed countries have chosen to reference international instead of their own domestic treaties or organisations on sustainability. The International Labour Organization, the Universal Declaration of Human Rights, the Rio Declaration and the Kyoto Protocol are among those most cited. Such references have a dual function. They increase the credibility of the non-trade objectives while also underlining the authority of the third-party institution itself.

Since 2000, the EU has increasingly referred to these third-party organisations and international treaties on sustainability. This shift was facilitated by the EU's commitment to and promotion of the United Nations Millennium Development Goals, which were established that year. Considering the EU's agenda on climate change, it is interesting to see that very recent trade agreements, such as that between the EU and Mercosur, emphasise commitment to the Paris Agreement. These references undoubtedly help 'lock in' important international treaties. Countries may be less likely to violate international regulations on sustainability or exit an international agreement if it has direct consequences for trade relations.

### **Finding the right institutional design**

Non-trade objectives are certain to remain a core pillar of EU trade policy. Considering the increased domestic and international pressure, sustainability clauses will likely have more teeth in future trade agreements. Deeper integration between trade agreements and international bodies is also expected, particularly on labour rights and environmental protection. However, to figure out the optimal institutional

design for regulating and improving global sustainability, further analysis is needed. In particular, it is important to better understand the consequences of the different non-trade provisions in modern trade agreements.

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### **About the author**

Lisa Lechner is Assistant Professor of Methods and Methodology in Political Science at the University of Innsbruck. Much of her research uses network and text analysis to study international treaties such as trade agreements, bilateral tax treaties and environmental agreements, as well as national and international jurisdictions.







# Non-paper from the Netherlands and France on trade, social economic effects and sustainable development

International trade rules and benefits are being challenged both outside the EU and within Member States. Moreover, new challenges for sustainable development, such as the fight against climate change, need mainstreaming in all EU external and internal public policies. These challenges still stand after COVID-19 pandemic. If we need to keep our markets open during and after the crisis, now more than ever is the time for the EU to step up cooperation and coordination to protect human life and lay the foundations for a strong economic recovery and a sustainable, balanced, and inclusive growth after this crisis. In that context, the Dutch and French Trade ministers are calling the EU to improve its approach in analyzing the socio-economic aspects of trade effects, and to increase its ambition regarding the nexus between trade and sustainable development in all its dimensions, consistent with the implementation of the European Green New Deal.

## 1. Stronger sustainability chapters

Trade policy instruments can provide additional leverage to the implementation of international environmental and labor standards. The EU has since 2006 aimed to leverage sustainable development and inclusive growth by including Trade and Sustainable Development (TSD) Chapters in trade agreements. Currently these chapters commit both parties to implement multilateral environmental

agreements to which they are party and ratify and implement fundamental ILO-conventions. They provide an additional bilateral forum for dialogue and facilitate cooperation and the exchange of knowledge and best practices. Given the lack of progress in compliance with TSD commitments in some partner countries multiple years after trade agreements were concluded, the EU should raise the ambition and improve the

implementation of TSD Chapters. The EU should strive for more ambitious TSD chapters and ensure effective implementation thereof. The ambition of TSD chapters should be enhanced, for example by including commitments of parties to cooperate on climate policies such as carbon markets. Moreover, parties should reaffirm their commitment to implement the post-2020 framework of the Convention on Biological Diversity. Where international

agreements are lacking, parties should bilaterally agree on sustainability standards in trade agreements while leaving sufficient space to develop international regimes and aiming for a high level of environmental or social protection. The EU should improve the effective implementation of TSD chapters, if necessary by supporting capacity building in the partner country.

In the European Green Deal the European Commission announced that a Chief Trade Policy Enforcer, among his other functions, will ensure effective implementation of trade agreements including labor rights, environmental commitments and the role of civil society in implementing the agreements. This initiative is warmly welcomed by France and The Netherlands. We propose a more streamlined EU notification mechanism to respond to possible breaches of TSD-commitments.

Such a mechanism would facilitate the Chief Trade Enforcer's work on TSD. Moreover, the EU could incentivize effective implementation by rewarding partner countries that live up to TSD commitments. Parties should introduce, where relevant, staged implementation of tariff reduction linked to the effective implementation of TSD provisions and clarify what conditions countries are expected to meet for these reductions, including the possibility of withdrawal of those specific tariff lines in the event of a breach of those provisions. This approach would allow the EU to bear the fruits of its cooperative approach, while strengthening enforcement.

## **2. Social-economic aspects of trade agreements**

The European Commission runs an economic impact assessment study at the opening of each trade agreement negotiation as well as around the time the deal is closed and about to be implemented. Those studies, highly necessary, need to be improved further to address stakeholders needs and societal concerns. Indeed, the studies only show data aggregated for the whole EU, without any information about the impact on EU regions. Although labour market effects are modelled, the quality of this modelling can further be improved through a recurrent and more detailed sector specific analysis of the impact on employment. The consistency with other EU policies can also usefully be addressed. Beside, such studies often come too early, in particular as negotiations can last over a lengthy period, or too late, once a political agreement is already announced, or even when the EU Council or national and/or European Parliaments have already reviewed the deal.

In spite of clear aggregated economic benefits, gains and losses from trade agreements can be unevenly distributed throughout sectors and regions. The data currently available are not sufficient to grasp this distribution, both on the process and timing as well as on the content. The Netherlands and France ask the European Commission to conduct ex ante and ex post impact assessments in a way to maximise their value for all stakeholders, including EU Member States with as many sectoral or regional level data as possible.

Regarding the content, even though trade policy is an EU competence, Member States need, for their

public debate, national and sectoral information which are not available in the current impact studies carried out by the Commission. Indeed, such assessment should help Member States regarding the impact of the agreement and to identify the sectors that are impacted the most by increased trade openness. Those data are needed for each trade agreement but a cumulative impact assessment such as the European Commission is planning on would be important to become a real steering tool for the EU and its Member States.

Concerning the process and the timing, the European Commission should try to set up a procedure to take on board EU Member States sensitivity points on each agreement in the design of such impact assessment, especially on sustainable development issues (Sustainable Impact Assessment – SIA). To be as useful as possible, those SIA need to be available before the conclusion of the negotiations and then be updated once the outcomes of the negotiation gets clearer.

## **3. Responsible Business Conduct**

European cooperation on responsible business conduct (RBC) is necessary to ensure a coherent and harmonized policy and to achieve the greatest impact while establishing a level playing field for the EU internal market. Together France and The Netherlands therefore stress the importance of the development of an EU framework on RBC: an EU RBC Action Plan. An EU RBC Action Plan should be the overarching strategy of ways in which the EU fosters fair trade and responsible production and management of supply chains.

The Plan should consist of a smart mix of measures: mandatory<sup>i</sup> and



voluntary<sup>ii</sup>. An Action Plan could include the scaling up of existing national sectoral measures, create peer-learning structures for Member-States' National Action Plans, combine the efforts on sustainable trade promotion, provide guidelines (notably based on the work done at OECD on RBC including sector specific guides) on its expectations from companies within its jurisdiction and include the role of the EU as a market actor, for example with regards to EU public procurement. This work should also include the revision of the non-financial reporting directive and the discussions on EU-level legislation on due diligence, based on the Commission study on due diligence requirements through supply chains. The Commission is asked to develop this Action Plan before 2022 in cooperation with the Council – where responsible Council preparatory bodies should be tasked with RBC – and in conjunction with the private sector and civil society.

#### 4. Paris Agreement as essential element of EU agreements

The Paris Agreement and its legally binding obligations should be an essential element in comprehensive and future trade and political framework agreements, including those being currently negotiated, building on the European Commission's commitment in the European Green Deal. This means that the parties should be party to the Paris Agreement and live up to the legally binding commitments, notably the obligation to submit Nationally Determined Contributions (NDCs) every five years representing a progression beyond the Party's then current NDC and reflecting its highest

possible ambition (in accordance with Art 4.3 Paris Agreement). The Paris Agreement should be added to the two existing essential elements, namely the respect for human rights and the fight against the proliferation of weapons of mass destruction. In case an existing EU trade agreement is modernised and renegotiated, the Paris Agreement and its legally binding obligations should become a part of the essential elements.

#### 5. Carbon Border Adjustment Mechanism

Carbon leakage, that is the increase in greenhouse gas emissions in countries with less stringent climate policies linked to a shift of EU production, undermines the global reduction efforts and the efficiency of emission reduction measures towards the EU objective of carbon neutrality in 2050.

To effectively limit carbon leakage, the Netherlands and France look forward to the proposal of the European Commission on the different possibilities of a carbon border adjustment mechanism (CBAM). A CBAM could strengthen the effectiveness of the European Union's climate policy and reduce the EU carbon footprint, hence contributing to the global climate objectives, if designed properly. If a CBAM is implemented, it should take into account existing instruments, such as the ETS. France and the Netherlands/ we stress that the CBAM needs to be designed to comply with WTO rules and should be implemented with a step-by-step approach.

#### 6. WTO

France and the Netherlands believe the WTO has a special role to play in

addressing major global challenges in terms of sustainable development, including the fight against climate change and the preservation of biodiversity. In that respect, and in accordance with the objective of sustainable development stated in the Marrakesh agreement, WTO should offer an enabling space to apply sustainability disciplines.

In that respect, France and the Netherlands welcome the organization of a dedicated event and declaration to trade and climate change at the next WTO ministerial conference.

#### Notes:

i An example of a EU mandatory measure includes the EU "Conflict Minerals Regulation" (Regulation EU 2017/821).

ii Examples of the different measures can be found in the Commission Staff Working Document: Corporate Social Responsibility, Responsible Business Conduct, and Business & Human Rights: Overview of Progress. Available at: <https://ec.europa.eu/transparency/regdoc/rep/10102/2019/EN/SWD-2019-143-F1-EN-MAIN-PART-1.PDF>



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# Practitioner perceptions on linkages between trade & non-trade issues

The EU may need to reconsider the use of trade agreements for promoting non-trade policy objectives. Many experts and stakeholders surveyed deem trade agreements to have limited utility in that regard. Instead, a stronger emphasis on support for non-governmental organisations, expert dialogues and targeted technical and development assistance seems warranted.

By Robert Basedow, Matteo Fiorini, Bernard Hoekman and Aydin Yildirim

Countries frequently use trade policy to pursue broader public policy objectives. The US-China trade war is a case in point. Here, trade policy was transformed from a technocratic domain to an instrument in the geopolitical struggle for global leadership. In the current COVID-19 pandemic, some countries have used trade policy to maximise domestic access to medical supplies and drugs. This is another manifestation of linkages between trade policy and broader public policy objectives.

The European Union (EU) is an especially avid user of such linkage strategies, owing to its unique legal and political nature as an actor in global affairs. The EU uses trade policy to advance so-called non-trade policy objectives (NTPOs) in partner countries. Examples of NTPOs are human rights, labour standards and environmental protection. To attain

NTPOs, the EU conditions third country access to the EU market and other trade privileges on cooperation in key non-trade policy domains.

## Fit for purpose?

EU trade policy is increasingly embedded in the EU's broader public and foreign policy strategy. Yet, this has raised questions about policy linkages. Who supports linkages between trade policy and NTPOs in the EU? How effective are these linkages for attaining NTPOs in the eyes of stakeholders? Do these policy linkages undercut trade policy objectives? Finally, how could the EU improve its use of policy linkages for better outcomes?

An expert survey undertaken as part of the Horizon 2020 research project 'Realising Europe's Soft Power in External



Cooperation and Trade' (RESPECT) sheds light on these questions. Respondents comprised representatives of European institutions, member state governments, businesses, civil society organisations and third country governments. The key findings are presented in a forthcoming article in the Journal of Common Market Studies.

### Support for linkages

Overall, most survey respondents welcomed linkages between trade policy and NTPOs. Respondents from the European institutions, member state governments and civil society organisations were particularly supportive of policy linkages. Representatives of businesses and third country governments were less enthusiastic. Interestingly, respondents from large firms were more supportive of policy linkages than respondents from small and medium-sized firms. Large firms may be less troubled by policy linkages because they have greater resources to cover any additional costs they may bring.

When it comes to the perceived effectiveness of policy linkages in promoting NTPOs, officials from the European institutions and member state governments were more aligned with business representatives. Overall, they considered policy linkages to be effective in promoting NTPOs. However, they also felt this came at the expense of trade policy objectives. Respondents from civil society organisations considered policy linkages less effective for promoting NTPOs, and were also less convinced that policy linkages had negative implications for attainment of trade policy objectives.

### What instruments are best?

Respondents were asked their views on the effectiveness of various instruments for achieving NTPOs, including trade agreements, technical cooperation, development assistance, dialogue, support for non-governmental organisations (NGOs) and foreign direct investment (see table). Respondents in all categories considered targeted support for NGOs and expert dialogue between the EU and partner countries to perform best. Preferential trade agreements – with built-in

**Table 1. Views on instruments for attaining non-trade policy objectives (NTPOs)**

	Targeted assistance for NGOs / unions / regulatory bodies	Expert dialogues between EU and partner country stakeholders	Technical assistance	EU assistance funds (e.g. European Development Fund)	Bilateral development assistance programs of EU member states	Trade agreements	Study tours and student exchanges	Development assistance for infrastructure improvement	Direct investment by European multinational firms	Twinning of cities and similar partnership initiatives	Other instruments	National export promotion activities	Total number of respondents by professional category	Total number of responses by professional category
EU institutions	20	20	11	15	5	16	2	4	5	0	2	0	33	96
GVT EUMS	20	15	12	9	15	7	8	3	3	5	1	2	39	143
GVT partner countries	18	15	15	10	10	0	8	8	10	5	0	0	13	39
Firms	17	19	12	7	5	8	12	3	7	5	3	1	33	95
Business associations	16	18	14	8	8	8	8	4	6	6	4	0	33	106
CSOs	23	14	10	10	8	9	9	3	5	2	4	3	25	92
Academia	17	15	12	12	8	9	9	8	4	4	2	0	150	466
IOs	13	15	13	8	13	8	7	5	8	3	3	2	18	60
<b>Total number of respondents from main categories</b>	<b>196</b>	<b>174</b>	<b>132</b>	<b>116</b>	<b>99</b>	<b>96</b>	<b>87</b>	<b>61</b>	<b>55</b>	<b>44</b>	<b>27</b>	<b>10</b>		
SMEs	21	21	13	10	2	8	6	2	10	2	2	2	18	48
Large firms	13	17	11	4	9	9	17	4	4	9	4	0	15	47
Western EUMS	21	16	11	8	16	4	7	4	3	5	1	3	26	95
Eastern EUMS	18	9	18	9	18	14	5	5	0	5	0	0	7	22
High income partners	21	17	17	8	13	0	8	0	8	8	0	0	7	24
Low income partners	8	0	17	17	8	0	8	25	17	0	0	0	4	12
<b>Total number of respondents from sub-categories</b>	<b>46</b>	<b>39</b>	<b>31</b>	<b>21</b>	<b>28</b>	<b>15</b>	<b>22</b>	<b>11</b>	<b>14</b>	<b>13</b>	<b>4</b>	<b>4</b>		

Note: Data collected in 2019. A total of 356 respondents completed the survey. For details see the RESPECT survey instrument at <http://respect.eui.eu/publications/>. GVT = government; EUMS = EU member state; CSOs = civil society organisations; IOs = international organisations; SMEs = small and medium-sized enterprises.



conditionalities – were largely seen as less effective and desirable for attaining NTPOs. Officials from the European institutions were outliers here, as they considered preferential trade agreements to be an effective instrument to pursue NTPOs.

The survey findings come at a relevant time for EU policymakers, as the European Commission is presently conducting an internal review of its trade policy. Judging from comments made by Trade Commissioner Phil Hogan at his European Parliament hearing in September 2019, the Commission seems poised for a stronger focus on NTPOs and ensuring policy coherence in external relations.

Our findings suggest that the EU may need to reconsider its strong commitment to trade agreements for promoting NTPOs, as many of the experts and stakeholders surveyed regarded trade agreements as having limited utility in that regard. Instead, a stronger emphasis on support for NGOs, expert dialogues and targeted technical and development assistance seems warranted.

**We need to pay greater attention to specific instruments rather than researching blanket support or opposition to trade agreements and the pursuit of NTPOs among stakeholders.**

### Bringing specifics into focus

Most previous research has scoped the general preferences of stakeholders on linkages between trade policy and NTPOs. Our survey provides a more detailed picture of stakeholder preferences. Our results show that stakeholder groups don't just support or oppose such linkages. Their attitudes may differ depending on the specific policy instruments being considered for NTPO attainment.

Scholars have so far paid relatively little attention to variation in preferences – and evidence – on the effectiveness of specific policy instruments and the extent that different instruments

can complement or substitute for one another. Another area that calls for more work is how political economy dynamics shape choices of policy instruments and their effects on policy outcomes.

In sum, the survey offers new insights on stakeholder preferences and perceptions regarding the effectiveness of policy linkages to attain NTPOs. It suggests that to design effective and efficient policies and better understand the political economy dynamics that inform the EU's choices of policy linkages, we need to pay greater attention to specific instruments rather than researching blanket support or opposition to trade agreements and the pursuit of NTPOs among stakeholders.

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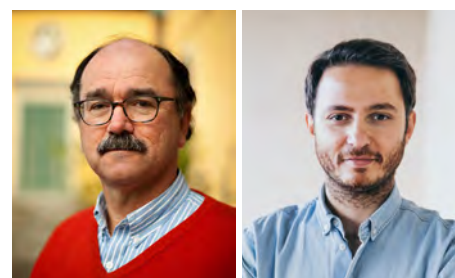
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# EU trade policies: Carrot-and-stick mechanisms in pursuit of non-trade policy objectives?

European Union (EU) trade policies increasingly link access to its large market to compliance with Non-Trade Policy Objectives (NTPOs), such as human rights or labour and environmental standards. We argue that for pursuing these kinds of objectives the EU's Generalised System of Preferences (GSP) is better suited as a carrot-and-stick mechanism than free trade agreements.

**By Ingo Borchert, Paola Conconi, Mattia Di Ubaldo and Cristina Herghelegiu**

The EU is the world's largest exporter of manufactured goods and services. It is also the biggest export market for many countries. The EU often conditions preferential access to its market on achievement of Non-Trade Policy Objectives (NTPOs), such as sustainable development, human rights and good governance.

It has been argued that trade policy is "the principal instrument of foreign policy for the EU" (Sapir 1998). Through trade policies, the EU can "export" its values to its trading partners. This idea is enshrined in the Treaty on European Union (TEU). Article 21 of the Treaty states, "[t]he Union's action on the international scene shall be guided by the principles which have inspired its own creation", including democracy, the rule of law and

human rights. It also refers to the pursuit of NTPOs such as international security and sustainable economic, social and environmental development.

Ursula von der Leyen promised that under her leadership the Commission will further strengthen the use of trade tools in support of NTPOs. In her 'Agenda for Europe', she stressed, "Trade is not an end in itself. It is a means to deliver prosperity at home and to export our values across the world" including "the highest standards of climate, environmental and labour protection, with a zero-tolerance policy on child labour".

In a recent paper (Borchert et al. 2020), we examined the extent to which the EU can promote NTPOs through its two principal instruments of trade policy: free trade agreements and the Generalised System of Preferences (GSP). We assessed whether these trade tools can be used as a 'carrot-and-stick' mechanism to incentivise trading partners to achieve NTPOs. The key question was whether preferential access to the EU market can be used to reward trade partners for 'good behaviour' on NTPOs (positive conditionality) and to punish 'bad behaviour' (negative conditionality).

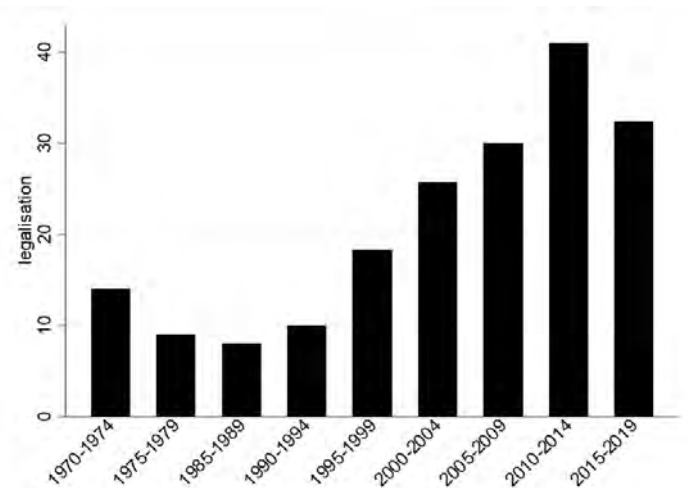
### NTPOs in EU trade policy

The first policy tool through which the EU can grant preferential access to its market is trade agreements. At present, the EU has the largest trade network in the world, with over 40 agreements in force. The legal basis for these agreements is Article XXIV of the General Agreement on Tariffs and Trade (GATT).

Figure 1 shows the evolution of NTPOs in these agreements using data compiled by Lechner (2016) in the context of the Design of Trade Agreements (DESTA) project. DESTA groups

NTPOs into four main categories: civil and political rights; economic and social rights; environmental protection; and security issues.

**Figure 1. Legalisation of NTPOs in EU trade agreements, 1970-2019**



Note: Interval scores were computed by first summing the legalisation scores of all Non-Trade Policy Objectives (NTPOs) and then averaging these overall scores across the EU trade agreements concluded over the five years concerned. The average score for 2015-2019 is lower than that for 2010-2014 mainly due to the agreements concluded by the EU with different groups of African countries.

These are then scored according to the degree they are legalised in trade agreements. Average legalisation scores over five year intervals show that NTPOs have clearly gained prominence (and bite) in EU trade agreements since the 1990s. This trend has mostly been driven by the rise of labour and social/environmental provisions, whose average legalisation scores more than doubled during the last two decades.

**Table 1. Evolution of NTPO-related provisions in the EU's GSP programmes**

Arrangements with conditionality provisions in the GSP regulation	Drugs Arrangement (1991)	Special Incentive Arrangements concerning Labour Rights and Environmental Protection (1998)	Special Incentive Arrangement for Sustainable Development and Good Governance (2006)
NTPO areas concerned	Security	Security ESRs EP	Security ESRs EP CPRs

Note: The 1991 Drugs Arrangement and the 1998 Special Incentive Arrangements concerning Labour Rights and Environmental Protection were superseded by the 2006 Special Incentive Arrangement for Sustainable Development and Good Governance. GSP = Generalised System of Preferences; NTPO = Non-Trade Policy Objectives, ESRs = economic and social rights; EP = environmental protection, CPRs = civil and political rights.



The GSP is the second policy tool that the EU can use to grant preferential access to its market. The legal basis for GSP schemes is the 'enabling clause' adopted under GATT in 1979, which allows positive, pro-development trade discrimination. It thus allows donor countries to offer better than Most-Favoured-Nation tariffs to developing countries, without extending the same treatment to developed countries.

Over the years, the EU has introduced in its GSP regulations several provisions aimed at pursuing NTPOs. In particular, the Special Incentive Arrangement for Sustainable Development and Good Governance (GSP+), introduced in 2006, grants developing countries full removal of tariffs on two thirds of all product categories, if they ratify and comply with a core set of international conventions on human rights, labour and environmental protection. Table 1 summarises the evolution of NTPO-related provisions in the EU's GSP programmes.

**Given that tariffs must be eliminated reciprocally across the board, the EU cannot extend or restrict preferential access to its market depending on the behaviour of a trading partner.**

#### **Conditionality in EU trade agreements and GSP schemes**

We argue that trade agreements are not an effective tool to incentivise trading partners to achieve NTPOs. The key reason is that the EU must comply with Article XXIV of GATT. This requires that countries negotiating preferential trading arrangements eliminate "duties and other restrictive regulations of commerce" on "substantially all the trade between the constituent territories in products originating in such territories". Given that tariffs must be eliminated reciprocally across the board, the EU cannot extend or restrict preferential access to its market depending on the behaviour of a trading partner.

Once tariffs are eliminated following the entry into force of a trade agreement, there is no positive conditionality. In other words, trade preferences cannot be used as a 'carrot' to reward a trading partner's good behaviour on NTPOs. In

terms of negative conditionality, the EU could in principle trigger the 'essential elements' clause in case of severe NTPO violations, which could lead to suspension or termination of the trade agreement. However, this clause only applies to some NTPOs (human rights, democracy, the rule of law and security), excluding provisions on labour and environmental standards. Moreover, the EU has rarely activated the 'essential elements' clause, and even when it has it has never suspended or terminated the trade agreement. This may be partly because the 'stick' is too drastic. Given the reciprocal nature of a trade agreement, its suspension or termination can be extremely costly, not only for the trading partner but also for the EU. This is not to say that the EU cannot use negative conditionality in trade agreements, but that the sanctioning mechanism itself cannot rely on trade policy instruments.

By contrast, the EU can use GSP programmes as a carrot-and-stick mechanism to promote NTPOs in developing countries. The key difference between GSP and trade agreements is that GSP preferences are offered on a unilateral basis, which affords more leeway in using conditionality by preference-granting countries. Through its GSP programmes, the EU can reward countries that make progress on NTPOs, by offering lower tariffs and broader product coverage. For example, in 2014 the Philippines was upgraded from the GSP to the GSP+ programme. This increased the number of products eligible for zero tariffs from 2,442 to 6,274. If a trading partner violates NTPOs, the EU can respond by suspending part or all GSP preferences. For example, in 2010 the EU withdrew Sri Lanka from its GSP+ programme due to shortcomings in Sri Lanka's implementation of three UN human rights conventions: the International Covenant on Civil and Political Rights, the Convention Against Torture, and the Convention on the Rights of the Child. Similarly, violations of labour standards have led to temporary withdrawals of preferences from Myanmar and Belarus. Since labour standards would be outside the scope of the 'essential elements' clause, these cases demonstrate that the scope for negative conditionality is much broader in GSP than in free trade agreements.

The European Commission has reported many instances of noncompliance with NTPOs. However, application of negative conditionality to GSP recipients has been scattered. Restraint is usually justified by the desire to limit harmful impacts on the target population. A less altruistic explanation of selective enforcement is linked to trade partners' economic size: the EU might refrain from using negative conditionality for fear of retaliation, or to avoid an increase in the cost of sourcing key inputs, when violations occur in larger emerging markets such as India, Pakistan or China.

## Concluding remarks

The literature on issue linkage suggests that large trading blocs such as the EU may seek to enter into free trade agreements with smaller countries to exchange market access concessions with concessions on non-trade issues (Limão 2007). Conconi and Perroni (2012) found that trade agreements can help small countries achieve domestic policy objectives. These studies rely on the idea that trade policy can be used as a 'carrot-and-stick' mechanism to enforce commitments in other policy areas. We argue that there are important legal and economic limitations to both positive and negative conditionalities in trade agreements.

## If the EU wishes to rely more on trade policy to promote such objectives, it should focus on GSP programmes

Our analysis suggests that, if the EU wishes to rely more on trade policy to promote such objectives, it should focus on GSP programmes. The unilateral nature of these programmes implies that the EU can use them to enforce NTPO commitments by its trading partners. However, conditionality in GSP schemes should be administered in a more consistent and rules-based way, with beneficiary countries regularly monitored and their trade preferences more systematically revoked or suspended in cases of non-compliance with NTPO commitments.

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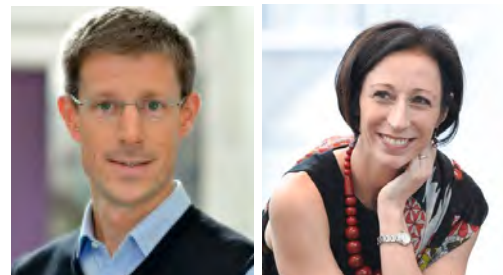
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# Trade preferences need predictability

Many developing countries export their products to the European Union (EU) at reduced tariffs. But these preferential market access conditions can be withdrawn, which can discourage trade. Removing the Damocles sword of continued uncertainty can lead to substantially more trade.

By Ingo Borchert and Mattia Di Ubaldo

Most industrialised countries offer developing countries preferential market access under so-called Generalised System of Preferences (GSP) schemes. In doing so, their overarching aim has always been to facilitate export-led growth. GSP recipients benefit from tariffs lower than Most-Favoured-Nation rates. In fact, tariffs are often reduced to zero. There is evidence that awarding non-reciprocal trade preferences can boost exports from eligible countries (Frazer and Van Biesebroeck 2010).

Yet a significant flaw of GSP schemes is that preferential tariffs are uncertain. GSP schemes are offered on a temporary basis, and some schemes have built-in mechanisms to remove preferences from countries or sectors that become internationally competitive. The uncertainty that characterises GSP-style preferences is likely to undermine the development scope and effectiveness of GSP schemes. Concerns have been reinforced by growing empirical evidence that uncertainty about future

trade policy might act as a break on international trade. Handley and Limão (2017), for example, showed that elimination of trade policy uncertainty explained much of the increase in China's exports following its WTO accession.

### The 2014 reform of the EU GSP

The EU's GSP regime establishes that a beneficiary whose exports become 'too competitive' will no longer be in need of a preferential tariff and therefore loses its GSP membership (so-called 'graduation').



Competitiveness is determined by the share of EU imports from a country in a particular sector, relative to total EU imports from all GSP countries in that sector. Thresholds determine when GSP status is lost. The threshold was originally set at 15% (12.5% for textiles). It was revised upwards in 2014 to 17.5% (15% for textiles) and raised again to 57% (47.5% for textiles) in 2015 when large beneficiaries, including China, exited from the scheme.

The threat of preference removal may act as a barrier, deflecting trade from GSP beneficiaries away from the threshold. Removing the uncertainty of GSP preferences could lead to increased trade with beneficiary countries (Borchert and Di Ubaldo 2020). We had

the opportunity to observe this effect in 2014, when the EU eliminated the threat of competitiveness-related graduation

**The threat of preference removal may act as a barrier, deflecting trade from GSP beneficiaries away from the threshold. Removing the uncertainty of GSP preferences could lead to increased trade with beneficiary countries**

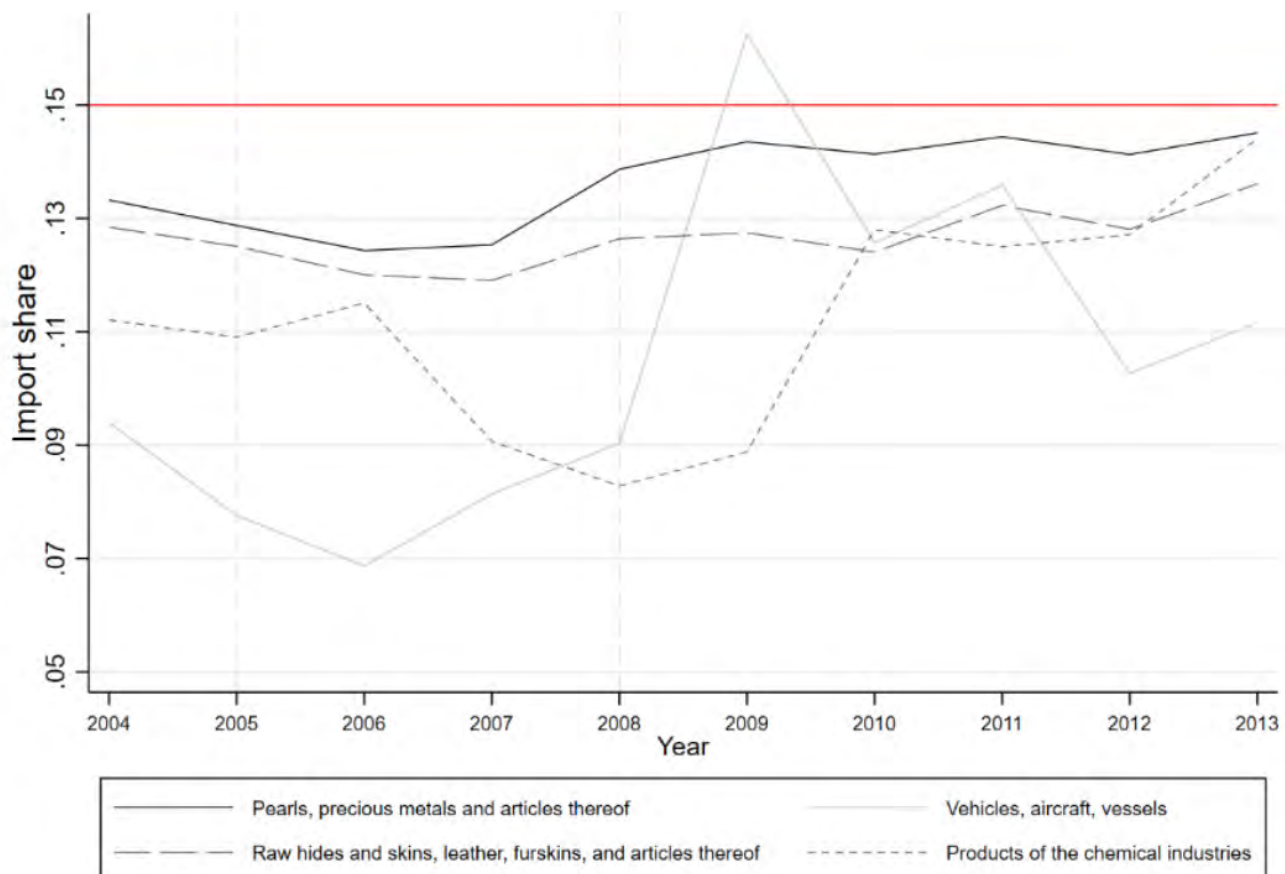
for the so-called GSP+ members. This rule change meant that GSP+ countries would henceforth be certain of their

preferential access to the EU market, regardless of the size of their exports relative to those of other members.

Looking at the trade performance of GSP+ countries, we find that the 2014 reform led to an increase in EU imports by 46% from these economies relative to all other countries that were unaffected by the reform. Since we can exclude the effect of all other conceivable changes in market access conditions, including changes in preferential tariff margins, it is very plausible that the trade growth observed after the reform is attributable to the removal of uncertainty.

Sectors where import shares are close to the graduation threshold are arguably more directly affected by uncertainty

Figure 1. EU Import shares from India by top sectors, 2003-2014



about future tariffs, as they are just a few steps away from the 'cliff edge'. Firms in developing countries from these sectors might hold back export growth to eschew graduation. Indeed, we found that imports from country-sector pairs closer to the threshold (within 7.5 percentage points) increased by nearly 70% after the reform, which is appreciably higher than the average impact of 46%.

The cheer over the post-reform boost in trade would be tarnished if the increase in exports to the EU came at the expense of other export destinations, representing merely a diversion of trade. Yet we found no evidence of beneficiaries simply having redirected exports from alternate destinations to the EU. Rather, GSP+ countries appear to have taken advantage of their more secure access to EU markets by increasing their overall export activity.

### What if...?

Based on the impact of the 2014 reform on GSP+ countries, one might wonder whether countries in the standard GSP scheme, which are still subject to preference uncertainty, would equally benefit from uncertainty removal. An illustrative example is India, which is currently the largest beneficiary in the standard GSP programme. Figure 1 shows the shares of EU imports from India in four main sectors from 2004 to 2013.

Though India's import shares grew over time, they remained just below the 15% threshold which would have triggered graduation. India was not affected by the 2014 reform. However, given our findings for GSP+ countries, India and other standard GSP beneficiaries could benefit a great deal from uncertainty removal.

## Conclusion and implications

Trade policy uncertainty can adversely affect trade flows. For exporters in developing countries to take full advantage of the benefits of non-reciprocal preference schemes, they need a sufficiently high degree of predictability in trading conditions going forward.

### The cheer over the post-reform boost in trade would be tarnished if the increase in exports to the EU came at the expense of other export destinations

This research is part of the ongoing RESPECT project ('RESPECT' stands for Realising Europe's Soft Power in External Cooperation and Trade). Our aim was to shed light on one of the project's overarching objectives, namely, to identify success factors for effective EU external policies and to better realise the EU's trade and development strategy. Based on our results, we conjecture that recipients of trade preferences would benefit from further reform that eliminates discretionary elements from GSP schemes.

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# Making EU trade and development policy 'smarter'

Coherence in the values the European Union (EU) promotes makes it more likely that partners will take European principles on board. Both the EU institutions and member states have a role to play to reinforce and add value to each other's efforts.

By [Julia Magntorn Garrett](#), [Peter Holmes](#) and [Jim Rollo](#)

## Introduction

In 'The Brussels Effect' Anu Bradford argued that the EU has, for many years, been emerging as a global economic regulatory hegemon. The rules and regulations governing what can be sold into the EU are adopted by firms around the world, even when their goods are not being sold directly to the EU. China, for example, makes mobile phones to both EU and US standards, but it has chosen to use the EU GSM system internally.

Hand-in-hand with the EU's regulatory influence comes promotion of broader EU

values. For example, alignment with EU environmental regulations promotes EU values about a cleaner environment. By conditioning access to the EU market on partner countries making commitments in areas such as environmental protection, human rights and labour rights, the EU can influence others to follow its example.

## Soft power and smart power

The EU's ability to secure compliance with its norms shows its soft power. Soft power is a force of attraction that induces partners to see a country

or bloc as an example they want to copy. An extreme example of pure soft power would be when a partner has internalised EU norms to such an extent that it does what the EU would wish it to do voluntarily in a spirit of emulation. However, we would normally expect some additional incentives, 'carrots' or 'sticks', to be needed.

Since the EU's trade policy provides incentives and carries implicit penalties to induce actors to align with its values, it is not an expression of pure soft power. The combination of harder policy



instruments with soft power is what Joseph Nye referred to as 'smart power'. Using incentives in a 'smart' way, building on the EU's existing soft power, can make external action more effective and less costly. For example, if a country already has some goodwill towards the EU (i.e. the EU has soft power), less additional suasion is likely to be needed to achieve a certain outcome.

### **The significance of coherence**

The EU is not a single actor. It is made up of both the EU institutions and the individual member states. As acknowledged in the 2015 Trade for All strategy, the EU's success in promoting its values and standards depends on its ability to act coherently, both across member states and across policy areas. More coherence in the values projected could increase the chance that partners will adopt common EU principles.

Our research explored how the EU, both collectively and the individual member states, has pursued its soft power 'objectives', the values it shares and wishes to instil in other countries. Specifically, we examined whether the institutions of the EU and the member states supported the same goals and projected the same values through their trade and development policies. In other words, we wanted to assess the coherence of the collective impact of the 'Brussels effect', alongside the 'London effect', the 'Paris effect' and so on.

### **Coherence between member states and the EU institutions**

We focused on trade-related aid, since it spans both trade policy and development policy. Trade policy is an exclusive EU competence, meaning that it is made centrally by the EU rather than by the individual member states. Development policy is a shared competence, where the EU implements a collective development

policy while member states also have national development policies reflecting their own strategic interests and priorities.

In the absence of a definitive measure of soft power, we tried to infer what might be thought of as the soft power 'objectives' of the EU institutions and member states by looking at the types of activities and the countries they support through their trade-related aid commitments. As a measure of similarity, we computed the overlap between the EU institutions' and member states' aid allocations across aid activities and recipients. Given the lack of de jure obligations in the development policy area, if the member states and the EU institutions allocated their aid to the same purposes and countries, this was viewed as a manifestation of them voluntarily projecting the same values and common principles.

**With respect to aid allocations across recipients, the UK and the Netherlands displayed considerable divergence. Overlap between Dutch and EU aid recipients was under 10%**

We found that while the member states and the EU institutions overall pulled in the same direction, supporting similar activities and countries through their development aid, degrees of coherence varied across the member states. In the most recent years, Germany and France were found to be most aligned with the EU institutions' objectives. Germany showed particular coherence with the EU

institutions, having around 60% overlap with the EU institutions' aid spending across aid categories. With respect to aid allocations across recipients, the UK and the Netherlands displayed considerable divergence. Overlap between Dutch and EU aid recipients was under 10%, and overlap between the UK and EU was around 20%.

### **Coherence in EU trade and development policy**

While most modern EU trade agreements incorporate provisions on sustainable development, some agreements emphasise this dimension more than others. Sustainable development is particularly central to the EU's GSP+ programme which grants deeper preferences than the original GSP in exchange for the beneficiary countries ratifying 27 international conventions on sustainable development, human rights and good governance. Sustainable development is also a key objective in the EU's economic partnership agreements (EPAs) with African, Caribbean and Pacific (ACP) countries.

In light of this, we explored the coherence of the EU's development policy with its trade policy aims by grouping aid recipients by their trade relationship with the EU and looking at whether aid to country groups with agreements emphasising sustainable development received more aid targeted towards these objectives.

Overall, we found the strongest coherence between development assistance and trade policy objectives for the EU institutions. A higher share of EU institutions' total development assistance to GSP+ countries was focused on sustainable policy objectives compared to the standard GSP group. This is consistent with the stronger emphasis on sustainable development in

the GSP+ programme. For example, over 2015 to 2017, some 68% of aid from the EU institutions to GSP+ countries was motivated by an objective to improve

**Around 67% of aid had an explicit gender objective, 48% had an environmental protection objective**

participatory development and good governance, compared to 50% for the standard GSP group. Similarly, around 58% of EU institutions' aid to the GSP+ group had an explicit gender equality objective, compared to 52% for the standard GSP group. The same pattern was found for some, but not all, EU member states.

Development aid from the EU institutions to countries with an EPA was also particularly focused on sustainable development objectives. Around 67% of aid had an explicit gender objective, 48% had an environmental protection objective and 77% was targeted to improve participatory development and good governance.

However, there was less coherence among EU member states. For them, we found considerable variation in the focus of aid on sustainable development objectives across the relevant recipient groups.

### **Smart power in EU trade and development policy**

Acting in unity is important to project a common set of European values, where

they exist. However, as the case of the West Africa EPA Development Programme (PAPED) shows, declaring a need to act in concert does not guarantee policy coordination. What emerges from our research is a mixed picture. While the EU and member states appeared to pull in the same general direction, they varied considerably in their degree of coherence with the EU institutions. Further, while the EU institutions' development aid was relatively coherent with its trade policy objectives, less coherence was evident among the member states, where national priorities appeared to influence priorities more.

**Both the EU institutions and the member states have a clear role to play to reinforce and add value to each other's efforts**

In practice, acting in complete unity may not always be best. The concept of smart power suggests that where a partner country has a favourable attitude towards a particular member state, it makes sense to let that member state take the lead in engagement to promote the EU's values.

This coordination of development assistance is something which the EU acknowledges. Indeed, the EU has set out measures to enhance the complementarity of aid spending by EU donors, to allow each actor to focus its assistance on areas where it can add the

most value. Such coordination among member states and the EU institutions might lead to less overlap of aid spending among the donors, but could enable the EU to maximise its smart power and influence attitudes globally in a more efficient way. In this regard, both the EU institutions and the member states have a clear role to play to reinforce and add value to each other's efforts.

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# EU-China convergence on sustainable development may be on the (far) horizon

China has long pursued economic growth 'at all cost'. Evidence from the past decade suggests it is nudging towards a more sustainable growth path. EU trade policy may have helped.

By Jacques Pelkmans

The EU prides itself on using trade and investment policy to promote the 'sustainable development' of trading partners. Sustainable development here relates to a conglomerate of policies, including those for environmental protection and climate change mitigation. Pursuit of such goals reflects two separate rationales. The first is the EU's desire to promote its own 'values' abroad. The second is the EU's concern that trade be conducted on a 'level-playing field' in terms of policies, regulations and costs of doing business.

## Values or fairness?

Since 2015, the EU's position has leaned overwhelmingly towards the values rationale, as set out in the Union's 'Trade for All' strategy. However, this does not make the 'level-playing field' irrelevant. Indeed, in a 2020 strategy paper on

the systemic challenge that China represents for the EU, BusinessEurope devotes a comprehensive chapter to the 'level-playing field', including environment and climate regulation. The sensible position is that the two approaches are not incompatible and can actually be regarded as complementary.

One subject of research in our Horizon 2020 'RESPECT' project (RESPECT stands for 'Realising Europe's Soft Power in External Cooperation and Trade') is the effect of EU trade and investment policy in nudging China towards a sustainable development path. China is a very important EU trade partner, and the two have worked closely on sustainability issues for some 25 years. There can be no doubt that in the early part of this period (the first 15 years or so) China exhibited a worrying divergence on environmental and climate mitigation policies.



This stance was harmful first of all for its own citizens, workers, farmers and nature (water, air, soil and forests). But it also became a major preoccupation for EU policymakers keen to support and cooperate with China in its endeavours to engage in market reforms and open trade and investment (both before China joined the World Trade Organization in 2001, and even more since).

**Not long ago China was still a developing country, though today it has achieved upper middle income status. But its unprecedented economic growth path was pursued 'at all cost'**

#### **Growth, at all cost**

Not long ago China was still a developing country, though today it has achieved upper middle income status. But its unprecedented economic growth path was pursued 'at all cost'. The high-growth imperative permeated all levels of government and became a powerful credo for businesses. Other considerations and concerns were ignored or subjugated to the primacy of growth. That focus continued even after seemingly serious environmental and climate mitigation policies started to be adopted. For example, the central role of cheap coal to power industry and provide heating has been maintained up to this day – despite a push for households to replace coal with gas (and before that with less polluting coal briquettes). Modest reductions in coal's very high share in energy supply have now been accepted (though only recently).

Meanwhile, CO<sub>2</sub> emissions tripled from the mid-1990s to today, despite Kyoto. China remains by far the world's largest emitter. Other greenhouse gasses, like methane and NO<sub>x</sub>, are also still on the rise. Although CO<sub>2</sub> worsens the climate, it does not have noticeable effects on people. But coal use has caused huge SO<sub>2</sub> pollution, with dramatic consequences for health, as well as acid rain in China and its neighbours. Severe pollution went virtually unchecked for decades, and is evident in the country's 'black' rivers, lakes and groundwater; the constant smog that envelopes many cities; and the numerous unreported instances of soil contamination.

Besides putting millions of citizens, workers and farmers at higher risk of diseases and premature death, the pursuit of growth 'at all cost' also implied a de facto refusal to push domestic and international business to shoulder the cost of preventing and correcting unacceptable negative externalities.

#### **Dialogue and partnership brought a wind of change?**

This sad picture held until perhaps a decade ago, but now stands to be corrected. The EU has been a tireless supporter of China altering its policies and regulations (including taxes). It has engaged China in dialogues on climate, the environment, emissions trading, clean coal, sustainable forestry, sustainable fisheries and other issues. It has collaborated with China on action programmes and a joint water platform. The two have issued joint policy statements and summit conclusions, and worked together in the Clean Development Mechanism under Kyoto (with China as the leading user and EU companies as the leading investors), as well as in other initiatives, such as the ambitious EU-China roadmap on energy cooperation (2016-2020).

**There is little doubt that nowadays China is on a path of increasing convergence with the EU's broad preferences**

How effective these EU collaborations with China have been is less clear. China has also turned to international economic organisations, such as the Asian Development Bank, the World Bank and the Organisation for Economic Co-operation and Development (OECD), and to some extent to Japan and the United States. Moreover, pressures built up from within the country too. The Chinese people have become ever less patient with the incredibly unhealthy air and water pollution.

The contributions of all these factors means it is next to impossible to rigorously 'measure' whether and to what extent the EU's efforts have been a driver in the recent reversal of China's environmental and climate strategies. But there is little doubt that nowadays China is on a path of increasing convergence with the EU's broad preferences.

#### **Proof of convergence?**

1. Both China and the EU are signatories to the 12 most important multilateral environmental agreements, including various additional protocols and new annexes.

2. China's record on sustainable development is actually more mixed than many realise. European attention typically focuses on the excesses and dismal circumstances. Far less is said about the achievements. These include China's leading global position in renewables production and equipment, and its 25-year-old reforestation programme (which led to a jump in area covered from 15% to 23%, and is set to reach 26% in 2030). There is also China's significant increase in relevant taxation over the past decade or so.
3. China joined the Paris Agreement, and this is bound to have major consequences for domestic policies in the coming three decades. In doing so it has made a U-turn away from its former stance that its emissions are irrelevant given the cumulative emissions from OECD countries over the past two centuries.
4. China enacted three significant and risk based laws on water, air and soil pollution between 2015 and 2018, with much tougher enforcement provisions.
5. China has moved to confront the main weakness of its environmental policies, which is enforcement and monitoring. For example, it is investing in technological hardware such as cameras to monitor illegal waste and pesticide dumping in Western China, and it is carrying out more frequent inspections (leading to detection of thousands of illegal waste dumping sites on the Pearl River). It is also issuing tougher sanctions in some cases, and setting more precise targets for provincial authorities in some instances.
6. Partly due to the Paris Agreement, 'hard' reduction targets have become more common. The most important of these is the cap on the share of coal use in energy supply (58% by 2020). This is something that had been carefully avoided thus far.
7. We see less fear of employing pricing and tax measures in environmental and climate policies. The spectacular example is of course China's national emissions trading system, with a carbon price that is meant to increase over time, due to start in earnest in late 2020. The use of pricing to encourage greater water use efficiency is no longer taboo.

### Mixed signals

It is very difficult, at this point, to assess China's environmental and climate policy, because of the mixed signals surrounding its strategy. Certainly some indicators point to lousy results. But there are also enlightened policies and controls, and indicators showing leadership. Where the EU seems to have exercised considerable influence is in technology, strategic thinking, policy formulation and underpinning 'best practices',

as well as possibly in the setting up and improvement of monitoring and data banks. The EU and China also have similar long-run preferences in almost all multilateral environmental agreements, and often even in the instruments and calendars. The caveat here is that China was recently a developing country, and that status has consequences for environment-related obligations under some multilateral agreements. Also, in China, policy formulation is usually far ahead of actual results realised in markets, in empirical data and in the wellbeing of citizens. The lag can easily be a decade or (much) more.

### A telling thought experiment

A thought experiment can help us appreciate China's progress on the sustainable development path. Modern EU free trade agreements (FTAs) contain a chapter on 'sustainable development'. The EU FTA with Japan is one of the most ambitious. It expresses quite well the EU's preferences on trade and investment-relevant sustainable development provisions.

Let's take chapter 16 of that FTA, and break it down into 10 main issues, with in total 41 sub-items. Even though China does not, of course, have an FTA with the EU, careful verification of the 41 items shows that China broadly approximates this 'EU standard', with some uncertainties about a few items and definitely a few weak points. Admittedly, this exercise does not go beyond broadly formulated wording but nonetheless it demonstrates that China and the EU are on a gradually convergent path.

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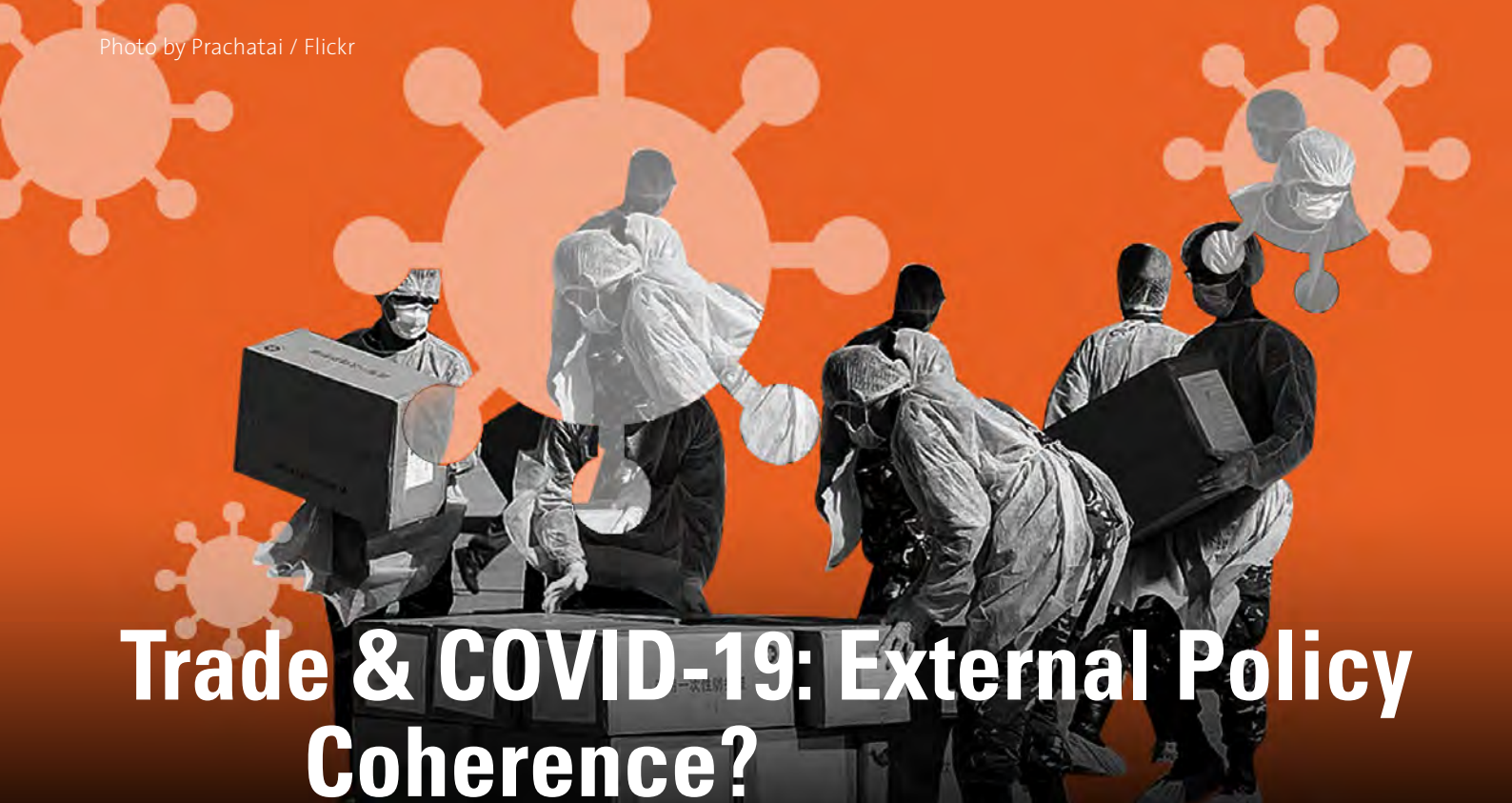
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# Trade & COVID-19: External Policy Coherence?

Widespread use of trade policy to maximise access to medical supplies may have had significant knock-on effects internationally. While robust government intervention is arguably critical in emergencies like the COVID-19 pandemic, recent experience offers at least six lessons for external policy coherence.

**By Bernard Hoekman and Matteo Fiorini**

As part of the response to the COVID-19 pandemic, governments around the world resorted to trade policy to increase their access to medical supplies and personal protective equipment (PPE). Available domestic supplies were requisitioned and export restrictions enacted, as well as measures to facilitate imports and public purchases of critical products. According to the Global Trade Alert, an independent trade policy monitoring initiative, as of end May 2020 over 80 governments had implemented export restrictions and/or lowered barriers to imports of COVID-relevant products.

## **Trade policy responses in the EU**

The European Union (EU) imposed temporary export restrictions for essential supplies such as PPE in March 2020 as did the United States. In addition to trade measures affecting exports from the EU as a whole, individual EU member states – Belgium, Bulgaria, the Czech Republic, Germany, France, Hungary, Italy, Poland and Romania – enacted export controls for specific

products, including drugs, PPE, disinfectants and ventilators. Particularly striking was that in these initial policy responses, some EU member states applied export restrictions to other European nations as well as to non-EU countries. A prominent example, discussed in Hoekman, Fiorini and Yildirim (2020), was French authorities' requisition of PPE consignments owned by Mölnlycke, a Swedish company. These consignments involved products that had not been produced in France but were being transported to destinations in the EU through Mölnlycke's distribution centre in Lyon. Actions by EU member states to requisition supplies and block exports to other European countries are not prohibited by the EU treaties in situations where the public interest is at stake. Yet, because they impeded the operation of the single market, the national recourse to export controls was an important motivation for the European Commission's decision on 14 March to issue its EU-wide controls on exports of certain medical and protective equipment to non-EU countries.



The upshot was that a policy first imposed by several member states at the national level was extended to the EU as a whole. The EU-level regulation introduced an export authorisation requirement, depending on assessments of the availability of different products within the EU. Initially, the regulation applied to all non-EU export destinations, but it was quickly amended (on 19 March) to exempt shipments to the four European Free Trade Association members and overseas territories and countries listed in Annex II of the Treaty on the Functioning of the EU. The export authorisation regime was initially scheduled to last six weeks. On 23 April the regulation was extended for an additional month, with the Western Balkans added to the list of excluded countries. It ceased to apply after 26 May.

## As of end May 2020 over 80 governments had implemented export restrictions and/or lowered barriers to imports of COVID-relevant products

### Unintended consequences

Robust government intervention is critical in emergencies like the COVID-19 pandemic. Regulation is needed to ensure that scarce critical supplies are allocated to priority uses, to control speculation and to ensure health and safety standards. This cannot be 'left to the market'. But while export restrictions and requisition of domestic supplies of essential goods seem obvious and justifiable in times of crisis, they can give rise to unintended consequences. The result may be to reduce access to critical supplies, significantly increase average prices and market volatility. Moreover, from the perspective of policy coherence, policies to maximise supplies for domestic purposes may generate significant negative spillover effects on other countries – not least, the EU's trading partners, particularly developing countries. A noteworthy feature of the temporary EU export control regime is that it did not distinguish between external partners. In principle it also applied to signatories of economic partnership agreements (EPAs) with the EU and to least developed countries (LDCs).

### Effects multiplied

The international price-increasing effects of requisitions and export controls by a major trade power like the EU may be worsened if similar actions taken by other countries affect access to inputs that plants – wherever they are located –

need to import to ramp up production. Many manufacturers of medical supplies and PPE produce through international networks. They source intermediate inputs from different countries to process into final goods. Allowing global value chains to function is critical to permit such producers to ramp up supply. It is still too early to know exactly what impact the widespread use of export restrictions and competition between governments had on essential supplies. But anecdotal evidence suggests these effects were significant. At this preliminary stage, the COVID-19 pandemic offers at least six lessons for external policy coherence.

### 1. Reshoring production is not the answer

Many have latched onto the shortages of essential supplies that became evident after the pandemic struck to argue that countries should not and cannot rely on international markets and that the degree of specialisation and extent of global value chains that has emerged over time is undesirable. What is needed instead, they say, is greater self-sufficiency and thus policies that incentivise – or require – 're-shoring' of production. In the EU such arguments are sometimes articulated under the 'strategic autonomy' label. They are not limited to essential medical supplies but extend to food and a broad cross-section of industries and technologies deemed strategic.

Such arguments are misconceived. In the case of medical supplies and PPE, serious short-term supply constraints would inevitably also arise if countries had greater domestic capacity, as the need to ramp up supply would still exist following an unexpected demand shock. Having to cross a border is not a binding constraint on firms' ability to rapidly expand production, given that it takes only 48 hours or so to get anything from anywhere in the world. Autarky will not make it any faster to get whatever is critical in a crisis to those who need it. What is needed is for governments to ensure that stocks of essential supplies are built up before crises hit, and to diversify production capacity across different parts of the world. The focus should be on encouraging and supporting business responses as opposed to disrupting supply chains and engaging in negative-sum competition for existing supplies and production capacity.

### 2. Better information on value chains and bottlenecks

To ramp up production of essential protective and medical products, companies need information on demand and applicable product and production standards. They need to be able to obtain rapid certification and to source the requisite inputs – including from foreign suppliers. Effective two-way communication channels are needed to enable firms to identify specific bottlenecks that impede ramping up of supply. Firms

also need systems to monitor market conditions and identify slack and chokepoints in their global network, so they can make the production adjustments needed to respond to changes in demand. Governments need information systems that allow them to determine where supply capacity exists and help them understand the relevant supply chains. While firms generally have information on supply options, governments seldom have such information readily to hand. Both sets of actors need to be able to identify bottlenecks in the supply chain in real time and cooperate in addressing them.

## **What is needed is for governments to ensure that stocks of essential supplies are built up before crises hit, and to diversify production capacity across different parts of the world.**

This calls for information systems that permit identification of sources of friction impeding production expansion that are due to – or can be overcome – through policy action. Such information systems were not in place in many if not most countries. Authorities did not have a good understanding of the prevailing supply chains and production capacity. There are exceptions. In New Zealand, for example, the Medicines and Medical Safety Authority requires firms to disclose their supply chain, including where active ingredients for medicines are made and where they are packaged. However, most authorities and jurisdictions seem to be largely in the dark. There is a notable contrast here with other policy areas such as food products, where traceability throughout the supply chain has become a common feature of the production and distribution process (Hoekman and Sabel 2019).

### **3. Common product standards and recognition arrangements can help boost production**

Standards and certification of products, plants and suppliers are critical for safety. But the associated regulatory enforcement processes can constrain rapid response in an emergency. One good practice here is for governments to accept foreign standards during an emergency, as was done by the US Centers for Disease Control and Prevention when it approved use of respirators that satisfied equivalent foreign standards, including

China's GB 2626-2006 and GB 2626-2019 standards and the European EN 149-2001 standard.

The existence of common product standards and mutual recognition of standards facilitates supply responses and cross-border production arrangements. This reinforces the value of international regulatory cooperation, mutual recognition arrangements and efforts to determine whether and where regulatory regimes across countries/systems have the same goals. Where that is the case, the next step is establishing equivalence regimes.

The opportunity cost of not having equivalence and recognition regimes in place was illustrated by China's decision to impose new export license requirements in early April 2020. The government was responding to several European countries' rejection on quality grounds of PPE shipments sourced from Chinese companies. The Chinese authorities feared a reputational backlash and moved to ensure that exported products met quality and safety standards by limiting exports to firms certified to sell in its domestic market (i.e., firms accredited as meeting Chinese technical standards). The new regulation blocked companies accredited by buyers in the United States and EU – e.g., firms with CE certification – from exporting until they had obtained certification in China.

Cooperation between governments (regulators) to establish recognition and equivalence arrangements for certification and acceptance of foreign standards would help prevent such application of rigid national standards and the associated detrimental trade-restricting effects. This could be especially important in times of crisis, when unilateral action can have very high humanitarian costs.

### **4. No way around multilateral cooperation**

The post-financial crisis period has made clear that G20 countries are unwilling to live up to strong trade policy commitments (Hoekman and Wilkinson 2020). The attenuated support for multilateral cooperation and the electoral success of political parties opposed to globalisation and an open world economy, makes any effort to agree to disciplines on export restrictions very unlikely to succeed. However, cooperation centred on information exchange, dialogue and peer review may be more feasible. Such efforts should encompass the private sector, as it has the best grasp of the relevant supply chains. Public-private policy partnerships to generate and share up-to-date information on supply conditions and supply chain capacity around the globe would help governments and industry understand the state of play and coordinate policy responses,

address supply chain bottlenecks, and strengthen supply responses.

### **5. Open plurilateral agreements can be a way forward**

The EU is currently pursuing several potential plurilateral agreements that would apply only to signatories, including on e-commerce, investment facilitation, services regulation, and support for micro, small and medium-sized enterprises. As part of their COVID-19 response, New Zealand and Singapore have agreed to eliminate applied tariffs for essential medical and protective products, medicines and agricultural products; to refrain from export restrictions on such goods; and to expedite the movement of these goods through their ports. They have indicated they would welcome other countries joining them. As of this writing, the EU had not done so, presumably reflecting its actions to restrict exports of essential supplies. This is arguably a missed opportunity. Looking forward, participation in such initiatives could bolster the ability of EU governments to respond to shocks like the COVID-19 pandemic with policies that do not generate the types of adverse spillover effects associated with export controls.

Another policy area where open plurilateral agreements could add value is mutual recognition and equivalence regimes for technical regulation and certification of protective equipment and medical supplies. Such agreements can clear a path towards positive and proactive cooperation to address supply-side constraints, complementing desirable unilateral actions to facilitate trade.

### **6. Considering subsidies' effects beyond EU borders**

Subsidies is another policy area that lends itself to plurilateral cooperation. In the years since the global financial crisis, subsidies have come to account for an increasing share of the trade-related policies adopted by emerging economies and high-income countries. Subsidies are often motivated by legitimate policy objectives. In the context of COVID-19, for example, governments have provided extensive subsidies to domestic firms to help them meet the costs of lockdown policies that have disrupted both demand for and supply of many goods and services. However, these measures inevitably have spillover effects on other countries.

In the EU, subsidy programmes are subject to approval and monitoring by the European Commission, as state aid is subject to EU-wide competition rules. Yet, no such rules exist at the global level. Furthermore, EU competition policy does not consider non-EU markets in its assessments of the effects of state aid and the behaviour of EU firms. Governments are

unlikely to be willing to consider stronger multilateral rules on competition policies. However, Hoekman and Nelson (2020) argue that a plurilateral initiative to assess the magnitude of negative spillover effects from subsidy policies would help clarify the extent that different types of subsidy policies have systemic implications. This is an area where the EU has extensive experience and is well placed to take a leadership role. The aim would be a common understanding of the effects of subsidies and approaches for attaining legitimate public policy goals while minimising competitive distortions.

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# The under-tapped potential of trade and investment tools: The Enterprise Europe Network

Swedish SME expands into Bulgaria with expert guidance from the Enterprise Europe Network.  
Photo copyright : HP Tronic

Trade and investment promotion tools such as the Enterprise Europe Network (EEN) can contribute to making better use of trade policies and agreements to deliver real results for consumers, workers and businesses, with respect for the planet and human rights.

**By Jeske van Seters and San Bilal**

The focus of the Enterprise Europe Network (EEN) on small and medium-sized enterprises (SMEs) is critical. They are the “backbone of the EU economy”, as the European Commission’s new SME strategy points out. SMEs provide two out of every three jobs in the EU. They account for more than half of Europe’s GDP. They also bring innovative solutions to challenges like climate change, resource efficiency and social cohesion.

Global markets are an important source of growth for SMEs, and this will continue in the post-corona era. The COVID-19 pandemic hit the world economy hard, and Europe was not spared. While the virus has spurred protectionist sentiments, isolation is unlikely to help turn the economic tide. Estimates suggest that 90% of global growth will originate from outside the EU in the coming years. While this figure predates the COVID-19 outbreak, the bottom line is unlikely to change. Internationalisation of European companies beyond the EU therefore remains important to ensure Europe’s competitiveness, economic growth and innovation.

More could be done through networks like EEN to take advantage of trade opportunities with third countries. Four avenues in particular could be explored to unlock the under-tapped potential of tools like EEN: (i) maximising geographical scope; (ii) more explicit inclusion of social and environmental issues; (iii) promoting collection and use of company feedback on the design and implementation of trade policy; and (iv) enhancing synergies with development cooperation.

## **Maximising geographical scope**

At the end of 2018, EEN was active in 65 countries. These included, in addition to all EU member states, the eight non-EU countries participating in the EU Competitiveness of Enterprises and SMEs (COSME) programme, which co-finances EEN. These countries are Albania, Armenia, Iceland, Moldova, Montenegro, the Republic of Macedonia, Serbia and Turkey. In EU and COSME countries, EEN consortia offer services free of charge, with the EU providing 40-60% of co-funding.

The Enterprise Europe Network (EEN) is a business support initiative launched in 2008 by the European Commission.

It helps small and medium-sized enterprises (SMEs) innovate and grow internationally, both within and outside the EU. EEN offers a mix of international matchmaking, advice for international growth and support services for business innovation.

EEN is implemented by the Executive Agency for Small and Medium-sized Enterprises (EASME) through consortia consisting of technology poles, innovation support organisations, universities and research institutes, regional development organisations and chambers of commerce and industry. Each consortium offers services in a defined geographical region, to ensure proximity to local SMEs.

EEN is also active in non-COSME countries. In these countries, EEN partners, called 'Business Cooperation Centres' (BCCs), are not EU funded. They participate on a self-financing basis. The BCCs provide a more limited set of services. At the end of 2018 there were BCC in 27 countries, including China, India, Brazil, Japan, the USA and New Zealand. See Figure 1 for all countries with BCCs.

The number of BCCs is on the rise and they contribute to an increasing number of matches between EU and non-EU companies. Nonetheless, there is considerable scope to extend EEN partnerships to more countries. EEN presence is particularly low on the African continent. The Network is currently only active in Cameroon, Egypt, Nigeria and Tunisia. Expansion of EEN activity in Africa would fit the EU's evolving approach towards Africa, which emphasises deeper economic and trade relations between the continents.

### **Inclusion of social and environmental sustainability**

Though EEN underscores issues of social and environmental sustainability, it has maintained a largely hands-off approach. EEN sector and thematic groups provide platforms for information sharing and collaboration among EEN staff on issues like the circular economy. A 2008-2014 evaluation found that EEN services have contributed to companies' environmental sustainability. However, when it comes to social and environmental sustainability, it is not reflected in the selection criteria for companies to receive EEN support and EEN still puts the main onus on network partners.

The European Commission could strengthen EEN's role in promoting social and environmental sustainability in business development and economic relations between the EU and

third countries. This could be done, for example, through more targeted selection criteria and support, and by ensuring that the newly proposed 'sustainability advisors' and other EEN sustainability services cover BCC countries. This is fully in line with the European Green Deal, which requires all EU actions and policies to take into account climate and environment-related challenges.

With greater engagement on these themes, EEN could better serve EU values while further enhancing economic opportunities for Europe's 'green' companies. For instance, there is a strong business case for circular innovations, investments and trade relations, as recognised by the Netherlands in its circular economy government-wide programme. Some estimate that moving to a circular economy could bring the EU €550 billion in economic growth and produce two million new jobs.

### **Company feedback on trade-related policies**

EEN is a powerful communication channel on EU policies, including trade policies. EEN also provides practical advice on doing business in another country, with BCCs contributing information on national rules and regulations. As such, EEN complements online tools such as the EU Trade Helpdesk, the Trade Market Access Database and the EuroMed Trade Helpdesk. EEN's network includes a very large number of SMEs with international ambitions.

EEN also collects feedback from SMEs on existing and upcoming EU policy measures. Collecting feedback has been an integral EEN activity since its launch. The Network has different feedback mechanisms, including SME panels, an SME feedback database and online consultations, which it uses for different purposes. However, these mechanisms have been remarkably little used in relation to trade policies.

Nine legislative and administrative initiatives were put to SME panels in 2017-2018. Yet, none related to trade policy matters. More emphasis on trade policies could bring substantial benefits. The EEN evaluation concluded that Network consultations were "an effective instrument to collect inputs from SMEs in the EU policy making process" and went on to suggest that such consultations were "significantly better than the Commission's public consultations in reaching SMEs in Europe".

In its SME feedback database, EEN captures spontaneous reports of problems resulting from EU legislation and policies. In 2017-2018, 495 cases were registered. The numbers of cases reported vary considerably between member states and sectors. This hints at the potential for more actively seeking feedback on trade policies. The data in the system could also be analysed for policymakers' use. Disseminating findings to relevant audiences could incentivise SMEs to communicate more.

**Figure 1. Countries with EEN Business Cooperation Centres (BCCs)**



*Source: Adapting for the future. 2017-18 Final Activity Report Enterprise Europe Network. Brussels: EASME.*

EEN has acknowledged the difficulty of convincing SMEs to provide feedback. This is due partly to uncertainties about how feedback will be used and the lack of evidence of feedback having any effect. In addition to more explicit use of feedback, consideration could be given to expanding the SME feedback database beyond EU policies and the single market, to cover partner countries' trade-related policies.

### **Development cooperation as a lever**

Enhancing synergies between commercial tools such as EEN and development cooperation could boost sustainable private sector development and trade. Development cooperation can help local business organisations in lower income countries qualify for EEN membership. The end result could be to strengthen services to local firms, including services offered under the EEN banner.

Links between EEN and development cooperation activities are particularly relevant in Africa. These could help shore up business support organisations and their local services, while promoting the capacity of private sector actors to engage with European companies in a socially and environmentally sustainable way. Development cooperation can help address systemic issues, clearing the way for EEN engagement towards new trade and investment relations with the EU and sustainable private sector development in African countries.

Furthermore, feedback collected through EEN on trade bottlenecks between the EU and low-income countries could be valuable to guide development cooperation. Beyond EEN, there are other mechanisms too that can play such roles, including European business organisations in partner countries. This is in essence the third pillar of the External Investment Plan,

which seeks to identify specific bottlenecks that governments can address, possibly with support of the European Union. EEN can thus be a valuable tool in the EU's broader international cooperation toolbox.

### **An upgrade in EEN's future**

The European Commission announced in its SME strategy its intention to 'upgrade' EEN. The considerations and recommendations presented in this article can be part and parcel of this agenda. EEN is a strong tool for promoting business-to-business linkages and trade within the internal EU market. It is time to step up its contributions to social and environmental sustainability and global trade. This upgrade could serve as an example for other trade and investment promotion tools.

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# Trade agreements, non-trade provisions and bilateral foreign direct investment



Today's deeper and more complex preferential trade agreements have ushered in substantial growth in bilateral foreign direct investment (FDI) between partners. Non-trade related provisions in trade agreements also seem to have a positive effect, particularly provisions related to civil and political rights.

By [Hugo Rojas-Romagosa](#)

## Preferential trade agreements and bilateral FDI

The main purpose of preferential trade agreements is to increase bilateral trade between partner countries by reducing trade frictions (tariff and non-tariff measures), in combination with other provisions that facilitate trade. Recent preferential trade agreements also include provisions that benefit not only trade, but also bilateral investment. In addition, and with increasing frequency, several non-trade issues are being incorporated into trade agreements. These include provisions on political and civil

rights, economic and social rights, and environmental protection (Lechner 2016). These are sometimes referred to as non-trade policy objectives (NTPOs).

Given today's proliferation of deeper and more complex preferential trade agreements, we conducted research on the effect of PTAs on bilateral foreign direct investment (FDI) between partners. In an initial study (Kox and Rojas-Romagosa 2020) we found that indeed, preferential trade agreements had a positive effect on FDI. Implementing any preferential trade agreement increased bilateral FDI by 30% on average. However,

we found no conclusive empirical evidence that signing deeper preferential trade agreements had a substantially different impact than signing simpler, more shallow agreements.

## The benefits of a single market

Belonging to the European Union (EU) single market does have a very large impact: increases bilateral FDI by 135%. Hence, the impact of the greater economic integration associated with the EU single market was almost quadruple that of signing a preferential trade agreement. This was expected, since facilitating the

free movement of capital is one of the four fundamental principles of the EU single market (together with the free movement of goods, services and labour). Other economic integration mechanisms also facilitate bilateral investment within the EU. These include the EU's customs union and common external trade policy, the large number of EU-wide regulatory bodies, and the enforcement of EU law through the European Court of Justice. Most of these mechanisms are absent in even the deepest and most recent preferential trade agreements.

### Effects of bilateral investment treaties

Another finding from our study is that signing a bilateral investment treaty increased bilateral FDI by around 40%. Moreover, the impacts were similar regardless of whether the treaty was legally enforced or only signed. Thus, the impact of bilateral investment treaties on bilateral FDI was around the same order of magnitude as signing a preferential trade agreement. It is important to note that these types of agreements are usually substitutes and not complements. Countries that sign a bilateral investment treaty do not have a preferential trade agreement between them. Conversely, countries that sign a preferential trade agreement usually do not need to sign a bilateral investment treaty afterwards. Our empirical results suggest that signing either has a very similar overall effect on bilateral FDI.

### Adding non-trade issues to the mix

In a second study we expanded on the initial research by assessing whether including non-trade issues in a preferential trade agreement had any additional positive or negative impact on bilateral investment. A priori, it was unclear how inclusion of non-trade provisions in a trade agreement would affect bilateral FDI. Stronger commitments, for example, on labour and environmental protection, could hinder the entry (or expansion) of a multinational enterprise (MNEs)

into a country by increasing operational and compliance costs. However, MNEs with strong corporate responsibility and social awareness policies might prefer countries with explicit commitments on non-trade issues. Therefore, the direction (sign) and magnitude of the effect of including non-trade issues in preferential trade agreements was an open empirical question.

To account for the presence and extent of non-trade provisions in preferential trade agreements we used data from Lechner (2016). These trace provisions on non-trade issues in preferential trade agreements over time. In conjunction with the existence of a preferential trade agreement, they allowed us to estimate the potential effect of non-trade issues on bilateral FDI. Lechner (2016) developed metrics for three broad categories of non-trade issues: civil and political rights (CPR), economic and social rights (ESR), and environmental protection (EP).

**While signing a preferential trade agreement increased bilateral FDI, including civil and political rights provisions in the agreement had an additional positive effect on investment**

### Positive effects, if any

We found that only CPR provisions had a positive, significant and robust effect on bilateral FDI. Thus, while signing a preferential trade agreement increased bilateral FDI, including civil and political rights provisions in the agreement had an additional positive effect on investment. The other two indicators generally had

positive coefficient signs, but they were not robust to different specifications. In other words, we found no strong empirical evidence that adding economic and social rights and environmental protection provisions to a preferential trade agreement increased bilateral FDI. At the same time, we found no negative FDI effects of including more or stronger non-trade provisions in trade agreements. To sum up, when NTPO provisions were included in a preferential trade agreement, they had a positive effect, if any, on bilateral FDI.

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# Export promotion: Another tool to reduce unemployment?

Export promotion helps reduce unemployment, especially when export promotion agencies focus their promotion efforts on sectors where a country has a comparative advantage. When they focus on sectors with high labour market frictions, unemployment increases.

By Cristian Ugarte and Marcelo Olarreaga

## Do export promotion agencies work?

Most analysis done in the 1980 and 1990s on the effectiveness of export promotion agencies (EPAs) concludes that they were ineffective. Reasons given are lack of awareness by the private sector of the services provided by EPAs, no client orientation, inadequate funding and a strong anti-trade bias in most countries' trade regimes. Agencies have since reformed and become more responsive to private sector needs, while trade regimes have become more open. In fact, recent evaluations of EPA performance suggest that they have a strong positive impact on export growth. Researchers at the World Bank found that on average a one per cent increase in export promotion budgets was associated with a 0.04 per cent increase in exports. Is promoting exports the ultimate objective?

Export growth can be a valid target for policymakers, but it is seldom the ultimate objective of economic policy. After all, export growth is not very helpful if it is accompanied by a decline in economic activity or higher unemployment levels. EPAs must ensure that by promoting exports they are not hurting other policy objectives.

A recent study from the University of Geneva examined whether export promotion helps or hinders GDP per capita growth. It found that increased export promotion budgets were associated with higher GDP per capita in all of the countries examined. This suggests that by promoting exports, EPAs also promote economic growth. However, the same study found that different export promotion policies can have divergent effects on exports and GDP per capita. A policy like matching grants, for example,



may be effective in terms of increasing exports, but may not be beneficial when it comes to increasing GDP per capita.

### Can export growth help reduce unemployment?

Trade economists have long known that there is no straightforward answer to the question of whether export growth leads to more or less unemployment. Of course, as exports grow, employment increases in the firms that are producing and exporting more. This is almost mechanical, as output grows employment increases in those firms. But whether aggregate employment increases and unemployment declines is a more complex question. Its answer, in principle, has remained ambiguous since the seminal work of the Canadian trade economist Richard Brecher in the 1970s. To learn whether export growth helps reduce unemployment we need to consider all the economic interactions of firms and sectors in goods and labour markets.

## Whether export growth results in increased or decreased aggregate unemployment, depends deeply on the structure of the economy

A recent study from the University of Geneva and United Nations Conference on Trade and Development (UNCTAD) found that countries with a comparative advantage in sectors with low unemployment tended to have lower levels of aggregate unemployment. On the other hand, countries with a comparative advantage in sectors with high unemployment tended to have higher levels of aggregate unemployment. The reason is simple. If a country's comparative advantage is in sectors with high labour market frictions, then more of its labour force will be attracted to these sectors where unemployment is high, and move out of sectors with relatively low unemployment. This leads to increased aggregate unemployment. Thus, whether export growth results in increased or decreased aggregate unemployment depends deeply on the structure of the economy.

### Can export promotion help reduce unemployment?

The relation between export promotion and unemployment was the subject of a study we recently did for the Horizon 2020 RESPECT project ('RESPECT' stands for Realising Europe's Soft Power in External Cooperation and Trade). A priori if the impact of export growth on unemployment is ambiguous, then the impact of export promotion is also likely to be ambiguous. Like previous studies, we found that countries with a comparative advantage in sectors with high labour market frictions tended to have higher levels of aggregate unemployment.

However, once this was accounted for, we found that increased export promotion budgets were associated with reduced unemployment. In other words, export promotion did indeed help to reduce unemployment.

More interestingly, the type of sectors targeted by EPA promotion efforts mattered. Aggregate unemployment was lower in countries where EPAs allocated more of their budgets to sectors with greater comparative advantage. If EPAs spent more of their budgets on sectors with high labour market frictions, aggregate unemployment increased. Thus, unemployment can increase or decrease, depending on how EPAs allocate their export promotion budgets across sectors.

This tells us that in countries where export promotion budgets are largely allocated to sectors with greater comparative advantage, and a small fraction to sectors with high unemployment, we should observe that export promotion reduces unemployment. Countries illustrative of this category are France, Turkey, Belgium, the Czech Republic, Vietnam, Malaysia, and Trinidad and Tobago. At the other end of the spectrum are agencies that spend more of their export promotion budgets in sectors with high unemployment and little comparative advantage. Their efforts would lead to increased unemployment. Examples in this category are Spain, Lithuania, Cyprus, Brazil and Mexico.

### Policy implications

The policy implications are clear. Even if the mission of EPAs was to shift from export promotion to reducing unemployment, their export promotion efforts should still target sectors where a country has a comparative advantage rather than sectors with high labour market frictions. By targeting sectors with more comparative advantage, EPAs can boost export growth while also reducing unemployment.

Of course, export promotion remains a second-best policy when it comes to tackling aggregate unemployment. Addressing the labour market frictions in each sector directly is no doubt a more efficient policy.

### About the authors

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# Using official export support in a crisis

Publicly funded export credit agencies (ECAs) help businesses access opportunities abroad, particularly in times of crisis, like the COVID-19 pandemic. Yet, without a clear governance framework, ECA support can become a 'race to the bottom' in export support terms and conditions. That could crowd out the private sector and have severe implications, particularly for developing countries. Now is the time to negotiate a clear regulatory framework to prevent a zero-sum subsidy race and observe the sustainable development agenda in official export credit support.

By Kamala Dawar

The COVID-19 health crisis has profoundly impacted international trade. The resulting shock to global capital markets and credit stress have affected numerous countries. Rising export costs, disrupted supply chains and the loss of markets are making it difficult for many exporters to access vital commercial finance. This has disproportionately affected small and medium-sized enterprises (SMEs), increasing their default risk.

In times of crisis, major industrial governments have historically supported domestic exporting companies through export credit agencies (ECAs). Publicly funded ECAs help businesses find opportunities abroad, and may also act as lender of last resort if commercial banks retreat as providers of medium and long-term (MLT) finance. The role and significance of ECAs faded in the 1980s, as commercial financial markets became

more robust. However, when the 2008 financial crisis hit, ECAs were revived as critical shock absorbers ensuring liquidity in the international trading system, though not all resumed their traditional role as lender of last resort.

## ECAs during COVID-19

ECAs have asserted their role in the COVID-19 crisis too. For example, in 2020 Denmark's export credit agency, EKF,

extended its reinsurance scheme to cover OECD and EU countries where importers of Danish goods were struggling with liquidity issues. Poland's export credit agency, KUKE, expanded its protection to cover all political and commercial risk on export transactions with repayment terms greater than two years. Export Finance Australia created a new A\$500mn capital facility for established and previously profitable exporters that, due to COVID-19, could no longer obtain finance from commercial sources. The Export-Import Bank of the United States (EXIM) passed a series of emergency coronavirus measures to "inject liquidity into the market" and help US companies trading internationally.

While all crises are different, some lessons can be learnt from the past. One is that we live in an integrated global system, so problems are most effectively tackled through globally integrated solutions. Unfortunately, the global governance framework for regulating official export credit support was fragmented even before COVID-19. Following the 2008 financial crisis, most ECAs did not resume their former role of ensuring liquidity in the international trading system. Instead, they became cogs of domestic industrial policies set to secure export markets at a time of global stagnation. ECAs were increasingly 'weaponised' for this task, competing for scarce export markets both with each other and with the private sector. In doing this, they stretched the boundaries of the carefully constructed legal framework that governed most ECAs most of the time.

### ECA rules framework

ECA activities are regulated by various agreements. Key among these is the OECD Arrangement on Officially Supported Exports Credits (referred to as the 'Arrangement', with adherent countries called 'Participants'). The Arrangement sets terms and conditions for export credit, including minimum interest rates, risk fees and maximum repayment terms. Additional ethical agreements, known as 'Common Approaches', address anti-bribery, environmental, social and human

rights (ESHR) impacts and sustainable lending to heavily indebted poor countries.

These dynamic, voluntary guidelines are linked to binding multilateral rules under the Subsidies and Countervailing Measures (SCM) Agreement of the World Trade Organization (WTO). The SCM Agreement permits export credits conforming to the terms of the Arrangement, but also introduces prohibitions, such that governments may not provide export credit at rates below the rates actually paid for the funds. It thus provides a safe harbour for export credits conforming to the OECD Arrangement terms.

### A joined-up governance system

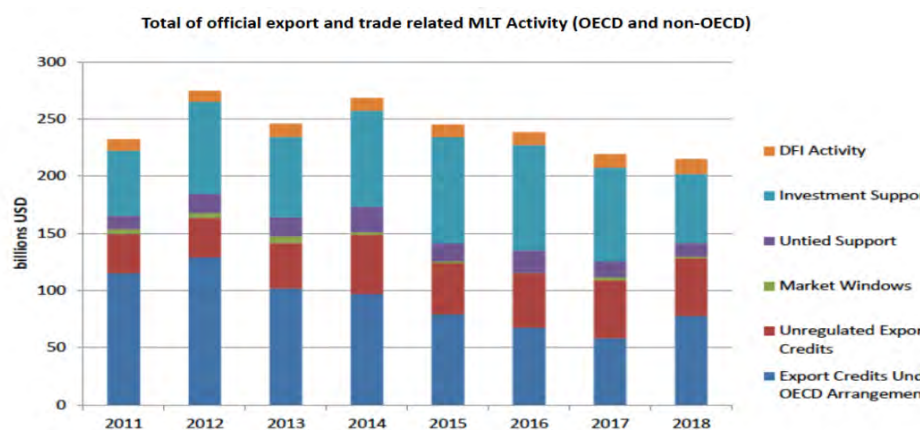
Previously, this joined-up governance system created a powerful synergy, increasing both the relevance of the SCM Agreement and the attractiveness of participation in the Arrangement. However, the influence of the Arrangement has declined in light of geopolitical factors, such as the significant volumes of export support provided by countries that are not Participants to the Arrangement. China is an example, as its power transition has been accompanied by a rise in its trade-related ECA activity (Hopewell 2019). But China is not alone. By 2017, the top two export credit providers, China and India, were not

Arrangement Participants. This means they operated outside the guidelines of the Arrangement and Common Approaches.

Participant country ECAs have responded to the increased competition by exercising flexibilities under the Arrangement, and by designing programmes outside the scope of the Arrangement. They are shifting towards a 'whole of government' approach; establishing export support programmes such as investment insurance, market window arrangements and increased development finance institution (DFI) activity. These are not covered by Arrangement rules. Since 2012, there has been an observable decline in Arrangement-covered MLT export finance, with a commensurate gain in non-Arrangement export support, see Figure 1. The increased activity outside the ECA governance framework has allowed providers to avoid some of the financial conditions and due diligence required with financing within the framework.

As more ECA activity takes place outside of the governance structure of the OECD Arrangement and Common Approaches, further pressure is placed on the WTO SCM to regulate the growing volume of these opaque. This comes at an already challenging time, with the WTO dispute settlement mechanism under attack, and

**Figure 1. Official medium and long-term (MLT) export and trade-related activity from OECD and non-OECD countries**



Sources: EXIM, bilateral engagement, OECD, Berne Union, annual reports

Note: DFI = development finance institution. Source: EXIM 2019: 31.



trade wars and economic nationalism raging. Inevitably serious questions have emerged about the compliance of ECA activity with international norms and rules, as these norms and rules remain relevant during a crisis.

### European ECAs and compliance

In the EU, the Arrangement and Common Approaches were incorporated into Community law by a 1978 Council Decision and has become part of the *acquis communautaire*. The soft law Arrangement framework thus gained a stronger character within the EU. The EU has exclusive competence in the area of common commercial policy, which includes official export credit rules and WTO membership. Common commercial policy must be based on uniform principles and conducted in the context of the principles and objectives of the Union's external action.

Yet, when it comes to providing export credit insurance and guarantees, competence lies at the national level, with the individual EU member states. EU member states are required to screen applications for export credit support with regard to environmental and other risks, following the Common Approaches and other EU obligations. Member state self-reports on these screenings suggest total compliance with both the Arrangement and Common Approaches since 2011. The European Commission, too, reports that member state ECAs are in full compliance with Union objectives and obligations.

However, in July 2013, a European Parliament resolution (2012/2320(INI)) asserted that neither the annual reports of the member states nor the Commission's evaluation of these reports enabled the EU to adequately determine whether the member states' export credit activities in fact complied with the Union's foreign policy goals. Nor could it assess the treatment of environmental risks. A subsequent investigation by the European ombudsman found that by not taking sufficient steps to evaluate

export credit agencies' compliance with Union objectives and obligations, particularly with regard to respect for human rights and the environment, the Commission had failed to adequately implement Article 41 of the EU Charter of Fundamental Rights and the principles of good administration (Case 212/2016/JN).

The Commission rebutted that it was not required to verify information provided by the member states. Without evidence that EU law had been broken, the Commission said, it had no case to launch an investigation. This leaves it to civil society to bring complaints, though without the necessary transparency to monitor ECA activity effectively.

## Increasing defaults, due to the COVID-19 crisis and the US-China trade war, provide a rare opportunity to push both the United States and China towards greater international cooperation on official export support.

### What now?

The COVID-19 health crisis has generated turbulence in the trade finance market, contributing further to the global economic downturn. With supply chains interrupted and many large-scale projects stalled, financially over-leveraged borrowers are increasingly defaulting on trade and export loans. ECAs and private insurers are paying out unprecedented numbers of claims. Against this backdrop of crisis, ECAs must fulfil their fundamental role of providing security for businesses when commercial institutions are unwilling or unable to do so.

Nonetheless, outstanding governance questions remain. Since 2008, ECAs have become a vital cog of industrial policy.

Without a clear governance framework for financial, due diligence and sustainability standards, ECAs could ultimately contribute to a 'race to the bottom' in official export support terms and conditions. This would crowd out the private sector and have severe budgetary and societal implications, particularly for developing countries.

Increasing defaults, due to the COVID-19 crisis and the US-China trade war, provide a rare opportunity to push both the United States and China towards greater international cooperation on official export support. The framework for this support should take the form of a successor to the current OECD Arrangement. Now, more than ever, the G20 and International Working Group on Export Credits need to negotiate a regulatory framework to prevent a zero-sum subsidy race and observe the sustainable development agenda in official export credit support.

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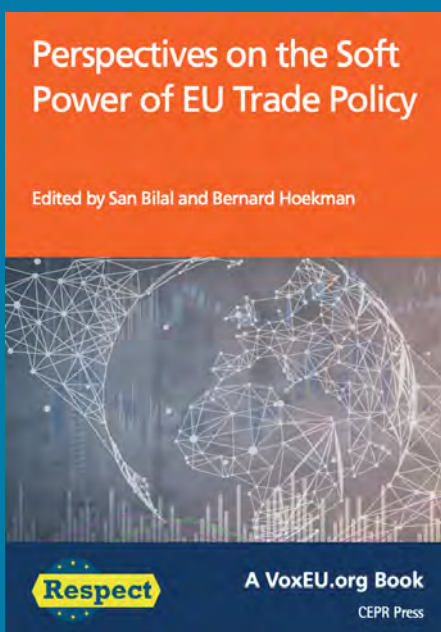


## RESPECT ACTIVITIES AND PUBLICATIONS



### Commissioner Phil Hogan Launched the Review of European Trade Policy

The EU's trade policy is evolving in an increasingly challenging environment both externally and internally. The COVID-19 pandemic has been added to the growing list of challenges, requiring a strong EU trade policy response. Against this backdrop, Commissioner Hogan launched a Trade Policy Review, in a forum organised by Bernard Hoekman in the framework of the RESPECT project. To watch the dialogue click here: <https://www.youtube.com/watch?v=NrVO9kurlgQ&feature=youtu.be>



### Perspectives on the Soft Power of EU Trade Policy

*San Bilal, Bernard Hoekman 31 July 2019*

EU trade agreements aim at reducing foreign market access barriers, but also condition the terms of preferential access to the Single Market on regulation in partner countries in areas such as social and labour standards. Is this an effective strategy? Does it come at the cost of attaining economic objectives? This eBook brings together different perspectives on these and other questions.

Download the PDF here: [https://voxeu.org/system/files/epublication/Perspectives\\_EU\\_Soft\\_Power.pdf](https://voxeu.org/system/files/epublication/Perspectives_EU_Soft_Power.pdf)

## A series of webinars on the impact of COVID-19



### COVID-19 Trade and Development Agenda: African and Caribbean Perspectives and Expectations from Europe. June 18 2020

The four panellists addressed the global economic crisis in the wake of COVID-19 from their perspective. Is this an opportunity to revisit the Trade & Development agenda? How will Africa and the Caribbean region adjust their trade strategy? What do they expect from their partners, particularly the EU?

**Stephen N. Karingi** | Director, Regional Integration, Infrastructure and Trade, UN Economic Commission for Africa

**Faizel Ismail** | Director of the Nelson Mandela School of Public Governance

**Jan Yves Remy** | Deputy Director at Shridath Ramphal Centre for International Trade Law, Policy and Services (SRC), The University of the West Indies

**Junior Lodge** | International Trade Expert, Advisor to the Caribbean post-Cotonou negotiations with the EU

**Chair:** Kathleen Van Hove, Senior Policy Officer, ECDPM

<https://www.youtube.com/watch?v=SRmeH5Y4BKU>



### EU and trade policy coherence at the times of COVID-19. May 18 2020

The panel considered the coherence of EU trade and other external policy responses to the COVID-19 pandemic. Speakers debated the measures taken by the EU Member States, the EU institutions and the rest of the world and analysed the impacts and implications for developing countries and European business.

**Simon Evenett** | University of St Gallen and Director, Global Trade Alert

**Laura Puccio** | Research Fellow, Robert Schuman Centre for Advanced Studies, EUI

**Pamela Coke-Hamilton** | Director, International Trade and Commodities, UNCTAD

**Klemens Kober** | DIHK Deutscher Industrie- und Handelskammertag

**Chair:** Bernard Hoekman | Director, Global Economics, Global Governance Programme, Dean, External Relations, European University Institute

<https://www.youtube.com/watch?v=HujEOekhygs>



# ECDPM BLOGS & EVENTS



## How to avoid the aid trap in the AU-EU strategic relationship

*Fernando Jorge Cardoso, ECDPM guest blog, 15 June 2020*

COVID-19 has had far-reaching effects all over the world, the most visible of which on the world economy and public health. Could it also have an impact on Europe-Africa relations? With an EU-AU summit scheduled for late 2020, the pandemic will undoubtedly play a central role in it. Fernando Jorge Cardoso reflects on the nature of Europe-Africa relations since 2000 and argues that separating aid from strategy could help relaunch the relationship.



## EU development cooperation in sub-Saharan Africa: What did we learn?

*Alexei Jones, Pauline Veron and Katja Sergejeff, ECDPM blog, 8 June 2020*

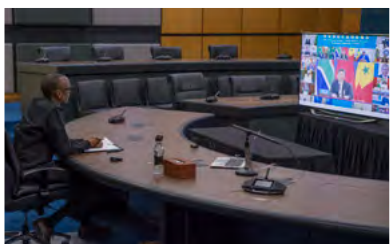
Together with our colleagues from DIE, we recently completed an ambitious study for the evaluation department (IOB) of the Ministry of Foreign Affairs of the Netherlands on EU development cooperation with sub-Saharan Africa in the period 2013-2018. After several months of intense analytical work, we want to share some of the things we have learned along the way.



## Eight ways the European Investment Bank can help tackle climate change in Africa

*San Bilal and Pamella Eunice Ahairwe, ECDPM blog, 11 May 2020*

The European Investment Bank (EIB) has set off to become the EU climate bank, after having pioneered the green bonds market over a decade ago. Now, in this new leading role, the bank is asking institutions, civil society and the general public to share their views, to be integrated into the EIB Group Climate Bank Roadmap.



## The China-Africa summit on COVID-19: Geopolitical and economic considerations

*San Bilal and Lidet Tadesse, ECDPM blog, 22 June 2020*

While the EU weeps over the slow progress in the preparation of the EU-Africa Summit in October – partly slowed down by the COVID-19 pandemic – China and African leaders held an ‘Extraordinary China-Africa Summit on Solidarity Against COVID-19’ last week.

## DAI - ECDPM Webinar series

From 15 June until 6 July, DAI and ECDPM held a series of webinars that brought together public and private practitioners to reflect on the immediate reaction of the development community to the challenges posed by COVID-19, and support the post-pandemic global response of the European Union.

- 15 June: Strengthening MSMEs for economic resilience and sustainable development
- 22 June: COVID-19 and the accelerated digitalisation of developing countries' economies
- 29 June: How COVID-19 calls for an alliance for financing
- 6 July: Building stronger health systems going forward

Further information on the speakers and programme. The webinars were recorded and remain available on the website of DAI and ECDPM.



# Latest ECDPM publications



## **Towards an EU global COVID-19 response 2.0: Boosting smarter finance**

*San Bilal, ECDPM paper, June 2020*

The European Union (EU) has responded promptly to the unprecedented crisis caused by the COVID-19 pandemic – within, but also beyond its borders. The EU global response to COVID-19 includes quickly reallocating EU support to developing countries to address immediate COVID-19 challenges, amounting to some 20.8 billion. The ‘Team Europe’ approach adopted provides ample opportunities for cooperation and synergies among EU institutions, member states and their development finance institutions, as well as with international actors. These are vital first steps.



## **EU development cooperation with Sub-Saharan Africa 2013-2018: Policies, funding, results**

*Alexei Jones, Niels Keijzer, Ina Friesen and Pauline Veron, study for the evaluation department (IOB) of the Ministry of Foreign Affairs of the Netherlands, May 2020*

ECDPM, jointly with the German Development Institute (DIE), conducted a study on EU cooperation with Sub-Saharan Africa for the evaluation department (IOB) of the Ministry of Foreign Affairs of the Netherlands. The review analyses EU policies, aid spending and results achieved by EU development cooperation with Sub-Saharan Africa between 2013 and 2018.



## **African regional responses to COVID-19**

*Alfonso Medinilla, Bruce Byiers and Philomena Apiko, ECDPM paper, 18 May 2020*

The world is not on track to meet Sustainable Development Goal (SDG) 2. Hunger has risen for the fourth year in a row, fuelled particularly by growing food insecurity in Sub-Saharan Africa. Achieving SDG 2 requires urgent action at country level, but also a more effective food and agriculture global institutional landscape. This paper describes this landscape and its challenges and looks at ongoing reform efforts and their shortcomings.



## **COVID-19 in Africa: Driver of conflict or too early to tell?**

*Sophie Desmidt and Ashley Neat, ECDPM Briefing Note, June 2020*

COVID-19 has caused disruptions across the globe on a scale not previously imagined. This brief looks at the consequences of the COVID-19 crisis for conflict-affected areas in Africa, as well as measures taken against the pandemic, which are likely to be even more profound and far-reaching. But as the virus continues to spread, the impact of COVID-19 on ongoing conflicts is still uncertain.



## Realising Europe's soft power in external cooperation and trade

### Project description:

RESPECT is a project funded by the European Commission under HORIZON 2020 for the period 2018-2021. The project comprises a large consortium of members.

Seismic changes in global geopolitics, increasing contestation of trade integration initiatives with third countries, and challenges to ensuring coherence across external policy initiatives at EU and Member State level are making the pursuit of EU external policy objectives more complex. The overarching goal of the RESPECT project is to identify options and opportunities for better realising the EU's soft power in achieving the external policy goals set by the Lisbon Treaty and the EU's trade and development strategy. The project will develop multidisciplinary analysis of the effects of trade and trade policy on Non-Trade Policy Objectives (NTPOs) – relating to issues such as labour standards, political and civil rights and protection of the environment – as well as conceptual frameworks to better understand the economic drivers of external policies. Such work will aim to inform the design of a more coherent external policy mix for the European Union and its Member States.

*Four broad objectives are pursued in RESPECT:*

- Documenting the prevailing situation – the set of EU and Member States' policies that together characterise the EU's trade and investment-related policy regime;
- Improving the understanding of the inter-relationships between EU external policies and those of EU member states;
- Determining success factors for effective EU external policies; and
- Developing practical and operationally feasible recommendations to promote better EU external policy objectives.



Coordinator



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