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Non-economic objectives: How they are driving trade policy and impacting low-income countries

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Abstract

This essay discusses the growing importance of non-economic objectives (NEOs) as drivers of international trade and trade policy, as discussed at the 2023 World Trade Forum organized by the Robert Schuman Centre for Advanced Studies and the World Trade Institute. While NEOs cover a wide range of topics, a focus is put on two prominently discussed themes: How can trade rules address the increasing role of geopolitical objectives, such as supply-chain resilience in the face of increasing geopolitical tensions, as well as environmental concerns, such as the carbon content in traded goods. Each discussion explores the potential consequences for governments and firms in low-income countries and outlines strategies to adapt to changes in the international trade environment.

Keywords

Noneconomic objective; Economic development; Trade policy; International cooperation

Non-economic objectives: How they are driving trade policy and impacting low-income countries

Trade policy is increasingly being used to pursue **non-economic objectives,** such as national security and environmental goals. While for many years **economic objectives**, such as liberalising trade and improving economic productivity, were the driving forces behind trade policy, today it is used to advance other goals often related to geopolitics or climate change. To explore how these non-economic objectives are shaping international trade, researchers and policymakers came together for the 2023 World Trade Forum, organised by the Robert Schuman Centre for Advanced Studies (European University Institute) and the World Trade Institute (University of Bern). This essay summarises the conference discussions around the impact of geopolitical shifts and environmental concerns on trade policy and sheds some light on how this might affect low-income countries (LICs).

The use of trade policy to achieve non-economic objectives

Trade policies can aim to achieve economic objectives (EOs) as well as non-economic objectives (NEOs). The following is based on Hoekman, Mavroidis and Nelson (2023) which set the stage for the 2023 World Trade Forum.

While EOs are commonly pursued to improve economic competitiveness or productivity, NEO-related trade policies often focus on national security, economic and social stability, environmental concerns, and policy independence, while also safeguarding and promoting societal values. An example of the latter is the recent exclusion of Uganda from the African Growth and Opportunity Act (AGOA)[1] by the US due to its domestic anti-homosexuality bill (Biryabarema, 2023). Another example is given by the EU's provisional agreement on the European Supply Chain Act under which firms of a certain minimum size and in certain high-risk sectors (such as manufacturing and wholesale of food and textile) will be required to address and manage their social and environmental impact along the entire value chain and hence not only their own operations.

For analytical purposes, this essay treats EOs and NEOs as distinct objectives in domestic policy-making and international trade. In practice, however, both categories are very intertwined. NEOs, while non-economic in their goals, directly or indirectly affect economic outcomes, such as income distributions, or rely on economic tools, such as environmental taxes. A single trade policy may also target EOs and NEOs in parallel. For instance, climate-focused regulations in bi- and multilateral agreements, such as the EU's Carbon Border Adjustment Mechanism (CBAM), are designed to prevent the loss of domestic carbon-intensive industries due to their movement abroad, which is an economic objective. Yet, the broader policy aims are to address environmental and climate-related externalities, which is, arguably, based on non-economic goals.

Research presented at the 2023 World Trade Forum highlights the increasing use of NEO-related policies. Roux (forthcoming) finds that democracies, compared to autocracies and countries transitioning to democracies, are more likely to sign preferential trade agreements (PTAs) that contain democracy-related provisions such as democracy promotion, individual rights, and transparency. Ganeson (forthcoming) shows that in 2006, EU trade policy was dominated by trade-related economic issues. By 2021 this had changed, and social issues had become the primary focus.

However, NEOs are not a novel phenomenon. They have always been on the agenda of policymakers. The establishment of the General Agreement on Tariffs and Trade (GATT) in 1947, followed later by the creation of the EU, grew out of a bold attempt to use trade linkages as bonds to avoid political conflict. The current shift towards more NEOs in international trade may be a by-

1 The African Growth and Opportunity Act (AGOA) "provides eligible sub-Saharan African countries with duty-free access to the US market for over 1,800 products […]. To meet AGOA's rigorous eligibility requirements, countries must establish or make continual progress toward establishing a market-based economy, the rule of law, political pluralism, and the right to due process. Additionally, countries must eliminate barriers to U.S. trade and investment, enact policies to reduce poverty, combat corruption, and protect human rights." (Office of the United States Trade Representative, no date)

product of growing volumes of international trade itself. As trade has shifted from the exchange of undifferentiated goods to intra-industry trade of differentiated goods, and more recently services, the regulatory component of trade, such as environmental standards and consumer protection, has naturally become more important (World Bank, 2020).

This essay discusses two cases that exemplify the growing importance of NEOs in shaping national trade policy and international trade agreements: growing geopolitical tensions and the nexus of climate change and trade.[2] Based on this, it will explore how LIC governments and firms can adapt to changes in the international trade arena.

The rising importance of geopolitics for international trade

While a clear conceptualization is disputed by scholars (Kovac, 2023), "*geopolitics is concerned with questions of influence and power over space and territory"* (Dodds, 2019). It has long influenced trade policy, reflecting how national and regional interests intertwine with economic agendas. This interplay is not a recent phenomenon but has deep historical roots, particularly evident in the post-World War II era. Following the war, the global landscape was sharply divided by ideological rifts between the Western and Eastern bloc which significantly dictated trade relationships for over four decades as countries organised their economic partnerships along these ideological lines.

Despite this, the latter half of the 20th century also witnessed significant strides towards trade liberalization. The establishment of the GATT in 1947 and in particular the dissolution of the Soviet Union in 1991, parallel to the subsequent emergence of Global Value Chains (GVCs), seemingly led to the end of an era dominated by geopolitics. This period, often referred to as 'hyper-globalization' was driven by the belief that "*more trade and freer finance would unleash private investment and fuel global economic growth*" (Rodrik, 2019). In line with this philosophy, the World Trade Organization (WTO) was established in 1995 as a successor to the GATT, leading to a consistent expansion in global trade, with even former communist countries like China (2001) and Russia (2012) joining the organization (WTO, 2023).

However, the momentum of trade integration has slowed since the Global Financial Crisis (Cabrillac *et al.*, 2016; Campos, Pienknagura and Timini, forthcoming). Concurrently, there has been a resurgence in trade restrictions, encompassing both tariff and non-tariff barriers, many of them motivated by NEOs arising from geopolitical tensions.

A growing number of international conflicts exemplify the impact of geopolitics on international trade relationships: the United States and China have been engaged in a trade dispute driven by matters of national security, intellectual property and technology, and global economic dominance (Chen, Chen and Dondeti, 2020; Fajgelbaum and Khandelwal, 2022). Additionally, Russia's invasion of Ukraine triggered international sanctions against Russia and disrupted key food and fertilizer supply chains, exacerbating global food security challenges, and driving up import prices (Gourinchas, 2022; Hebebrand and Glauber, 2023).

Research shows mixed results on the effects of geopolitical alignment and divergence on international trade

A growing research body is looking into the trade effects of rising geopolitical tensions. The latest UNCTAD Global Trade Update reveals a rise in trade between geopolitically aligned countries in 2023, while trade between geopolitically distant nations declines (UNCTAD, 2023). Western governments are encouraging businesses to shift strategic manufacturing, like semiconductors, to allied nations, a trend known as "friend-shoring", which may be slowing global FDI and causing a slowdown in productivity growth (The Economist, 2023b; IMF, 2024). This geopolitics-driven approach impacts

2 Due to space constraints, this essay focuses on geopolitics and environment as the most important drivers of NEOs today. Other examples of NEOs currently influencing trade policy are digital trade and data regulation (Daza Jaller, Gaillard and Molinuevo, 2020), food security (Thow, Wijkström and Wolff, 2023) and international migration (Lavenex, Lutz and Hoffmeyer-Zlotnik, 2024), among others.

GVCs, leading to broader consequences such as the effect the Russia-Ukraine war has had on fertilizer and food prices, especially in LICs (Ben Hassen and El Bilali, 2022; IMF, 2023). A potential "decoupling" of the global economy into Western (dominated by the US) and Eastern (dominated by China) blocs could result in significant welfare losses globally (Campos *et al.*, 2023; Góes and Bekkers, 2023).

But not all is doom and gloom. Over the decades, trade has proven to be surprisingly resilient to geopolitical tensions, with the trade-to-GDP ratio increasing even during the height of the Cold War. Cevik (2023) finds no significant link between geopolitical alignment and trade flows from 1948-2021, and current geopolitical tensions are lower than during past peaks of post-9/11 or the Cuban Missile Crisis (Caldara and Iacoviello, 2022; Cevik, 2023). Rodrik (2023) suggests the current shift reflects a realignment towards national priorities post-hyper-globalisation. The evolving geopolitical landscape, particularly affecting LICs, underscores the need for strategic preparation for potential long-term shifts in GVCs.

Governments and firms in LICs need to internalize geopolitical uncertainty in domestic trade strategies and towards international trade agreements

Whether geopolitics is here to stay or not, it has current and long-term implications that countries need to be aware of and prepare for. Much of the discussion around geopolitics focuses on the US, the EU, China and Russia. But LICs have much to lose, or gain, should there be a permanent restructuring of GVCs.

The resurgence of geopolitics poses significant challenges for LICs which must navigate complex relationships with major global powers. Their political alignments, particularly towards China or Russia, could affect their standing with Western countries. Consequently, nations like India and Indonesia are striving for neutrality (The Economist, 2023a). LICs must consider geopolitics in their trade and growth strategies, as access to US and EU markets might require significant concessions, including institutional and social reforms. While these reforms could benefit long-term stability, they may cause short-term disruptions and political unrest. Western countries should offer transitional support for implementing these reforms. Alternatively, LICs might prioritise gaining or improving their access to Chinese and Russian markets.

At the firm level, the imposition of trade barriers for national security reasons leads to varied impacts in LICs. This can result in an organisational and geographical restructuring of GVCs with higher levels of vertical integration or fragmentation through offshoring and outsourcing (Gereffi, Lim and Lee, 2021). This restructuring will not be done just based on economic considerations but also geopolitical ones – whether these developments benefit the individual LIC firm, by giving it new opportunities to join GVCs, or harm it, by cutting it out of a GVC it is already participating in, is highly context dependent. However, it might certainly limit firms' avenues for buyer and supplier diversification and growth as it could restrict their access to either the Chinese, Russian or Western markets.

The proliferation of environmental regulations in trade agreements

Environmental and climate concerns are dominating much of today's economic discourse and have become policy priorities across the world (IPCC, 2023). The role of trade in relation to climate change is highly debated as it is often associated with high transport emissions. However, due to differing production emission levels across countries, importing can often present a greener alternative to buying local (Freedman, 2023).

Many governments are looking to green their domestic production and the supply chains of products imported into their country by introducing stricter climate policies. Two recent examples include the EU's CBAM, which aims to prevent the outsourcing of carbon-intensive production to LICs (a phenomenon called “carbon leakage”) (European Commission, no date a) as well as the EU Deforestation Regulation which requires exporters/importers of certain products to prove that they “*do not originate from recently deforested land or have contributed to forest degradation*” (European Commission, no date b).

These measures reflect a broader trend of integrating environmental provisions into trade agreements, addressing a wide array of ecological concerns (Berger *et al.*, 2020). Today, one in six notifications of trade measures to the WTO has an environmental component, compared to less than one in 12 in 1995 (WTO, 2020). While these provisions are designed to encourage national environmental regulations and reduce greenhouse gas (GHG) emissions (Baghdadi, Martinez-Zarzoso and Zitouna, 2013; Bastiaens and Postnikov, 2017; Zhou, Tian and Zhou, 2017; Brandi, Blümer and Morin, 2019), there is a risk they might act as trade barriers or lead to the relocation of GHG-intensive industries to countries with laxer environmental standards, potentially creating "pollution havens" (Kolcava, Nguyen and Bernauer, 2019; Brandi *et al.*, 2020) despite initiatives like CBAM. Research testing whether environmental provisions can prevent this has found mixed results (Kolcava, Nguyen and Bernauer, 2019; Brandi *et al.*, 2020).

Recent research from the 2023 World Trade Forum sheds light on the complex impacts of environmental provisions in PTAs on trade. Meinhart *et al.* (forthcoming) show that the influence of these provisions on trade varies with their number and type, but generally shows a positive effect on bilateral trade without significantly differentiating between "dirty" and "clean" goods. This indicates that environmental provisions seem unable to restrict "dirty" trade. In contrast, Martínez-Zarzoso (forthcoming) finds that stringent environmental regulations can reduce exports of "dirty" goods, particularly from non-OECD to OECD countries, hinting at the potential of such regulations to prevent the formation of pollution havens, which can harmful health-effects on the local population (Tanaka, Teshima and Verhoogen, 2022). Additionally, research by Brandi and Schwab (forthcoming) indicates that environmental provisions related to agriculture in PTAs can lead to lower GHG emissions in the sector, driven by stricter domestic policies, reduced agricultural land use, and a shift in demand towards lower-emission products.

Low-income countries need to develop strategies to act on more stringent environmental regulations…

Research by the World Bank (Brenton *et al.*, forthcoming) shows that climate change mitigation policies have a disproportional effect on low- and middle-income countries with negative effects on trade. To maintain market access, LICs are increasingly expected to adjust to trade agreements with comprehensive environmental clauses. This necessitates the integration of decarbonization strategies into their development agendas, the establishment of new environmental regulations, and the creation of effective monitoring, reporting and standardization to establish effective enforcement mechanisms. One example includes the establishment of transparent and efficient carbon tracing along domestic supply chains which will maintain market access to hence increase *green competitiveness* and facilitate the trade of "internationally transferred mitigation outcomes".

A potential response to the EU's CBAM, which lacks exemptions for Least Developed Countries (LDCs) and transitional provisions, could be the implementation of carbon taxes, and a related carbon price, in LICs. If the EU deems such a domestic carbon tax equivalent to CBAM, the country will receive a reduction or exemption from CBAM (Pleeck and Mitchell, 2023). This approach could offset the adverse impacts of CBAM, particularly on African exports of key commodities, which are projected to suffer significant declines (African Climate Foundation and LSE, 2023), by creating domestic incentives to de-carbonise while increasing fiscal capacity from tax revenues that would otherwise go to the EU. Yet, as of November 2023, no LIC has taken steps toward establishing such

a tax, highlighting a gap in research on optimal carbon taxation strategies. India's exploration of an export tax on CBAM-affected products presents a simpler interim solution, pending the EU and WTO's approval, which could serve as a model for other developing nations (Pleeck and Mitchell, 2023).

So far, the new set of environmental provisions in trade agreements has been Western-centric, mostly coming from the EU or US and imposing new rules on LICs. These countries often lack the bargaining power to engage effectively in reciprocal negotiations and hence find themselves takers of an increasing number of regulations. In Africa, for example, new trade regulations impose strict requirements on export goods and affiliated supply chains. However, this fails to account for dynamics intrinsic to the early stages of industrial development, which can imply a necessary increase in carbon content, and ignores that the share of global carbon exports by African countries is minimal (OEC, no date). This raises the question of how trade regulations can allow for necessary adjustment dynamics and apply a more holistic approach to not cause a downward spiral of high export costs and adverse impacts on economic development. While international trade regulations can set incentives for decarbonization at the firm and industry level, a more transitory adjustment process for LICs can give firms, with often relatively low financial and technical capacity, the necessary time to adjust production processes while not jeopardizing growth within LICs.

At the same time, growing international market integration and trade-cost reduction is facilitating market access for a wide array of countries, leading to diversified market opportunities for LICs. As previously touched upon, Chinese and Russian markets can offer LICs alternatives to accepting these regulations. At the same time, the West's reliance on resources predominantly found in LICs makes it likely that, in the long-term, the EU and the US must listen to the concerns LICs are raising about the development-stifling effects these regulations might have. In turn, this changing dynamic can potentially be leveraged by LICs to negotiate regulations, such as to allow for the above-discussed flexibility towards regulatory compliance. It might also prove as an opportunity to obtain additional development assistance, such as through the WTO's Aid-for-Trade programme, needed to help implement investments to adjust to the new external regulatory environment.

…and it will be on low-income country firms to adapt to these new policies

Businesses, particularly in LICs, play a crucial role in adopting greener production and business practices to access markets in rich nations. Leading firms in high-income countries are setting stricter sustainability standards within their value chains to meet new regulatory demands and cater to a more eco-conscious consumer base. Although aligning with tough environmental regulations presents challenges, it also offers firms a chance to enhance their competitiveness and climate resilience (ITC, 2021) and, through increasing consumers' trust in their products, may offer opportunities for more exports to high-income markets (Gourdon, Stone and van Tongeren, 2020). For small businesses, this may mean reevaluating resource usage, like electricity and water, whereas larger enterprises might invest in advanced production technologies. However, such investments demand capital, which can be particularly hard for small exporters in LICs to secure due to limited access to formal finance. Green finance initiatives are crucial in bridging this gap, enabling businesses to undertake the green transition (Meattle *et al.*, 2022).

In addition, international buyers are increasingly demanding evidence that their suppliers, especially in the agricultural sector of LICs, adhere to international standards. Voluntary Sustainability Standards (VSS) are a key method for signalling compliance, but the stringent requirements of VSS pose significant challenges for small businesses, involving substantial changes in production and management practices and high certification costs (Marx, Depoorter and Vanhaecht, 2022).

To facilitate compliance and enhance market access, governments as well as international organisations such as the WTO's Aid-for-Trade initiative should offer technical assistance and financial support for VSS certification, thereby boosting the export capabilities and productivity of firms in LICs.

Conclusion

The international trade environment is seeing a shift towards policies and regulations that are motivated by non-economic objectives. In this essay, two particular drivers of NEOs were discussed: The growing importance of geopolitics in international trade as well as the necessary use of trade in the fight against climate change.

While geopolitics has a direct effect on the Western, Chinese and Russian economies it also indirectly impacts the rest of the globe. A subsequent restructuring of GVCs can offer risks for LICs through supply chain disruptions but also opportunities through the exploitation of new market opportunities. Governments in LICs need to address a growing degree of uncertainty. This will require targeted policies to reduce those risks, such as through strengthened market diversification, and to explore new windows of market opportunities.

At the same time, environmental concerns are at the forefront of Western, specifically the EU's, trade policy. While is it critically important to reduce emissions in the fight against climate change, these policies should be designed so they do not unduly burden LICs. By emphasising the West's dependence on LIC resources and approaching negotiations as regional blocs, for example under the AfCFTA, governments can strengthen their bargaining power in the context of international fora to allow for more multilateral coordination in the design of these new regulations. Initiatives like the WTO's Aid-for-Trade can facilitate LIC regulatory compliance and foster a shift towards incorporating environmental thinking in development and business strategies, putting LIC economies on a greener path.

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