Rethinking trade policy for economic development

Position paper for Round 1 of the Roundtable on the coherence between development aid and trade policy, 23 October 2024, *Tweede Kamer*, *vaste commissie voor Buitenlandse Handel en Ontwikkelingshulp*.

Dr. Tristan Kohl (University of Groningen; t.kohl@rug.nl)

Ever since the late 1940s, a top priority for international trade policy has been to improve access to foreign markets. The underlying reason for this is because, compared to a world where countries do not trade with each other, free trade creates welfare gains. Free, or freer, trade on internationally connected markets is beneficial for consumers and firms. Through trade, buyers have a larger variety of goods that are sold at competitive prices. Sellers can expand their sales to new consumers, access cheaper or higher-quality resources needed for their operations and even learn to upgrade the quality of their exports through innovation.

The World Trade Organization (WTO) is the prime intergovernmental institution through which most of the world's countries negotiate and coordinate their international trade policies. The merits of this rules-based system and its importance for the Netherlands have been discussed in this committee before.[1] Crucially, developing countries benefit from WTO membership when the procedures regarding international trade are transparent, predictable, and uniformly applied by all member countries. Imports from WTO members are subject to Most-Favored Nation (MFN) tariffs: the EU's import tariff on any given product uniformly apply to all exporters from all WTO countries.

On top of this, the flagship policy instrument that combines trade and development policy is the Generalized System of Preferences (GSP). This instrument is an important exception to the non-discriminatory MFN tariffs. It allows developed countries to voluntarily, selectively, and unilaterally, grant preferential access (i.e., lower tariffs compared to MFN tariffs) to targeted developing and least developed countries.[2]

In doing so, developing countries grant non-reciprocal, preferential and *reversible* access to developed markets, which is intended to further reduces exporters' market access costs. When they expand their foreign sales in developed countries, these firms are expected to grow in sales, size, employment, profitability, and perhaps even product quality. As such, trade is intended to be a catalyst for economic growth and development in developing and least developed countries. However, based on the latest available empirical evidence, only the poorest WTO members expand their exports under GSP schemes: all other GSP beneficiaries do not seem to benefit.[3]

In this regard (and given space constraints, for brevity) I will focus on two major observations which stand out and are relevant in the discussion on rethinking trade and development policy:

[1] See https://www.tweedekamer.nl/kamerstukken/detail?id=2020Z20266&did=2020D43534.

[2] Armenia, Australia, Belarus, Canada, the European Union, Iceland, Japan, Kazakhstan, New Zealand, Norway, the Russian Federation, Switzerland, Turkiye, the United Kingdom, and the United States, currently grant GSP preferences. See: https://unctad.org/topic/trade-agreements/generalized-system-of-preferences.

[3] See Ornelas & Ritel (2020, *The World Economy*).

1. Preferential access through GSP is time-sensitive and subject to termination at any time by the benefactor. Starting to export is a very uncertain, risky, and costly activity for entrepreneurs. Once a foreign market is served, additional uncertainty about if, and when, preferential GSP tariffs will be removed creates an additional business risk. This means some exporters will decide not to reap the potential benefits of GSP. Recent evidence shows that temporary GSP removals or permanent expiration of these benefits have sizeable reductions on GSP beneficiaries' exports. This means that GSP benefits facilitate foreign market access for exporters in developing countries, who will not be able to compete on the foreign market without such preferential access.[4]

   → Policy makers need to rethink the ad-hoc, and temporary, reversable, nature of these preferences. Strong, predictable and inclusive institutions are a necessary ingredient for long-run economic prosperity.[5]

2. More generally, preferential access through GSP schemes is limited in practice. The so-called utilization rates of GSP preferences are not systematically high for all GSP beneficiaries or sectors. Important reasons include[6]:

   a. Exporters in developing countries may need to undergo costly administrative procedures to satisfy various rules of origin, technical, health, and safety standards imposed by developed countries. These exporters may not have the time, human resources, experience, and/or financial capacity to comply with these requirements.

   b. GSP benefits may at times be linked to even *stricter* rules related to, e.g., labor standards, compared to the default MFN tariff option. So, compared to the default option trading under MFN tariffs, the GSP *tariffs* may be lower, but additional requirements *higher*, which ultimately makes GSP unattractive.

   → Policy makers must design and harmonize preferential market access policies to make it easier and economically attractive to export, not costlier. In addition, The Netherlands need to support and strengthen initiatives through the WTO's Trade Facilitation Agreement.

   c. Exporters, including potential exporters, simply do not know that their products quality for preferential access to developed markets.

   → The Netherlands have a strong tradition of combining international trade and local economic development initiatives through partnerships of embassies with local governments, non-governmental agencies, Dutch and local firms, and knowledge partners. In line with a recent IOB report,[7] strengthening this local capacity must then be a top priority to effectively implement a coherent economic development policy that is (i) suitable to the local economic context, and (ii) leverages the available resources and know-how, to aid entrepreneurs in reaping the gains from trade.

---

[4] See, e.g., Hakobyan (2020, *Canadian Journal of Economics*) and Gnutzmann & Gnutzmann-Mkrtchyan (2022, *The World Economy*).

[5] See the 2024 Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel, https://www.nobelprize.org/prizes/economic-sciences/2024/summary/.

[6] See, e.g., Herz & Wagner (2011, *Review of International Economics*) and Blanchard & Hakobyan (2014, *The World Economy*).

[7] See https://english.iob-evaluatie.nl/results/aid-trade-and-investment.