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Impact of EU policies in areas of trade, global value chains and climate action for the eradication of poverty in developing countries

Introduction

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The most recent report on the Sustainable Development Goals (SDGs) states that the improvements of more than 50% of SDG targets are not sufficient, and 30% of them are either stagnating or reversing (United Nations, The Sustainable Development Goals Report, 2023). Moreover, the recent shocks, such as the global pandemic and the armed conflicts, challenged further the improvements in socio-economic standards, the redistributive effects of economic growth and the environmental protection. Consequently, it is important to reflect on the role of the European Union for the policies affecting those dimensions, with particular attention to poverty eradication in developing countries. Moreover, it is significant to understand to what extent, and in which domains, actions delivered by the EU as such can reach goals that would be more costly or challenging for Member States to pursue on their own. Advantages are expected to be in the creation of economies of scale in mobilizing resources, in a more efficient use of resources, and in improved coordination among stakeholders. In this issue of the OEET Newsletter we aim at briefly discussing some of these issues. The content of the Newsletter is inspired by a broad study

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conducted by the European Parliament Research Service (EPRS), to which the Turin Centre on Emerging Economies partly contributed. The study was requested by the European Parliament's Committee on Development (DEVE). The analysis focuses on three channels along which the EU policies may have impacts on poverty in the Global South: (i) actions for improving resource use in Official Development Assistance and climate finance; (ii) actions for redirecting trade policies toward development and poverty reduction; (iii) actions toward a fairer international economic system. The study focuses on the 46 least-developed countries.[2] Evidently, most of the challenges about poverty in the Global South encompass a global dimension, beyond the sole role of the EU. Nevertheless, the EU could have a crucial impact through its direct action and through the promotion of an appropriate multilateralism.

In this Newsletter, Cecilia Navarra broadly presents the main research questions and the main findings of the whole EPRS study, posing a particular focus on the added value of the role of the European Union in the above-mentioned areas. Celso Fuinhas focuses on the impacts of the EU global value chain's policies on poverty and development, mentioning the spaces for policy improvements and presenting a case study on Mozambique. Antonia Stock writes about the EU climate action, in particular in relation to poverty reduction in LCDs, again proposing some policy recommendations and discussing the case of the EU Carbon Border Adjustment Mechanism (CBAM). [3]

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[2] UN list of least developed countries

[3] The content of this newsletter is inspired by a research conducted by Donatella Saccone, Elena Vallino, Celso Fuinhas and Antonia Stock (OEET) for the European Parliament Research Service. The research is entitled "Cost of non-Europe in EU action to eradicate poverty in developing countries: Impact of policies in areas of trade, global value chains and climate action", and it is published as Annex III of the Report "Improving EU action to end poverty in developing countries. Cost of non-Europe report", written by Cecilia Navarra, Aleksandra Heflich and Meenakshi Fernandes, European Added Value Unit, European Parliament Research Service, April 2024.

The added value of European policies in trade and climate for multidimensional poverty eradication in developing countries.

by Cecilia Navarra[4]

The European Union commitment to address poverty in developing countries is in principle twofold. On the one hand, the EU has a development policy whose aims are defined by the European Consensus for Development, framed on the basis of the UN 2030 Agenda for Sustainable Development. On the other hand, the EU is bounded by a commitment stated in the Treaties to the principle of Policy Coherence for Development, which means that every EU policy should take into account development objectives and notably poverty eradication.[5]

In the light of this broad approach, a recent study conducted by the Research Service of the European Parliament[6] explores ways for further EU action in several areas that affect poverty reduction in developing countries, identifying twelve main challenges and a broad range of corresponding policy options at the EU level. The analysis aims at identifying the Cost of Non-Europe, that is the potential net benefit of greater coordination at EU level, or, more precisely, the foregone benefit of not taking further coordinated actions. The concept dates back to the 1980s and it was first applied to the completion of the single market[7], but it has been then applied to several policy areas and the focus has broadened beyond exclusively economic gains.[8] The Cost of Non-Europe in poverty reduction considers the potential of EU action to reduce multidimensional poverty in Least Developed Countries (LDCs)[9].

The study identifies an existing Cost of Non-Europe in three areas:

- Possible actions to deploy *more and more effective resources* for development aid and climate finance;
- Possible actions to reform *trade tools to make them more conducive to reducing poverty*;
- Possible actions to *promote a fairer global economy architecture*.

[4] Cecilia Navarra is a former Policy Analyst et EPRS. The views and opinions expressed in this article are those of the author and do not necessarily reflect the views or positions of the European Parliament
[5] European Commission, International Partnerships
[6] Navarra C., Fernandes M., Heflich A., (2024) Improving EU action to end poverty in developing countries - Cost of non-Europe report, European Parliamentary Research Service. This contribution is based on the results of this study.
[7] The concept of 'non-Europe' was first introduced by the European Parliament in a report by Albert and Ball in 1983 and then used in the 1988 Cecchini report, which supported the plan to complete the single market.
[8] European Added Value Unit, (2023), Mapping the cost of non-Europe report: Theoretical foundations and practical considerations, European Parliamentary Research Service.
[9] UN list of least developed countries. The main indicator used is the Human Development Index.

The three areas are overlapping and policy options may fall in more than one at the same time.

First, the study identifies a number of problems in the mobilization of sufficient funds and in their allocation. They are analysed in three areas: Official Development Assistance (ODA), debt relief and climate finance.

As regards ODA, both the amount of funds is insufficient (the EU has not yet hit its target of 0.7 % of GDP) and the coordination between Member States could be improved, despite the steps already taken.[10] To analyse the potential impact of closing these gaps for poverty eradication in LDCs, a two-stage modelling framework is employed. [11] The analysis finds that ODA from EU Member States has a statistically significant and positive impact on government spending on health and education, and that the latter have a significant and positive impact on the Human Development Index (HDI) of recipient countries. On the basis of the identified relationships, the study constructs a scenario where EU Member States meet their ODA commitments. It finds that this could lead to a cumulative average increase in recipient countries' HDI of about 4.1 % by 2050. Based on the same approach, the estimated savings due to the reduction in fragmentation of ODA from EU Member States, could lead to an increase in HDI of 1.4 % by 2050.

The same methodology is used to estimate the impact of debt relief measures. Debt servicing is a major constraint on social spending and the recent increase in interest rates is putting a strong pressure on public finances: in November 2023, the International Monetary Fund reported that 16 LDCs were at a high risk of debt distress.[12] This limits fiscal space for much-needed investment in public goods, in structural transformation and in the energy transition. The study estimates the impact of freeing government expenditure via debt relief programs: a moderate scenario just simulating the writing off of the additional debt incurred in 2020 following the COVID-19 pandemic could lead to an average increase in HDI of about 3 % by 2050.

As regards climate funding, the study highlights the insufficient and uncoordinated funding, especially for climate adaptation, resilience and loss & damage. Although the EU is a global bilateral leader in climate finance and in recent years has increased adaptation funding, the available resources from public donors remain short of what is needed. Globally, adaptation financing declined by 15 % in 2021.[13] Adaptation

[10] Notably the Neighbourhood, Development and International Cooperation Instrument-Global Europe (NDICI-Global Europe) and the 'Team Europe' approach.
[11] Navarra C., Fernandes M., Heflich A., (2024), ibid, Annex II.
[12] United Nations Conference on Trade and Development (UNCTAD), The least developed countries in the post-COVID world: Learning from 50 years of experience, 2021
[13] United Nations Environment Programme, Adaptation Gap Report 2023: Underfinanced. Underprepared. Inadequate investment and planning on climate adaptation leaves world exposed.

and loss & damage funds are particularly important for LDCs, who are more vulnerable to the adverse impacts of climate change. The study suggests a number of areas in which the EU could raise funds via new taxes and the inclusion of further transportation means in the EU Emission Trading System (EU ETS).

The *second* policy area where EU action could have an important added value is trade policy and trade implications of other policy actions. A major trade-related bottleneck to poverty reduction is the fact that LDC exports are focused on commodities, raw materials and, more generally, are "stuck" in the low end of global value chains. In 2021, 55.7 % of EU imports from Africa were natural resources and raw agricultural products, and this trend is likely to increase in the light of the search for "critical raw materials" for the energy transition. As a consequence, exporting to the EU does not seem to have increased manufacturing employment in African LDCs, which is considered a proxy for well-paid jobs. Using panel country-level data,[14] the study shows that EU exports are negatively correlated with manufacturing employment in (selected) African LDCs, while the correlation goes in the opposite direction in Asian LDCs.[15]

EU trade policy could introduce some elements to support value addition in LDC exports, such as tying trade measures with technology transfer, or adopting a dynamic approach to trade agreements, committing to increase value added imports over time. Another aspect that could be supported by EU policies is regional integration among LDCs. This is currently low: the share of intra-African trade has stagnated since 2007 at 15 %.[16] The weak complementarity between African national specialisations, linked also to the weight of primary natural resources in their exports, constitutes a first obstacle to regional trade. In turn, low regional integration is an obstacle to value addition: it is more likely that regional trade focuses on processed goods, while raw agricultural products and natural resources are mostly exported outside the African continent. This regional integration could be further supported by the EU, both with trade tools, and with greater coherence of other policy areas with development objectives, for example when it comes to favouring intra-African mobility of people, which in some cases has been hindered by EU migration policies. Greater development-coherent policies could be also developed in the area of green transition, and notably as regards the Carbon Border Adjustment Mechanism, which risks putting further cost burden on LDCs. To address this issue without undermining

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[14] Data on trade are from the BACI dataset and data on manufacturing employment are from ETD dataset.

[15] This is consistent with the observation that GVC participation encourages structural transformation only when it occurs in a larger context of expansion of manufacturing. Elissa Braunstein, Piergiuseppe Fortunato, Richard Kozul-Wright, Trade and Investment in the Era of Hyperglobalization. *The Palgrave Handbook of Development Economics: Critical Reflections on Globalisation and Development*, pp. 727-762, 2019.

[16] Cecilia Bellora, Cristina Mitaritonna and Andreas Maurer, Ways forward for EU-Africa trade and investment relations, European Parliament, 2022

emission reduction, several possible policy options have been discussed, including policies to support energy transition in the LDCs, via green technology transfer.

Third, the EU could both act directly and by supporting global actions in greater regulation of global markets and businesses in Global Value Chains. A problem that is frequently identified, is the lack of mandatory responsible business conduct standards in Global Value Chains, despite the evidence of potential adverse effects on social, environmental and governance standards of the companies' search for lower costs abroad. The EU just approved a directive on Corporate Sustainability Due Diligence, that establishes a corporate due diligence duty for large companies to identify, prevent and mitigate negative human rights and environmental impacts in a company's own operations, their subsidiaries and their value chains, which could partly address the issue.

At the multilateral level, the EU could "speak with a single voice" to support further actions in regulating global markets: one relevant example is represented by global food markets. Food prices have seen important volatility and notably important increases in recent years, due to several factors, including conflicts and instability. Among these, there is the high concentration of the global food market, largely dominated by four major companies, whose profits are rising sharply.[17] UNCTAD finds that the majority of LDCs are also net importers of basic commodities, including food, thus commodity price shocks can have an important impact on fiscal space and on poverty.

At the crossroads of business regulation at the global level and of the generation of resources to fill the development finance gap, a final area of action is the global architecture on taxation of multinational enterprises. The debate has been dominated in recent years by the OECD 'Inclusive Framework initiative',[18] which is entering into force. To address some criticisms raised by developing countries, the UN General Assembly adopted a resolution to establish a United Nations Framework Convention on International Tax Cooperation in November 2023. According to estimates that follow the same methodology as the one discussed above for ODA and debt relief, the simple full application of the current agreement could lead to greater resources for developing countries that could translate into an increase in HDI of around 1.7 % by 2050, if the public budget thus saved is channelled to the health and education sectors. Implementing a more ambitious threshold to include more MNEs, would increase the amount of relocated profit by one third, thus having a greater impact on public finances in developing countries.

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[17] UNCTAD, Trade and Development Report, 2023.
[18] About - OECD BEPS

To conclude, this analysis highlights that the main challenges are inter-related and some transversal conclusions can be drawn. First, being a major economic actor, the EU could contribute to keeping at bay (and reversing) the risk of "race to the bottom" in social, environmental standards and in taxation: the international arena is a context of strategic complementarities,[19] where, in the absence of policy intervention, there are incentives to compete on these standards in the global economy. Second, both direct transfer of resources and design of trade and investment relations should take into account the fiscal space that is needed to promote development objectives. In most of the discussed challenges, there is a "cost of lack of global action", of which the "cost of non-Europe" is a subset: not all actions depend on the EU alone, but the EU could both act in its own economic relations and as a player in the global multilateral arena.

[19] Sanjay Reddy, "International Trade as a Means to Diverse Ends: Development, Workers, the Environment, and Global Public Goods". In Oliver De Schutter, "Trade in the service of sustainable development: Linking trade to labour rights and environmental standards", *Bloomsbury Publishing*, 2017.

Impacts of EU policies in the area of global value chains.

by Celso Fuinhas[1]

Hereby we discuss how the participation of the European Union (EU) in global value chains (GVCs) can impact the fight against poverty in Least Developed Countries (LDCs). The analysis of the EU's participation in GVCs is subdivided into three main areas: i) the implications on the industrial structure, ii) the issue of due diligence, and iii) the limitations imposed on the policy spaces of LDCs. The case of the graphite sector Mozambique is used as an illustration of how these three areas of approach can come together.

The concept of global value chains was initially introduced by Gereffi and Korzeniewicz (1994) as a way of characterizing a new way for firms to organize their international activities that emerged in the 1980s. They consist of a mode of organization in which the productive process (and hence the process of value creation) is dispersed throughout various countries. This differs from conventional trade in which the productive activity is completely within the borders of one country and only after production the international exchange of finished goods takes place. The participation in GVCs can help developing countries alleviate poverty by creating well paid jobs (Shepherd, 2013), and also by upgrading their industrial structure to a state that is compatible with a higher degree of added value (Humphrey, 2004; Ravenhill, 2014). For this reason, the EU' trade policy could be framed with the objective of maximizing the poverty reducing potential of the incorporation of LDCs in its GVCs. On this point it is important to note that LDCs have, by definition, a low degree of insertion into global value chains. In fact they only account for around 1.15% of all global trade value (WTO) and this is especially true regarding processes with high value added. This means that the participation of LDCs in GVCs is mostly centered around the supply of raw materials to more advanced economies.

One way that the EU approaches its development aid programs is through an *Aid For Trade* framework. *Aid For Trade* is based on the facilitation of access to the European market of products produced in developing countries (WTO). This framework can take the form of programs such as the *Everything but Arms*, that applies to LDCs, or the *Generalized Scheme of Preferences*, that applies to lower-middle-income countries. Despite the potential that the participation in global value chains has to upgrade the industrial structure of LDCs the opposite might happen instead. The blanket removal of trade tariffs can lead developing countries to specialize in the areas in which they currently have a competitive advantage, that is the production and extraction of raw materials, leaving them stuck in a suboptimal local maximum.

[1] EPOG+ Program, University of Torino and Sorbonne University (Paris)

Even in cases where tariffs are removed only in areas determined in accordance with the wishes of local governments, there is still a high likelihood of reinforcing the underlying patterns in the industrial structure instead of encouraging their change. Furthermore, due to the highly standardized nature of the exchanges operated inside GVCs (Rodrik, 2018a), most capital employed in global value chains is adapted to the relative factor endowments of the rich world (high capital availability but scarce labor availability), and as such it is not compatible with creating a high number of well-paying jobs.

The decision of firms to shift part of their production process offshore can be driven by the desire to benefit from more relaxed labor and environmental regulations in the host country (Stern, 2003), as is the case in many LDCs. Furthermore, these companies create pressure, either implicit or explicit, to keep those regulations relaxed under threat of leaving the market (De Beule et al., 2022). This raises questions about the environmental and social sustainability of the extension of GVCs to LDCs. At this moment there is no comprehensive due diligence law at the European level that makes European based firms legally liable to environmental and human rights violations that happen outside of the EU. As a result, only 37 % of European firms operating in more than one country follow proper environment and human rights due diligence procedures. This share drops to 16% if we also consider their suppliers (Spinaci, 2023).

Lastly, trade agreements have become increasingly more comprehensive both in terms of breadth and scope. As a result of this increase the trade and cooperation agreements established by the EU with LDCs imply a very strong limitation of the latter's policy options (Rodrik, 2018b). Moreover, the strict rules associated with the trade agreements can foster integration with the European market at the expense of regional integration.

The graphite sector in Mozambique poses a good example of the problems associated with the incorporation of LDCs in GVCs. Mozambique's main exports are unrefined fossil fuels, metals, and minerals (Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, 2023). It is the world's second largest producer of graphite after China. Yet its great reserves of mineral wealth have brought little material wealth to the country, especially to its poorest inhabitants. Practically all the raw materials are exported without being refined (limiting their added value) and the mining sector employs only a very thin slice of the population. This is not sufficient to significantly reduce poverty, while at the same leaves the country subject to harsh environmental exploitation.

To help tackle these issues we propose three different policy options. The first of these is to foster internal integration in LDCs. A practical way of implementing this is through the manipulation of the rules of origin, in order to increase the threshold of value added in LDCs that a given product needs to

achieve to have tariff free access to the European market. Furthermore, the EU can use these same rules as a way of promoting the consolidation of raw material extraction and processing in LDCs. The second policy option regards establishing tighter standards of due diligence. Forcing European based firms to follow the same practices on environmental and human rights both outside and inside Europe would significantly improve the impact that they have on developing countries. The third policy option regards the encouragement of regional integration. When value chains are organized at the regional level, it is far more likely that high value-added activities will be executed in developing countries and LDCs (Berger et al., 2020). To encourage regional integration the EU can privilege the establishment of cooperation agreements at regional level and not only on a bilateral level.

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EU policies in the area of climate action

by Antonia Stock[1]

LDCs are especially affected by climate inequalities between countries, while having contributed least to the total world CO2 emissions from fossil-fuel combustion and industrial processes (Birkmann et al., 2022; UNCTAD, 2022). However, climate change is driving social inequalities within countries at an increasing pace, with marginalized groups being particularly affected. Furthermore, most LDCs are highly vulnerable to the effects of climate change. Actions aimed at reducing inequality, addressing poverty, and promoting proactive adaptation to climate-related shocks would reduce the size of the exposed and vulnerable population, especially if co-benefits with climate mitigation policies are also in place (Byers et al., 2018).

However, climate change and poverty are intertwined, further raising the concern whether both global challenges can be addressed simultaneously, especially in LDCs. Moreover, the effects of climate change would negate the poverty eradication efforts of recent decades in the absence of mitigation, adaptation, and socio-economic measures. Countries in the Global South are poorer today than they would have been in the absence of climate change (Hallegatte et al., 2016). Across all geographical regions, it is evident that climate change is impeding poverty alleviation (Denton et al., 2014). The implementation of responses to climate change is constrained by a number of factors, including worsening living conditions and the threat of food insecurity due to undernutrition, malnutrition, and low opportunities for income generation. Furthermore, the access to basic ecosystem services, such as rainwater, is in danger, creating favorable conditions for the spread of diseases. Additionally, gender inequalities are enhanced by climate impacts (Patt et al., 2009).

With regard to the external dimensions of European policies in LDCs, we identify a number of challenges and gaps in the area of climate. One challenge is the exposure to the European green techno-economic paradigm and correlated technology transfers (UNCTAD, 2023). The necessity of investments in "sustainable" technologies to enable LDCs to catch up would, however, pose further inequalities and challenges on the poorest parts of the world's population.

The EU Carbon Border Adjustment Mechanism (CBAM) provides a clear illustration of these contradictory patterns in LDCs. The CBAM is a tool that assigns a price to the CO2-equivalent emitted during the production of carbon-intensive goods imported into the EU. This price encourages cleaner

[1] EPOG+ Program, University of Torino and Sorbonne University (Paris)

industrial production in non-EU countries. The CBAM introduces a price on the embedded carbon emissions generated in the production of given items imported into the EU. This price will be equivalent to the carbon price of domestic production, thereby guaranteeing that the EU's climate objectives are not undermined. Between 2018 and 2020, 80% of LDCs were classified as commodity dependent, including highly emitting commodities such as minerals, metals, and fuels, which are also inputs in carbon-intensive value chains. All of these are now covered by the European CBAM (UNCTAD, 2021). The mechanism would impose an additional burden on the competitiveness of goods traded from developing countries to the EU. Nevertheless, it is important to note that not all LDCs would be equally concerned by these costs. Although the provision is of particular consequence for the BRICS countries, some LDCs are also particularly affected. Countries that export aluminum, such as Mozambique, Cameroon, Guinea, and Sierra Leone, as well as steel exporting LDCs like Zimbabwe and Zambia, will be affected by these costs. Mozambique is also among the countries that will be most socio-economically influenced by the CBAM. It has been estimated that 2% of Mozambican jobs (more than 250,000 jobs) and 6% of wage bills are exposed to the impact, as the country has a weak system of social protection (with a coverage of less than 25% of the population) (Magacho et al., 2022).

In addition to the aforementioned use case, we also identify further enhancements in the external impacts of European policy-making related to climate. Firstly, it underscores the necessity for transparency in EU private sector finance mobilization in order to channel these private resources towards the achievement of targeted climate goals. Secondly, it highlights the importance of addressing the asymmetry in adaptation and mitigation finance (Lundsgaarde, 2023). Despite its status as a significant financier of climate-related initiatives in developing countries, the EU continues to confront a financing deficit for climate adaptation through multilateral channels. One partial solution would be the imperative to design climate finance schemes that are highly accessible for LDCs, with the objective of increasing their capacity to react to the effects of climate change they are exposed to. This could be achieved through the issuance of more grants and concessional loans, taking into account the high debt of LDCs, and through the concentration of efforts on sustainable offers in adaptation funding, such as the construction of climate-resilient infrastructure, the implementation of early warning systems, the promotion of sustainable agriculture, and the enhancement of the transparency and accessibility of international climate funds, among other measures. Finally, the analysis emphasizes the crucial importance of incorporating gender-specific considerations into the nexus of climate action and poverty eradication (Allwood, 2021; Franklyn et al., 2022).

The analysis concludes with a series of targeted policy options designed to address the identified gaps. Firstly, the EU should address the structural conditions of LDCs. This could be enhanced by

strengthening the capacity for climate-informed decisions, investing in energy security and efficiency, and recycling the revenues from CBAM for the green transformation in LDCs. Secondly, the EU could address the existing deficiencies in the efficiency and additionality of climate finance. This could entail the establishment of loss and damage mechanisms for LDCs, the implementation of a more tailored approach to climate financing for LDCs, and the further clear and SDG-guided mobilization of the private sector. Finally, in order to comprehensively address existing inequalities and vulnerabilities in LDCs, it is of the utmost importance to ensure the coherent implementation of existing gender-sensitive mechanisms in mainstreaming and targeted climate action.

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