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Raw deal

The EU's unfair trade agreements
with Mexico and South Africa



**World
Development
Movement**

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Executive summary

Raw deal

Why do a bilateral or regional trade deal with the European Union (EU)? What benefits will it bring? These are questions that should be on the lips of developing country governments as the European Commission ranges around the world trying to implement its 'Global Europe' strategy; an aggressive agenda to secure access for European companies to markets in the developing world. This report is aimed at helping provide answers to these questions by analysing two previous trade agreements between the EU and developing countries.

The first half of the report looks at the EU-South Africa trade agreement created in 1999. The report shows how the EU negotiated 'special treatment' for itself by agreeing to cut tariffs on just 25 per cent of the goods South Africa actually exports to the EU while getting South Africa to cut tariffs on 40 per cent of the goods the EU exports to South Africa.

The report shows how the agreement reduces tariffs on agricultural and industrial goods well beyond South Africa's World Trade Organisation (WTO) commitments and how these reductions have already led to an increase in imports from the EU which are having a negative impact on South Africa's current account balance. If this continues, South Africa will be at increasing risk of a financial crisis. The food processing, clothing and electronics industries are being particularly affected by the surge in imports from Europe. As well as cuts in jobs, wages and employment conditions, the removal of tariffs makes it more difficult for South Africa to develop value-adding industries, making the country reliant on export of raw materials.

The report also briefly examines the impact on Botswana, Lesotho, Namibia and Swaziland. South Africa's membership of the Southern Africa Customs Union with these countries means they are also affected by the EU-South Africa trade agreement, despite the fact they were not fully included in negotiations. As well as increased imports from the EU, these countries are facing large reductions in government revenue as they are highly dependent on trade taxes on European imports for their government income. The Namibian government could see revenue decline by 7.5 per cent of GDP over coming years. In the UK, a cut in government revenue of 7.5 per cent of GDP would equal €100 billion; which is more than the UK government spends on education.

The second half of the report looks at the EU-Mexico trade agreement. The EU started pursuing a trade deal with Mexico after European exports to Mexico fell when the North American Free Trade Agreement (NAFTA) between Mexico, the US and Canada was signed in 1994. It is hard to view NAFTA and the EU-Mexico trade agreement, which was signed in 2000, in isolation. The report therefore looks at them both.

Executive summary continued...

The report shows that although NAFTA resulted in a large expansion in trade and foreign investment in Mexico, this did not translate into improved economic performance. If anything economic growth has fallen, employment has not increased and wages have remained low. Small farmers have been devastated by US subsidised agricultural imports; two million people have had to leave the land as the price received for growing maize-corn has collapsed.

The EU-Mexico trade agreement has had little effect on agriculture in comparison to the huge upheaval caused by NAFTA. The principal impacts have been in the other sectors of the economy - industrial goods and services. As with the EU's trade pact with South Africa, the EU-Mexico free trade agreement cuts Mexican tariffs well beyond the country's WTO commitments.

Despite Mexico having a trade surplus with its major trading partner, the US, the country still runs an overall trade deficit. Since the EU-Mexico trade deal was signed, with increasing imports of industrial products from the EU, the proportion of this deficit accounted for by trade with the EU has increased significantly from 37 to 60 per cent. Mexico's trade deficit with the EU and other trading partners is making Mexico more dependent on foreign capital and making Mexico's economy more vulnerable.

Unlike the South Africa deal, the EU-Mexico agreement also liberalises trade in services. Again the binding restrictions on how the Mexican government can regulate European services multinationals go well beyond the commitments the country has made in the WTO.

The report examines several service sectors including banking, where allowing European companies 100 per cent ownership of banks in Mexico has led to higher interest rates and reduced lending for productive activities, especially for local small and medium sized enterprises. This has exacerbated the creation of a Mexican economy focused on foreign investment and industrial assembly of goods imported then re-exported to the US, at the expense of developing the domestic economy.

The report concludes that the principal beneficiaries of the EU's bilateral trade agreements with Mexico and South Africa have been European companies. Poor and marginalised groups in Mexico and South Africa have tended to end up worse off rather than better off.

The report argues that signing a trade deal with the EU is not consistent with a sound development strategy. It is more consistent with a strategy aimed at maintaining the status quo; keeping developing countries in their place as exporters of low value commodities (except in products where the EU provides agricultural subsidies) and importers of western manufactured goods, western technology, western services and western capital.

For those developing countries that perceive some economic or perhaps broader political gain from bilateral trade treaties and are keen to negotiate with the EU the message is clear: be careful what you wish for.

1. Introduction

*"I am not, as a matter of basic conviction, in favour of intervention in markets or managing trade."*¹

**Peter Mandelson,
European Trade Commissioner**

In October 2006 the European Union (EU) Trade Commissioner, Peter Mandelson, launched a trade strategy for the European Union: 'Global Europe: Competing in the world'. The strategy sets out how the EU will pursue "activism in creating open markets" in developing countries.²

The Trade Commissioner perceives a world in which European companies are being treated 'unfairly'; a world in which developing country governments are erecting unjustified barriers to European products and European investment. As Mr Mandelson said in 2007, "In too many major emerging economies, the state is so much in the business of business, interfering so much in a wide range of so-called 'strategic' sectors, that our products and services are kept out or theirs are given an unfair advantage...It is a level of unfair competition which we cannot accept."³

In many ways, the new strategy marks a turning point. For years, the EU has pursued more open markets in developing countries based on a 'we know what's best for you' approach. The language of development has been widely used to justify the EU's demands for other countries to liberalise. So the argument goes, if developing countries open their markets it will be good for them and will benefit the poor.

In 'Global Europe' by contrast, much of the development rhetoric has been ditched and a more brazen strategy to open markets for the benefit of European business has been set out. The EU strategy of course mentions the World Trade Organisation's 'Doha Round' (or the 'Doha Development Agenda' as the EU likes to call it) as an ongoing priority. However, it is well known that the EU has been struggling to achieve its ambitions in the WTO, with several of its plans (e.g. new rules on investment, government procurement and export restrictions) being rejected entirely by large groupings of developing country WTO members.

The bulk of the 'Global Europe' strategy is, in essence, a recognition of this fact. It creates a mandate for the Trade Commissioner to seek regional and bilateral trade deals with developing countries in order to take them beyond WTO rules; what are called in the jargon 'WTO plus' agreements. As Pascal Lamy said when still European Trade Commissioner in 2004, "We always use bilateral trade agreements to move things beyond WTO standards. By definition, a bilateral trade agreement is 'WTO plus'. Whether it is about investment, intellectual property rights, tariff structure, or trade instrument, in each bilateral free trade agreement we have the 'WTO plus' provision."⁴

Specifically, the EU wants developing countries to:

- Cut import taxes on industrial and agricultural goods
- Remove so-called 'non-tariff barriers' on imports
- Eliminate restrictions on exports, particularly of raw materials
- Enforce strict intellectual property rights for European companies
- Remove regulations on European service companies
- Remove regulations on investment by European multinational companies
- Stop giving preferential treatment to their own companies when awarding government contracts

It has been argued that developing countries should sign up to a deal (however bad) in the WTO because if they don't, industrialised countries will simply seek liberalisation through bilateral or regional trade deals where developing countries have less strength in numbers. This of course is nonsense. Regardless of what happens in the WTO, the EU and other rich countries will seek further market opening for their companies through the bilateral/regional route. All the WTO talks do is set a new baseline from which to start the haggling. Trade Commissioner Peter Mandelson has made it clear that the EU will

pursue trade deals with individual countries and regions whether or not there is a deal in the WTO's Doha Round.⁵

The EU has already been busy negotiating regional trade deals with 76 African, Caribbean and Pacific (ACP) countries. In these so-called 'Economic Partnership Agreements' (EPAs), the EU has been pushing for the ACP countries to remove import taxes and regulations on European companies, in return for access to the European market which the ACP countries had previously received without giving anything in return.

The ACP group comprises many of the poorest countries in the world. The three regions contain 740 million people, of which the World Bank says 550 million live on less than the international poverty-line of US\$2 a day.⁶ It is perhaps not surprising then that the EU's attempt to open markets in these countries has been the focus of concerted civil society opposition both within the ACP countries and within the EU and has been a major concern for ACP governments.

In addition to the ACP countries, the 'Global Europe' strategy also targets a set of countries and regions for trade deals which the EU regards as having the greatest "market potential."⁷ The EU is seeking to get "the highest possible degree of trade liberalisation including far-reaching liberalisation of services and investment."⁸

Negotiations have already been launched with countries in the Mediterranean region,ⁱ South Korea, ASEAN,ⁱⁱ Central America,ⁱⁱⁱ Andean Community^{iv} and India. The EU also intends to launch negotiations on a trade deal with Mercosur.^v At first glance, many would regard these countries and groupings as fair game;

- i. Morocco, Algeria, Tunisia, Egypt, Israel, Jordan, Palestine, Lebanon, Syria, Turkey
- ii. Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam. The EU is suggesting that it will exclude the three Least Developed Countries in this region from negotiations: Cambodia, Laos and Myanmar.
- iii. Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama
- iv. Bolivia, Colombia, Ecuador, Peru
- v. Argentina, Brazil, Paraguay, Uruguay, Venezuela

larger developing countries that are legitimate targets for the EU's aggressive liberalisation demands. Yet on closer inspection, the picture is not so simple. These regions together contain 2.2 billion people, a staggering 920 million on less than the World Bank's international poverty line of less than US\$2 a day, 470 million of whom live on less than the World Bank's extreme poverty line of US\$1 a day (see map below).⁹

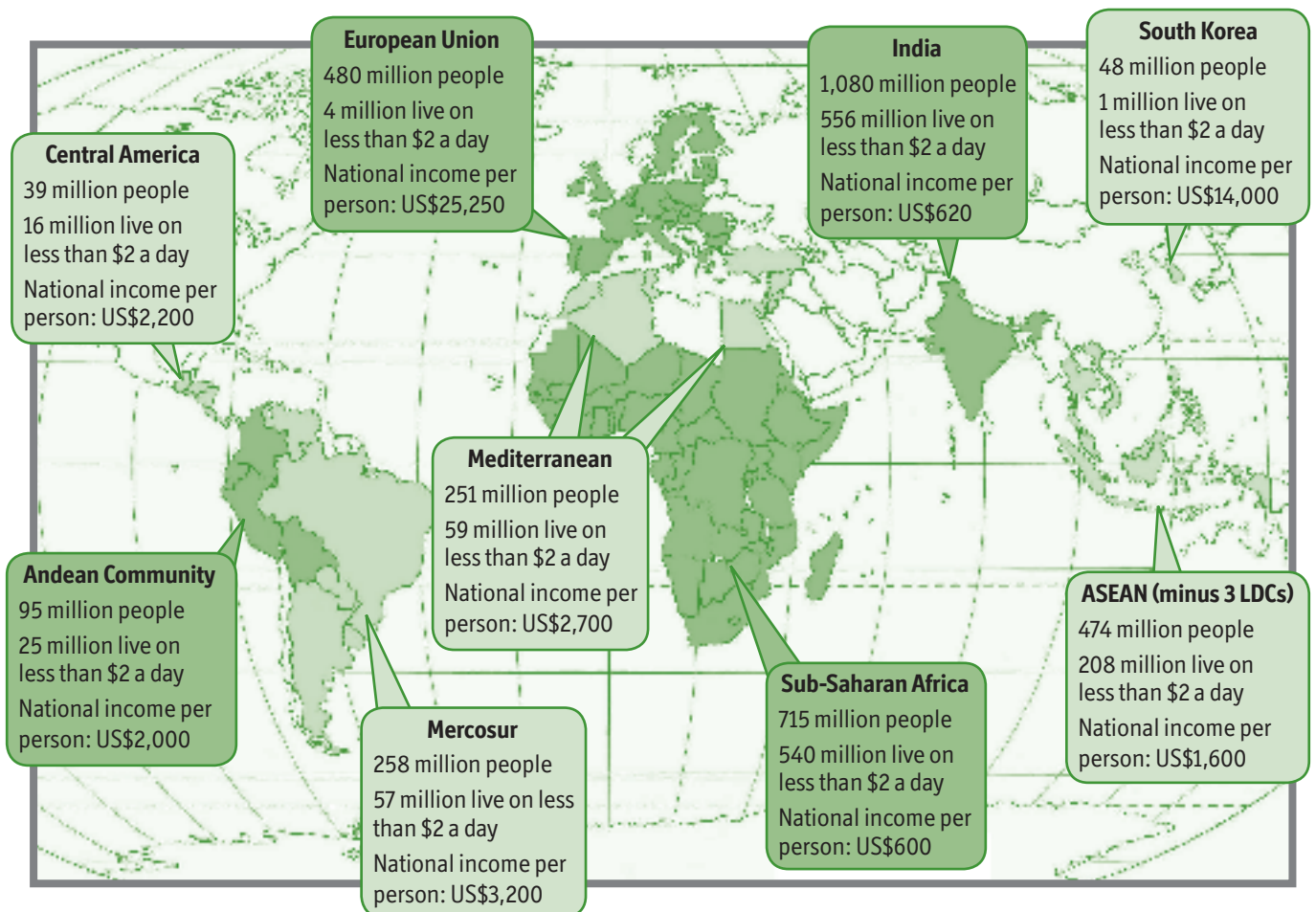
With the European Commission setting about a radical market opening effort across much of the developing world, the question is what can be expected for the hundreds of millions of poor people in the 'target' countries? What are the likely impacts?

The answer, or at least part of it, can be found in two of the bilateral deals the EU has already concluded. In the late 1990s, while the EU was loudly banging the drum for a new multilateral

trade round, it was also more quietly negotiating trade deals with a couple of larger developing countries. In 1999 it concluded an agreement with South Africa, in 2000 a deal was done with Mexico and a little more recently, in 2003, one with Chile.

Whilst these agreements set timescales for liberalisation over 10-12 years, some of the impacts of the South African and Mexican agreements can now be seen. This report aims to analyse these two agreements from a development perspective. The report firstly looks at the EU-South Africa trade agreement, outlining what it contains and assessing how it is already impacting on the country and its people. The second half of the report does the same for the EU-Mexico trade agreement.

The report concludes by drawing together the key lessons for policy-makers from both case studies.



2. EU-South Africa trade agreement

2.1 Introduction

On the ending of apartheid, South Africa entered into negotiations with the EU aimed at a deal to remove tariffs from South African exports to the trading bloc. Despite opposition from within the ruling African National Congress, the new South African government felt that such a trade agreement was necessary to expand the South African economy, Europe being South Africa's largest trading partner. The EU proposed a trade deal requiring liberalisation on both sides. The negotiations happened in the mid-to-late 1990s and concluded in 1999.

South Africa is part of the Southern Africa Customs Union (SACU) with four neighbouring countries: Namibia, Botswana, Swaziland and Lesotho. The five countries have abolished taxes on trade between them. This means that the EU-South Africa trade deal effectively applies to the four neighbouring countries as well. The four countries were only included in negotiations on the trade agreement late in the process, following South African demands on the EU to meet with Namibia, Botswana, Swaziland and Lesotho. Therefore, whilst the trade agreement is formally between the EU and South Africa, in reality it is between two regions, the EU and SACU.

The trade agreement's focus is on cutting trade taxes on industrial goods and agricultural products. There are no specific liberalisation commitments in areas such as services, intellectual property and government procurement. However, these areas are referenced in commitments to future talks. For example, on services the two parties state they will "endeavour to extend the scope of the agreement with a view to further liberalising trade in services [beyond WTO commitments]."¹⁰

South Africa has the largest economy in sub-Saharan Africa, but still suffers from extensive poverty and inequality. National income per

person (Purchasing Power Parity - PPP)ⁱ is US\$10,960, compared to US\$25,248 in the European Union.¹¹ And this income is divided extremely unequally; the richest 10 per cent of the South African population earn 33 times more than the poorest 10 per cent. South Africa is one of the most unequal countries in the world, alongside a few South American countries such as Brazil and Colombia, and the other four members of SACU (see Table 1 below).ⁱⁱ

Over 34 per cent of the South African population are estimated by the World Bank to live on less than the international poverty line of US\$2 a day.¹² Life expectancy at birth is just 47 years, infant mortality is 54 for every 1,000 births and the World Bank estimates that 33 per cent of workers are unemployed.¹³ In contrast, less than one per cent of the EU population live on less than US\$2 a day.¹⁴ Life expectancy at birth is 78 years, infant mortality is five for every 1,000 births and around nine per cent of workers are unemployed (see Table 1 below).¹⁵

Furthermore, it is likely that the World Bank figures for poverty and unemployment are underestimates. Those living below the national poverty line probably amount to half the South Africa population, and when workers who have given up looking for a job are taken into account, it is estimated that around 40 per cent are unemployed.¹⁶ The four other members of SACU tend to have even higher rates of poverty than South Africa (see Table 1 below). The EU-South Africa trade agreement is therefore a deal between two regions of vastly different income and poverty levels.

- i. Purchasing power parity figures seek to take account of differences in costs of living. South Africa's official GDP per person is US\$5,109, but goods and services in South Africa tend to be cheaper than in the US. The purchasing power parity figure attempts to correct for these differences in costs of living.
- ii. The Gini Index for South Africa is 57.8. Brazil is 58.0 and Colombia 58.6. Botswana is 63.0, Lesotho 63.2, Namibia 74.3 and Swaziland 60.9. UNDP. (2006). Human development Report 2006. UNDP. New York and Geneva.

Table 1. Poverty indicators for the EU and Southern African Customs Union

Country	National income per person (PPP)	Population living on less than \$2 a day	Life expectancy at birth	Infant mortality (for every 1,000 births)	Unemployment	Income inequality (Gini index: 0 = perfectly equal, 100 = one person has everything)
EU	US\$25,248	1%	78 years	5	9%	32.4
SACU	US\$10,390	36%	46 years	56	32%	58.9
<i>South Africa</i>	US\$10,960	34%	47 years	54	33%	57.8
<i>Botswana</i>	US\$ 9,580	50%	35 years	84	19%	63.0
<i>Namibia</i>	US\$ 7,520	56%	47 years	47	31%	74.3
<i>Lesotho</i>	US\$ 3,250	56%	36 years	80	N/A	63.2
<i>Swaziland</i>	US\$ 5,650	N/A	42 years	42	N/A	60.9

South Africa is also far more dependent on trade with the EU than the EU is on trade with South Africa. South Africa's exports to the EU are worth €18.6 billion, which equals 46.5 per cent of South Africa's total exports, and 14.3 per cent of South African GDP. In contrast, the EU's exports to South Africa are worth €20.5 billion; 0.6 per cent of the EU's total exports and 0.2 per cent of EU GDP (see Table 2 below). Therefore, in trade talks between the two regions, it is likely that the EU has far more negotiating leverage than South Africa.

It is also hard to escape the fact that, in trade negotiations between developed and developing countries, aid relationships can create additional leverage for the developed country. According to the European Commission's web pages on EU-South Africa relations, "The EU is by far the most important donor; the Commission and Member States together provide about 70% of total donor funds [to South Africa], which amount to about 1.3% of the government budget and 0.3 of GDP."²²

Table 2. Trade indicators for the EU and South Africa

	GDP¹⁷ (€ billion)	Total exports¹⁸ (€ billion)	Exports to each other¹⁹ (€ billion)	Exports to each other²⁰ (per cent of exports)	Exports to each other²¹ (per cent of GDP)
EU	9,440	3,600	20.5	0.6	0.2
South Africa	130	40	18.6	46.5	14.3

“The EU has much to gain from an FTA [free trade agreement] with South Africa. The further opening up of the South African market in the context of such an agreement will create competitive advantages for EU exporters compared to exporters from the USA, Japan and other suppliers of South Africa. The price the EU would have to pay for such an improved position in terms of loss of customs revenues is relatively low, due to the high level of existing duty-free access for South African imports and the relatively modest average level of the remaining tariffs at the EU side.”²³

European Commission, in a 1996 paper on an EU-South Africa trade agreement

The EU-South Africa trade agreement “is not a good agreement. It has not brought benefit to South Africa. Europe has been the beneficiary.”²⁴

Ben Turok MP, South African parliament’s portfolio committee on trade and industry

2.2 Special treatment for the EU

Under the trade agreement, the EU began cutting trade taxes on goods coming from South Africa in 2000, with most cuts having been completed by 2006. South Africa started reducing a few trade taxes on goods coming from Europe in 2000, but most cuts began in 2004 and are not due to be completed until 2012.²⁵

The EU is to eliminate trade taxes on 95 per cent of goods, whilst South Africa is to remove tariffs on 86 per cent of goods. However, the EU tariff changes only affect 25 per cent of South Africa’s actual exports to the EU before the agreement, and of these 25 per cent, the average trade tax the EU charged on them was only 2.7 per cent. Around 75 per cent of South African exports to the EU remain unaffected by the agreement.²⁶ More than half South Africa’s exports to the EU are in non-agricultural raw materials which the EU did not apply duties to before the trade agreement anyway.²⁷

In contrast, South African tariff cuts are on goods which account for 40 per cent of the EU’s exports to South Africa. The average tariff on these goods was 10 per cent before the agreement was signed.²⁸ From the very start of the trade agreement, EU exporting companies were set to gain far more than South African exporters.

For instance, under the agreement the EU does not have to cut any tariffs on wine, one of South Africa’s main exports to the EU. In contrast, South Africa had to start reducing tariffs on European wine in 2004, and remove them entirely by 2012. South African wine exporters have received no advantage from the trade agreement.

At the time the agreement was signed, the South African government was focused on increasing incomes for South African exporters, rather than building the capacity of local industries through supplying the South African economy. However, even on this reasoning, the trade agreement is a raw deal, giving far more liberalisation to EU exporters than South African. It has been argued that this imbalance reflects the fact that South Africa had much weaker trade negotiating skills

than the EU in the years immediately following apartheid.²⁹ Ben Turok MP has said that South Africa was “hoodwinked” into signing the deal.³⁰

One study of the cut in EU tariffs shows that it has had little effect on South African exports to Europe. As a proportion of exports, South African exports to the EU have not increased. Bizarrely, because of the highly selective nature of EU import tax reductions, the average tariff on goods South Africa actually exports to the EU has increased. The EU has cut tariffs in areas of no interest to South African exporters, and maintained tariffs on goods South Africa actually sells to the EU.³¹

2.3 South Africa's increased trade deficit

In recent years South African cuts in trade taxes on goods coming from the EU have contributed to an increase in the trade deficit. The trade balance between South Africa and the EU became a surplus in the first few years of the agreement, when the EU had started to cut tariffs, but South Africa had not. However, in recent years South Africa has gone back into a trade deficit with the EU (see Graph 1 opposite).

The South African total current accountⁱ deficit has increased from 1.1 per cent of GDP in 2003 to 6.5 per cent of GDP in 2006. Although South Africa's trade imbalance with the EU is not the sole reason for the current account deficit, it is certainly a key factor given that more than 40 per cent of South Africa's total trade is with the EU.³⁴

Table 3. South Africa's trade balance with the EU (2005 prices)³²

Year	South Africa exports to the EU (€ billion)	EU exports to South Africa (€ billion)	South Africa's trade balance with the EU (€ billion)
1994	8.1	9.5	-1.4
1995	8.9	10.8	-1.9
1996	9.2	10.7	-1.5
1997	10.6	11.3	-0.7
1998	11.5	13.2	-1.7
1999	12.2	11.6	0.6
2000	15.8	14.1	1.7
2001	16.6	13.9	2.7
2002	15.9	13.9	2.0
2003	14.6	15.4	-0.8
2004	16.7	17.5	-0.8
2005	18.3	18.5	-0.2
2006	18.6	20.5	-1.9

Graph 1. South Africa's trade balance with the EU (2005 prices)³³

This trade deficit fits with what would be expected from trade deals with rich countries. The United Nations Conference on Trade and Development (UNCTAD) has argued that a bilateral trade deal between a developed and developing country “often results in a surge in imports, which frequently leads to a worsening of its [the developing country] trade balance with the developed country.”³⁵

Current account deficits have to be paid for through increasing financial flows into the country, such as foreign direct investment by multinational companies, capital movements or international public debt. Increasing and persistent current account deficits mean that a country becomes:

- more dependent on the decisions of multinational companies as to whether to invest, and/or
 - at greater risk from large financial movements such as those that caused the collapse of some East Asian economies in 1997/98 and Argentina in 2001, and/or
 - burdened with debts such as those that crippled many African and Latin American countries in the 1980s and 1990s.
- i. The current account is primarily the difference between imports and exports; a deficit means that there were more imports than exports. However, the current account also includes flows of money which do not incur any obligation to repay, such as money sent home by migrant workers and aid which is grants (but not loans).

Table 4. South African financial movements (2005 prices)³⁶

	Overall trade balance [- = deficit] (€ billion)	Increase in public debt (€ billion)	Foreign direct investment (€ billion)	Short-term capital flows (€ billion)
2001	2.1	-1.2	8.9	-1.2
2002	1.6	1.7	0.8	-0.5
2003	-0.9	0	0.8	0.7
2004	-5.2	0.8	0.6	5.5
2005	-6.5	1.7	5.0	5.8
2006	-18.3	N/A	N/A	N/A

Table 4 above indicates the recent changes in the three areas of international public debt, foreign direct investment and short-term capital flows (there are no figures available yet for 2006). It is difficult to see trends in foreign direct investment as individual years are affected by particular decisions of multinational companies, such as reporting, mergers and acquisitions. For instance, the large figure for foreign direct investment in 2001 is due to the American company Anglo American changing its reporting from London to Johannesburg.³⁷ However, from the table above, it appears that foreign direct investment in South Africa is unrelated to the trade deficit.

In contrast, it is clear that South Africa's international debt and the size of short-term capital flows are increasing alongside the trade deficit. South Africa's extra imports that are not paid for by exports are being funded by an increase of short-term capital flows into the country.

The IMF has said: "[South Africa's] widening current account deficit and high reliance on portfolio inflows [short-term capital flows] have raised vulnerability to external shocks."³⁸ A high level of portfolio flows makes a country vulnerable to a sudden financial crisis if the money leaves the country, as happened in East Asia in 1997/98 and Argentina in 2001.

Whilst there are other factors involved, the increase in imports from the EU since South Africa began cutting its trade taxes on goods from the EU has contributed to the increase in the South African trade deficit. The increase in the South African trade deficit has led to a rise in capital flows into the country. If the trade deficit continues, and capital keeps flowing into the country, South Africa will be increasingly vulnerable to a financial crisis.

“Without the appropriate pacing and sequencing, trade reform programmes could lead to the destruction of existing industries, particularly infant industries, without necessarily leading to the emergence of new ones.”³⁹

Mandisi Mphahla, South Africa Trade and Industry Minister

“The elimination of tariffs and other trade barriers in almost all categories of goods removes important and powerful instruments of industrial and agricultural policy, which, in addition to protecting its infant industries, are often indispensable for improving the developing country's supply capacities in the long run – a precondition for maximizing the potential gains from trade liberalization.”⁴⁰

United Nations Conference on Trade and Development

2.4 Effects on particular sectors

Particular sectors in the South African economy have been affected by a surge in imports from the EU, lowering prices and making local companies less competitive. Over time, the removal of tariffs prevents sectors from having the protections they may need to develop technology, investment and skills in order to grow. Government interventions in trade such as the use of trade taxes can be a useful policy tool for countries to develop their industries.

If sectors are adversely affected by increased imports following cuts in trade taxes, there are likely to be job losses and falling wages from those sectors. Free market proponents claim that this is a good thing, as jobs can therefore be created in other ‘more productive’ sectors. However, South Africa has an unemployment rate of around 40 per cent of those able to work, which is shared across the other SACU countries. Where job losses do take place, it is unlikely that they will be replaced with jobs elsewhere, as over one-third of workers are already unemployed. In addition, falling wage rates will affect workers across the economy.

Below we consider how three sectors have been affected by the EU-South Africa trade agreement: agriculture, and particularly the processed food industry, clothing, and higher-technology industries such as electronic equipment.

*"We have been flooded with low-price canned goods from Europe. Cheap tinned Italian tomatoes, very cheap Danish jam where the glass costs more than the contents and Polish cucumbers. Quite a lot of products are now coming here, they are heavily subsidised, being sold below cost and are undercutting our own industries."*⁴¹

Ben Turok MP, South African parliament's portfolio committee on trade and industry

2.4.1 Agriculture

The EU-South Africa trade agreement requires South Africa to make larger cuts in agricultural tariffs than the EU. Between 60 and 75 per cent of EU tariffs on South Africa agricultural exports will be removed, whilst South Africa is to scrap tariffs on 95 per cent of agricultural imports from the EU over a 10-year period.

Furthermore, as a bilateral trade deal, the trade agreement cannot address agricultural subsidies, the primary way in which the EU protects its agricultural market. Subsidies to European farmers affect trade with all countries; they cannot and will not be changed through a bilateral trade agreement. The European Union will only negotiate legally binding subsidy reductions through the WTO, and it will only make commitments in the WTO once it has already agreed an internal reform programme. Any negotiation of agriculture in a trade deal with the EU is therefore heavily biased from the outset.

The tariff reductions South Africa is making on EU agricultural goods go well beyond South Africa's requirements at the WTO, or the tariffs which it actually uses (see Box 1 opposite). Under its WTO commitments, South Africa's average tariff could be up to 37 per cent. In reality, the tariffs South Africa implements average at 9 per cent. However, under the trade agreement, South Africa's average tariff on agricultural goods from the EU had fallen to 6 per cent by 2005, and will be cut to 2 per cent by 2012.

One researcher predicted in 2000 that the effects of the cuts in trade taxes on agricultural goods would be that: "Export earnings will remain in the hands of private companies. The benefits to workers in these industries are supposed to come about through the infamous 'trickle down' effect. But few farm workers in South Africa have yet experienced the benefits of sub-sectoral economic growth and there seems to be little reason why this might change soon."⁴³

At the same time, small and medium scale farmers producing food for local consumption may receive lower prices or be put out of business by subsidised

European imports. As well as directly impacting on the rural poor, this would lower South Africa's food security. A 1999 study for the Johannesburg South Africa Foundation found that local South African manufacturers of processed fruits and vegetables were expected to suffer losses from the trade deal.⁴⁴

Cuts in South African tariffs on agricultural products from the EU are taking place between 2004 and 2012. In 2004, significant cuts in a number of areas began, with cuts across all products beginning in 2005. Since 2003, imports of European agricultural goods have been increasing, growing by around 50 per cent between 2003 and 2006 (see Graph 2 below). The greatest increase in imports has been for dairy products, cereals, and processed food and drink.⁴⁵

South African imports of European processed food and drink have increased by more than two-thirds between 2003 and 2006 (see Graph 3 over). Most tariffs on processed food started being removed in 2004, and these reductions will continue until 2012.⁴⁸ The only processed foods excluded from liberalisation are chocolate and ice cream.⁴⁹

Box 1. South African agriculture and processed food tariffs⁴²

Average of highest tariffs permitted under WTO agreement: **37 per cent**

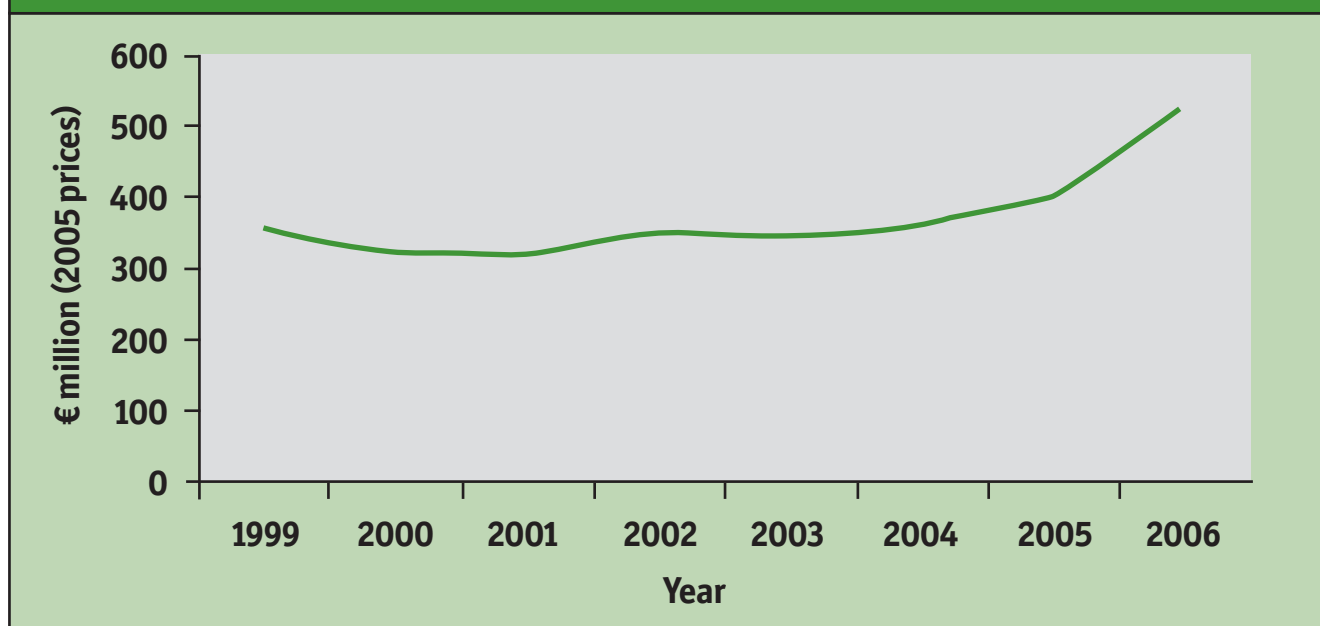
Average of actual applied MFN tariffs: **9 per cent**

Average of permitted tariffs on imports from EU in 2005: **6 per cent**

Average of permitted tariffs on imports from EU by 2012: **2 per cent**

The sudden increase in imports of processed food from Europe has undercut South African processed food producers, threatening jobs, wage rates and labour conditions. For instance, having declined dramatically between 1999 and 2002, imports of European processed vegetable products more than doubled between 2002 and

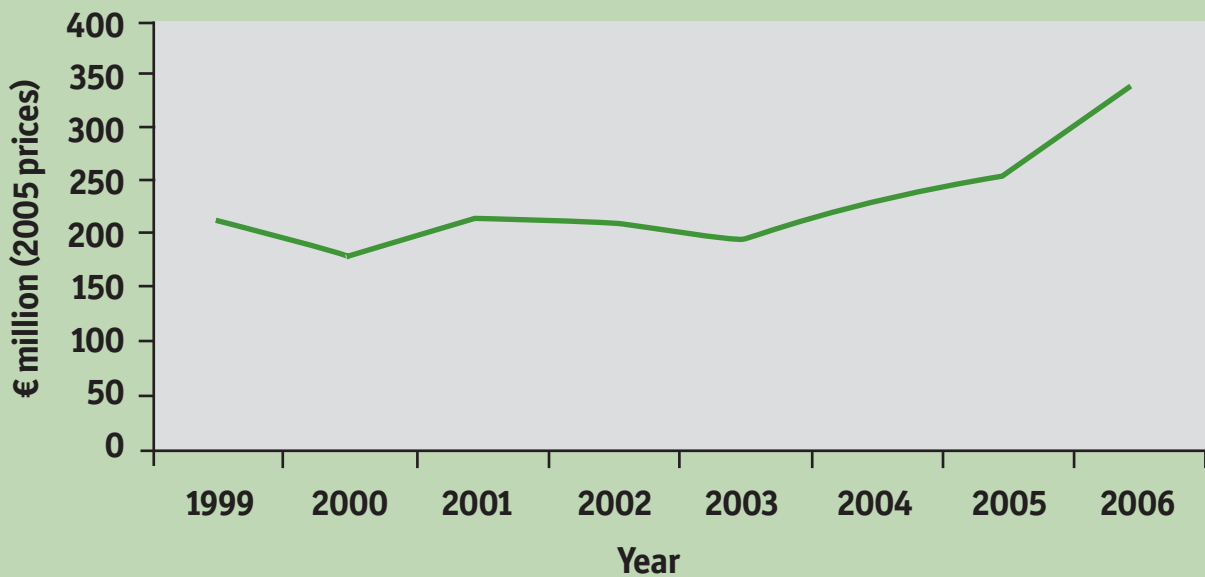
Graph 2. South African food and drink imports from the 25 members of the EU in 2005 (2005 prices)⁴⁶



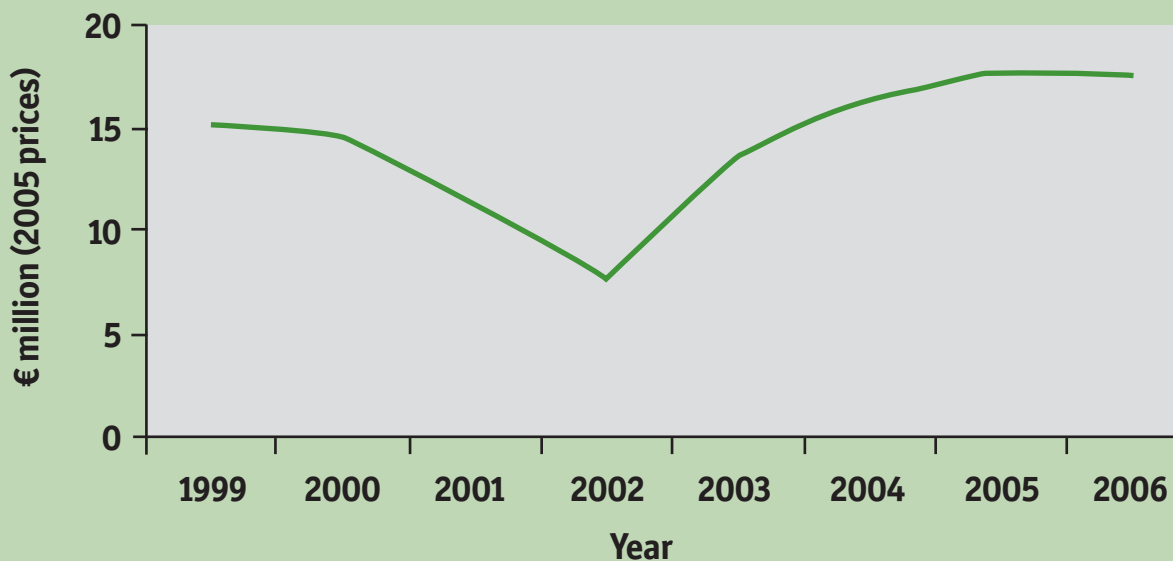
2005 (see Graph 4 below). South African producers are now being undercut by European imports of certain goods. Bottles of cucumbers are being imported from Poland and sold for R10 in South African shops, in comparison with South African cucumbers which cost R20, double the amount.⁵⁰

While such price drops may benefit consumers, these same consumers also experience the adverse impacts of a living in an economy of high unemployment and low wages, with all the social unrest this can create. Any government, particularly one in the developing world, has

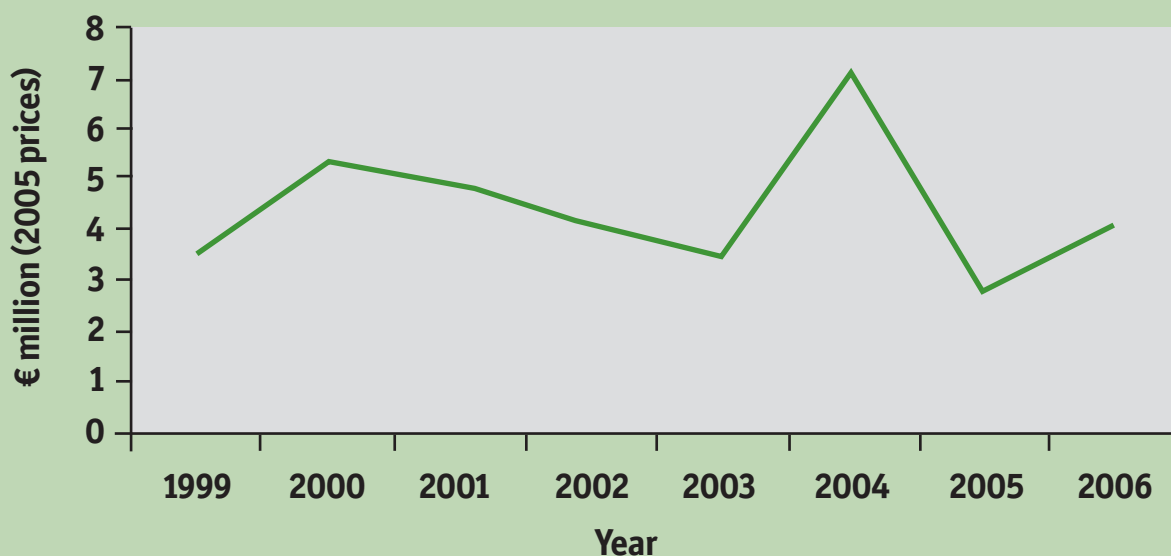
Graph 3. South African processed food and drink imports from the EU in 2005 (2005 prices)⁴⁷



Graph 4. South African processed vegetable imports from the 25 members of the EU in 2005 (2005 prices)⁵¹



Graph 5. South African sweet imports from the 25 members of the EU in 2005 (2005 prices)⁵³



a tough balancing act to perform and lower prices in the shops do not necessarily mean the economy is healthy.

In 2004, tariffs on European sweet imports began to be reduced which led to a sudden surge in European sweets into South Africa (see Graph 5 above). Employment in the South African sweet industry fell by 25 per cent in 2004. The South African government introduced a temporary safeguard measure, which allowed a recovery in the sweet sector in 2005. However, under the terms of the EU-South Africa trade agreement, this safeguard will be difficult to maintain as tariffs on European sweet imports are meant to continue to fall up until 2012.⁵²

Around 27,000 people work in the processed food industry, and with one-third of South Africans already unemployed, there is no guarantee that enough new jobs will be created elsewhere if there are job cuts.⁵⁴ The only alternatives to job cuts are cuts in wages or negative changes in working conditions, such as from permanent to temporary contracts. Women comprise a high proportion of workers in the processed food industry and agriculture in South Africa, and

consequently suffer disproportionately from the impacts of the trade agreement.

Increased imports have put pressure on South African businesses to cut costs. Some are industries already identified as having poor labour standards and human rights records. In the wine industry, there has been evidence in the past that some workers receive a proportion of their wages in wine rather than cash. Children from black families who live on farms may have to work during holidays because of the low wages and lack of social support for poor families.⁵⁵

The freer import of agricultural goods was also expected to impact on the other SACU countries, both by the effective duty-free import of European agricultural goods to all SACU countries, and also by SACU countries being out-competed in the South African market by European goods. Hidipo Hamutenya, the then Namibian Trade Minister, said: "The flood of imports of subsidised EU agricultural products will definitely impact negatively."⁵⁶ Up to 70 per cent of the population in the four smaller SACU countries is employed in agriculture. A study in 2000 predicted that increased imports from the EU would cost the four smaller SACU countries 12,000 jobs.⁵⁷

Researcher Paul Goodison has argued that the EU–South Africa trade agreement has caused deindustrialisation and decline of the value-adding food processing industry. And in turn, that this is undermining regional integration in Southern Africa. He argues, “in southern Africa EU consumer goods are entering South Africa at reduced duties, losing their EU identity and flowing freely onto regional markets, through the regional retail chains whose central purchasing is carried out in South Africa.”⁵⁸ This has resulted in what looks like an increase in regional trade. However, it is the re-export of goods originally imported from the EU, which do nothing to boost production or employment in southern African industries.⁵⁹

The US food processing industry has recently been lobbying the US government to conclude a trade agreement with South Africa. The US industry says EU food processors have gained from the EU–South Africa trade agreement, and the US industry therefore wants to be put back on a “level playing field” with the EU in getting access to the South African market.⁶⁰ The evidence presented in this report suggests the South African government should think twice before going down this route.

2.4.2 Clothing

The EU–South Africa trade agreement requires South Africa to reduce tariffs on EU clothing exports starting in 2001, but with the main reductions beginning from 2004. There were small falls in European clothing imports into South Africa between 2001 and 2004, although in 2005 and 2006 imports increased again (see Graph 6 opposite). At the same time, South African clothing exports to the EU have declined, from €87.6 million in 2003, to €70.3 million in 2004 and €49.8 million in 2005 (2005 prices) in all likelihood due to increased competition from other countries.⁶¹ Increased market access to the EU has therefore been no panacea for South African clothing manufacturers.

The size of South Africa’s clothing imports from the EU is relatively small in comparison with

imports from China. The value of clothing imports from China has more than doubled from €230 million in 2000 to €510 million in 2005 – six times the level of EU clothing imports to South Africa.⁶³ The fall in price for clothes has resulted in around 60,000 jobs being lost in South African clothing and textiles industries between 2003 and 2006 (see Graph 7 opposite).⁶⁴ Many of the jobs are low or semi-skilled and fulfilled by poorer sections of South African society, especially women.⁶⁵

Even before the recent impacts on the clothing industry due to the import of Chinese and European made clothes, a previous round of trade liberalisation in the 1990s had led to job losses across the clothing sector. As well as job losses, manufacturers cut costs through other means such as outsourcing of non-core functions and increasing use of informal, temporary workers. Many women experienced worsened working conditions and less secure employment. As one female worker commented in 2003, “I would like secure work where I can work for a couple of years. Everywhere you go, you sign a temporary contract. It’s a new thing. When the contract is finished, you have to go.”⁶⁷

At the start of 2007, the South African government set a quota for Chinese clothing imports, justified at the World Trade Organisation as a temporary emergency measure until the end of 2008. Initial estimates of the effect on trade in the first half of 2007 indicate that clothing imports from China have fallen, but imports from other countries, including the EU, have risen, giving little relief to South African clothing producers and workers.⁶⁸

Clothing is a relatively low-technology industrial sector which is often a starting point for industrialisation. Historically, countries have used government interventions such as tariff protections to develop their textile and clothing companies, allowing them to grow, increase investment and develop skills. However, South Africa’s opening of trade to the EU and other countries threatens to end such a process by flooding the economy with clothing imports that South African manufacturers cannot yet compete with.

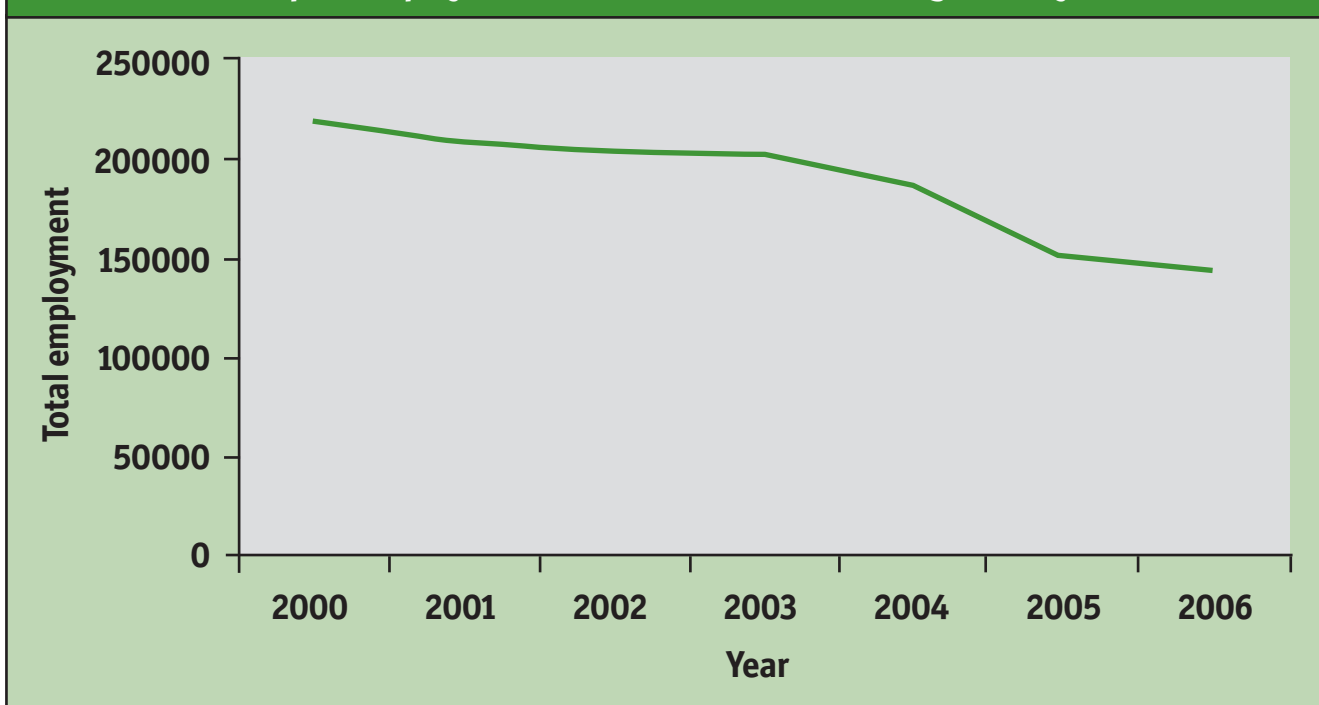
The rise in EU imports is particularly damaging for higher quality textile producers. One response to the challenge of clothing imports from China and other countries might be for South Africa to diversify into higher-technology, higher-quality

textiles. However, this policy will be more difficult to pursue by South Africa because there are no protections from European higher quality clothing exports. Both Italy and Germany are among the largest five clothing exporters in the world.

Graph 6. South African clothing imports from the 25 members of the EU in 2005 (2005 prices)⁶²



Graph 7. Employment in the South African clothing industry⁶⁶



“Our electronics industry has been decimated since the decision to liberalise tariffs more than under WTO requirements. We have classed ourselves as a developed and not a developing country and while we used to work on the components of TVs and other equipments, now whole sets are imported and this has decimated our industry.”⁶⁹

Rudi Dicks, Congress Of South African Trade Unions (COSATU)

2.4.3 Higher technology industries

The tariff reductions on European electronic and technical goods required of South Africa go well beyond South Africa's obligations at the WTO (see Box 2 below). Under WTO rules South Africa is permitted an average tariff on such goods of up to 13 per cent, although the tariffs it actually uses are on average 3 per cent. However, under the EU-South Africa trade agreement, the average allowable tariff had fallen to 2 per cent by 2005, and will reach zero when virtually all tariffs on such goods will be eliminated by 2012.

Looking at average tariffs masks the size and impact of some of the reductions taking place because some goods already have a zero tariff rate. Taking just electronic and technical goods which have a tariff placed on them by South Africa, the average applied tariff (MFN) is 12 per cent. However, for the EU this had fallen to 2 per cent by 2005, and will be reduced to zero by 2012.

South African tariffs on the majority of European electronic goods and technical equipment started being cut in 2004, and tariff reductions are due to continue until 2012.⁷¹ Between 2000 and 2003, there was little change (a slight decline) in South African imports of electronic and technical goods from Europe. However, since tariff cuts commenced in 2004, European imports have increased, growing by around 50 per cent between 2003 and 2006 (see Graph 8 opposite).

Box 2. South African electronics and technical goods tariffs⁷⁰

Average of highest tariffs permitted under WTO: **13 per cent**

Average of actual applied MFN tariffs: **3 per cent**

Average of permitted tariffs on imports from EU in 2005: **2 per cent**

Average of permitted tariffs on imports from EU by 2012: **0 per cent**

Graph 8. South African higher-technology imports from the 25 members of the EU in 2005 (2005 prices)⁷²



As tariffs on electronic and technical equipment are reduced further over the next five years, it is likely that imports of such items from the EU will continue to increase. South Africa's own development of such industries will be made far more difficult as the South African government will not be able to use tariff protections which have been vital to the development of industries in other countries.

2.5 Government revenues

Whilst the South African government gets a small percentage of its government revenue from trade taxes, Botswana, Lesotho, Namibia and Swaziland are a lot more dependent on trade taxes for their government income. Trade taxes provide around half of total government revenue for Lesotho and Namibia, about one-third for Swaziland and 14 per cent for Botswana.⁷³

Under the EU-South Africa trade agreement, government revenues for the four countries were predicted to fall by as much as 15 per cent, according to a working paper of the European Centre for Development Policy Management in 1998.⁷⁴ A paper for the IMF in 2004 found that

developing countries are unable to effectively replace lost tariff revenue with income from other sources. Middle-income countries can recover around 35-55 per cent of tariff revenue lost through trade liberalisation, while low income countries recover "essentially none."⁷⁵ Lesotho is classed as a low income country by the World Bank, whilst Swaziland, Namibia and Botswana are referred to as middle-income.

In Lesotho, revenues from tariffs have increased in recent years due to a different formula used to divide revenues among SACU members. However, the IMF predicts that revenues will decline after 2007/08, due in part to "trade liberalisation initiatives."⁷⁶

Similarly in Namibia, tariff revenues have been rising in recent years due to the new formula, but the IMF projects a "sharp drop" in revenues from trade "to some extent related to trade liberalisation" (see Graph 9 over).⁷⁷ There are no figures available from the IMF on the proportion of SACU members' trade that is with the EU, but it is presumably similar to South Africa: 45 per cent. Cuts in tariffs applied to EU goods would therefore account for much of this projected fall in revenue.

Table 5. IMF projections of tariff revenues in Namibia (per cent of GDP) ⁷⁸

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Tariff revenues	9.9	14.9	12.9	8.6	8.2	7.8	7.4
Total government revenue	33	36	34	29.7	29.3	28.9	28.5

Graph 9. IMF projections of tariff revenues in Namibia (per cent of GDP) ⁷⁹



Namibia's government revenue is predicted to decline by 7.5 per cent of GDP as a result of trade liberalisation. In the UK, a cut in government revenue of 7.5 per cent of GDP would equal €100 billion; which is more than the UK government spends on education.⁸⁰

Swaziland is also expected to see declining trade revenues in the years following 2007/08 although not as serious as in Namibia and Lesotho.⁸¹ In contrast it has been estimated that Botswana will lose as much as 10 per cent of its national income as a result of the EU-South Africa trade agreement.⁸²

2.6 Economic partnership agreements with SACU: Another raw deal

The EU-South Africa trade deal is not, however, the final chapter in Europe's trade relations with the country or surrounding region. A further complicating factor is the EU's negotiation of the so-called 'Economic Partnership Agreements' (EPAs) with 76 African, Caribbean and Pacific (ACP) countries.

Under previous non reciprocal trade arrangements between the EU and ACP, many African countries (not including South Africa) had duty free access to the European market for most of their exports, without being required to open their own markets in return. However, the EPA process requires the creation of reciprocal trade deals where this market access is granted on condition that African countries remove many of their tariffs on European goods, remove regulations on services and investment and give European companies the same access to government procurement contracts as local companies. The European Commission has also been suggesting that future aid will be influenced by whether a country has signed-up to an EPA.⁸³

South Africa was initially not part of these talks but called for, and was granted, a seat at the negotiating table in 2007 given its membership of the Southern Africa Development Community (SADC)ⁱ, a subsetⁱⁱ of which makes up a regional group with whom the EU is negotiating an EPA.

It is possible the reasons for South Africa wanting inclusion relate to regional politics but in terms of the economics it is not clear what South Africa has to gain. The EU has made clear that, "Due to South Africa's level of development and degree of competitiveness, it is...inevitable to grant a different treatment for the access of South African products to the EU market."⁸⁴

In return for probably little more market access to Europe than South Africa already has, the European Commission has been demanding that South Africa ban any use of export taxes and sign-up to a clause that any liberalisation South Africa

gives to another country will automatically be given to Europe as well. The European Commission has also been demanding that South Africa and other African countries remove regulations on European companies and allow European companies to bid for government procurement contracts.

The other southern African nations are in an equally difficult position. In late 2007, the European Commission threatened countries which had duty-free access to the European market, but were not classed as Least Developed Countries (LDCs), that their tariffs would go up on the 1 January 2008 if they did not sign what the EU called an 'interim trade agreement' (i.e. liberalising trade in goods). Facing the threat of losing exports to the EU, Botswana, Lesotho, Namibia and Swaziland all signed an interim-EPA trade agreement. The agreement means that these four countries will remove 85 per cent of their taxes on imports from the EU between now and 2018. It also means they are committed to further negotiations on services, investment and government procurement.⁸⁵

Given that the members of SACU should be implementing common external tariffs the question remained, at the time of writing, as to whether South Africa will apply the border tax levels agreed by Botswana, Lesotho, Namibia and Swaziland in the interim-EPA with the EU or whether it will continue to apply the border tax levels agreed under the EU-South Africa trade agreement.

The fact that other members of SADC are also members of the East African EPA negotiating group or the Eastern and Southern African EPA negotiating group means that it is also not clear how SADC will pursue its objective of regional integration over the coming years.

What does seem clear is that the EU's drive to open markets has made a complicated process of regional co-operation into a complete mess and has managed to open markets across a range of countries whilst giving very little in return.

- i. South Africa, Botswana, Lesotho, Namibia and Swaziland as well as Angola, the Democratic Republic of Congo, Madagascar, Malawi, Mauritius, Mozambique, Tanzania, Zambia and Zimbabwe.
- ii. Botswana, Lesotho, Namibia and Swaziland as well as Angola and Mozambique.

3. EU-Mexico trade agreement

3.1 Introduction

The EU-Mexico trade agreement came into force in 2000, having taken just a year to negotiate. Following the start of the North America Free Trade Agreement (NAFTA) in 1994 between Mexico, the US and Canada, trade flows from the EU to Mexico fell rapidly as US and Canadian goods received preferential access to the Mexican market. The EU-Mexico trade agreement was an attempt on the EU's part to reverse this process. The agreement covers services, government procurement and intellectual property as well as agricultural and industrial goods.⁸⁶

Mexico is the twelfth largest economy in the world,⁸⁷ but the Central American country still suffers from widespread poverty and inequality. One-fifth of Mexico's population, 21 million people, are estimated by the World Bank to live on less than the international poverty line of US\$2 a day.⁸⁸ Life expectancy is 75 years, compared to 78 years in the EU, infant mortality is almost five times higher at 23 for every 1,000 births compared to 5 for every 1,000 births in the EU. National income per person is US\$9,640, compared to US\$25,248 in the EU, and this income is divided up far more unequally in Mexico than in the EU (see Table 6 opposite).

As with South Africa, the Mexican economy is much more dependent on trade with the EU, than the EU with Mexico (see Table 7 opposite). Mexican exports to the EU make up 4.9 per cent of Mexico's exports, whilst exports from the EU to Mexico make up just 0.7 per cent of the EU's exports. However, the goods trade relationship between Mexico and the EU is small in comparison with Mexico's trade with the US. Mexico sends 80 per cent of its exports to the US (see Table 8 opposite).⁸⁹

NAFTA came into effect in 1994. NAFTA provided the spur for the EU to seek a trade deal with Mexico and to an extent a template the EU wished

Table 6. Poverty indicators for the EU, Mexico and the USA

Country	National income per person (PPP)	Population living on less than \$2 a day	Life expectancy at birth	Infant mortality (for every 1,000 births)	Unemployment	Income inequality (Gini index: 0 = perfectly equal, 100 = one person has everything)
EU	US\$25,248	1%	78 years	5	9%	32.4
Mexico	US\$ 9,640	20%	75 years	23	4%	49.5
USA	US\$39,820	0%	77 years	7	6%	40.8

Table 7. Trade indicators for the EU and Mexico

	GDP ⁹⁰ (US\$ billion)	Total exports ⁹¹ (US\$ billion)	Exports to each other ⁹² (US\$ billion)	Exports to each other ⁹³ (per cent of exports)	Exports to each other ⁹⁴ (per cent of GDP)
EU	11,800	4,542	31.2	0.7	0.3
Mexico	705	250	12.3	4.9	1.7

Table 8. Trade indicators for the USA and Mexico

	GDP ⁹⁵ (US\$ billion)	Total exports ⁹⁶ (US\$ billion)	Exports to each other ⁹⁷ (US\$ billion)	Exports to each other ⁹⁸ (per cent of exports)	Exports to each other ⁹⁹ (per cent of GDP)
USA	12,200	1,000	135	13.5	1.1
Mexico	705	250	212	84.8	30.1

to follow. NAFTA is also in many ways a test case of what happens when a trade area is agreed between countries or regions of vastly different levels of wealth and poverty. For these reasons, the next section looks in more detail at NAFTA before going on to assess current evidence on the EU-Mexico agreement.

“If the objective of NAFTA was to promote intra-North American trade and investment flows and to improve profitability for large multinational corporations, the evidence suggests that it has been successful. But NAFTA was not sold to the publics of the three countries based on these narrow objectives.”¹⁰⁰

Robert Blecker, Professor of Economics at American University

“Since the creation of NAFTA, Mexico has witnessed spectacular expansion in trade and FDI flows and relative macroeconomic stabilization. However, NAFTA has produced disappointing results in terms of growth and development.”¹⁰¹

United Nations Conference on Trade and Development

3.2 North American Free Trade Agreement (NAFTA)

3.2.1 Broader economic impacts

Since NAFTA came into force, Mexico's trade has expanded within the region and globally. Exports to the US and Canada rose from an already high level of 81.9 per cent of total exports in 1990-1994 to 88.2 per cent in 2002-2006. Mexico's share of world trade increased from 1.4 per cent in 1994 to 2.7 per cent in 2000, but has since declined to 2.1 per cent. Similarly there has been a big rise in the presence of multinational companies in Mexico; foreign direct investment increased from 8.5 per cent of GDP in 1990 to 27.3 per cent in 2005.¹⁰²

This expansion has had no positive effect on economic growth; instead it appears that NAFTA has had a negative impact on the Mexican economy. Average annual growth was 3.9 per cent in 1989-1993, falling slightly to 3.6 per cent from 1994-2000 and dropping more significantly to 2.3 per cent from 2001-2006.¹⁰³ In comparison growth was 3.4 per cent a year on average for Latin America as a whole between 2001 and 2006, 1 per cent a year higher than in Mexico.¹⁰⁴

Since NAFTA began, unemployment in Mexico has risen slightly from 3.5 per cent in 1994 to 4 per cent in 2007.¹⁰⁵ Various authors say there has been no net increase in jobs in the tradable goods sectors since NAFTA began so at best, NAFTA has not led to any increase in employment.¹⁰⁶ In addition, UNCTAD say that of new jobs created since 1994, the majority were in the non-tradables, rather than tradables, sector.¹⁰⁷

It could be argued that unemployment in Mexico has not fallen because the formal unemployment figures were already quite low - below those of the EU and US. If this were the case, then it would be expected that increased employment opportunities from NAFTA would have led to an increase in wages, because demand for workers would have increased.

But wage rates for Mexicans employed in manufacturing were lower in 2004 than they had been

in 1994. The peso crisis of 1994-1995 caused an initial setback in wages which, ten years later, had not returned to the same level as before.¹⁰⁸ Not surprisingly then, since NAFTA began, the richest 10 per cent of households have increased their share of national income, whilst the other 90 per cent have lost income or seen no change.¹⁰⁹

Much of the increase in the presence of multi-national companies and exports has created what has been labelled a 'dual-economy'. Companies import products for assembly to then be re-exported to the US. In the years immediately following the start of NAFTA, employment did increase in the import-assemble industries which then export back to the US. However, this was not enough to offset job losses elsewhere, particularly in agriculture (see section 3.2.2). And even jobs in these exporting industries fell by 200,000 in the first few years of the new millennium. Joseph Stiglitz has argued that this was because of Chinese exports to the US out-competing Mexico and a slow down in the US economy.¹¹⁰

NAFTA's proponents in the US claimed that it would help stem official and illegal migration from Mexico to the US. However, Mexican migration to the US increased during the 1990s. The share of Mexicans in the employed population in the US rose from 3.1 per cent in 1995 to 4.8 per cent in 2005.¹¹¹ The gap between Mexican and US wages has increased, and so the incentive to migrate has remained strong.

“Mexico’s most vulnerable citizens have faced a maelstrom of change beyond their capacity, or that of their government, to control.”¹¹²

Report from the Carnegie Endowment for International Peace on the impacts of NAFTA

3.2.2 Agriculture

NAFTA provisions on agriculture allowed for the removal of tariffs over 10 years, or 15 years for ‘sensitive goods’. The US’s agricultural subsidies were not affected by the agreement leaving Mexican farmers vulnerable to falling prices caused by the import of subsidised US agricultural products, with the worst impacts being felt by maize farmers.

US corn producers are heavily subsidised to the extent that, in 2002, US corn cost US\$2.66 per bushel to produce, but just US\$1.74 to buy.¹¹³ There was consequently a large increase in subsidised maize imports from the US into Mexico after NAFTA came into force. Maize imports to Mexico increased from 1,000 tonnes in 1991-1993 to over 4,000 tonnes in 1995-96 and over 6,000 tonnes in 2001.¹¹⁴ Growing maize-corn was the main livelihood of people working on the land in Mexico before NAFTA. As prices for corn fell in Mexico, the smallest and poorest farmers were hit the hardest.¹¹⁵ The impacts of increased corn imports from the US were exacerbated by the removal of government support programmes for farmers.¹¹⁶

Although agriculture accounts for only 5 per cent of Mexico’s GDP, one-quarter of the Mexican workforce lives off the land.¹¹⁷ Those most vulnerable to the effects of increased imports from America were poor and small farmers. Around 2 million jobs have been lost in Mexican agriculture since NAFTA began, as subsidised maize has put many small farmers out of business.¹¹⁸ This has consequently increased the rate of labour migration into cities. Workers leaving farming for urban areas have contributed to keeping wage rates low because there are more people looking for work.¹¹⁹

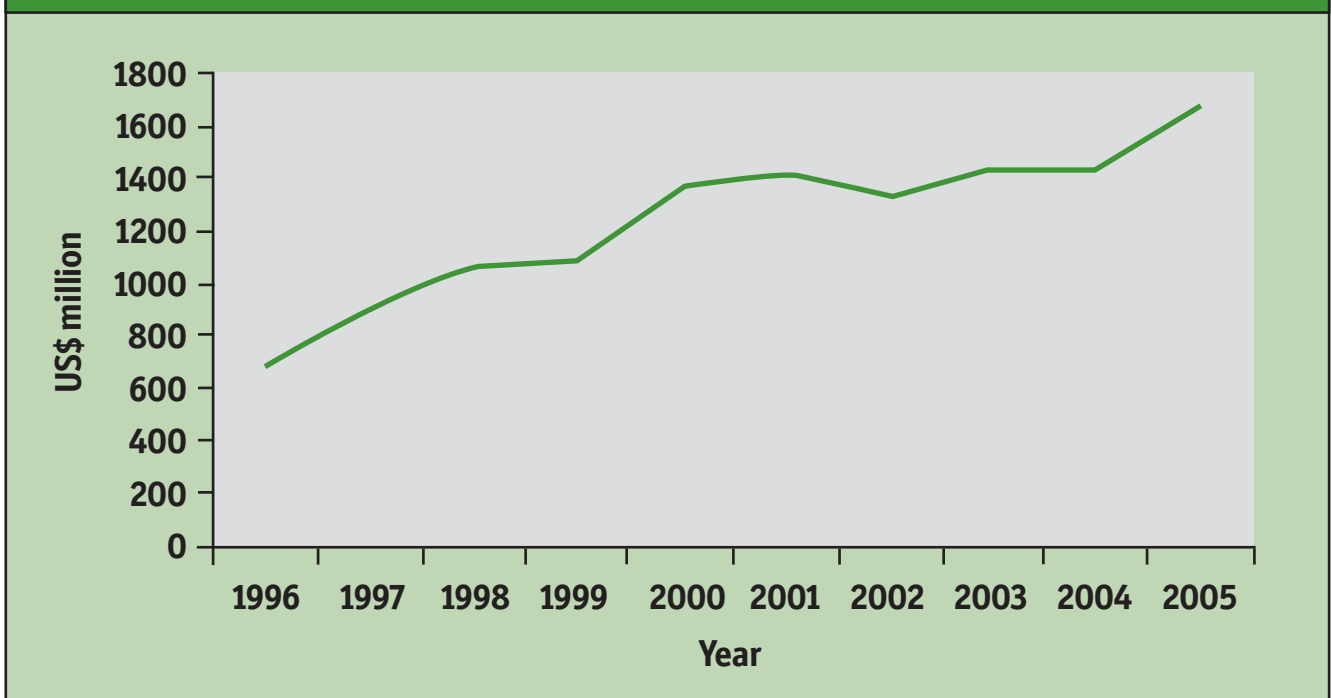
Proponents of the free market would argue that farmers should either grow other crops if the price of one collapses, or seek alternative employment. However, this is often not an option for farmers who do not have the resources needed to suddenly transform their whole method of farming or for whom alternative employment opportunities simply do not exist. Instead, for those small farmers who have continued to

work on the land in Mexico, the only response available to falling prices has been to grow more corn.¹²⁰ Increased marginal land has been farmed in response to the fall in prices. This has exacerbated price falls further, and has also contributed to deforestation in southern Mexico at a rate of around 630,000 hectares a year.¹²¹

Whilst the price received by small farmers for growing corn decreased, the price paid by consumers for corn products such as tortillas actually increased. Between the start of NAFTA and 2004, tortilla prices had increased by 279 per cent. Government subsidies for tortillas were removed in 1996 which accounts for some of the increase, but the Mexican tortilla market is also dominated by two companies: GIMSA and MINSA,¹²² who control 97 per cent of the corn flour market.¹²³ These companies can use their market power to take advantage of lower corn prices whilst not passing on savings to consumers.

Producers of corn are not the only farmers who have been affected by the opening up of the Mexican market to US agricultural imports. Meat imports to Mexico from the US have increased massively since tariff cuts began under NAFTA, trebling between 1996 and 2005 (see Graph 10 below).¹²⁴ In 2002, meat farmers protested in Guanajuato state against falling prices due to imports of meat from the US. Carlos Ramayo, head of the Confederation of Mexican Pork Producers, said: "If our situation doesn't change quickly, Mexico's 15,000 pork producers face complete collapse."¹²⁵

Graph 10. Meat imports to Mexico from the USA (2005 prices)¹²⁶



*Mexico's trade treaty with the EU "serves as an example for Latin America of the wrong route to follow with Europe, and an illustration of the urgent need to negotiate accords that are more similar to and more in keeping with the social, political and economic principles that exist within the EU itself."*¹²⁷

Manuel Pérez, an activist with the Mexican Action Network on Free Trade (RMALC)

3.3 The EU-Mexico trade agreement

3.3.1 Broader economic impacts

The EU-Mexico trade agreement came into force in 2000. The EU cut most of its industrial goods tariffs to zero by January 2003. Mexico cut some tariffs on a more gradual time scale, starting in 2000, but the final reductions were in January 2007.¹²⁸ The EU claimed that 96 per cent of EU-Mexico trade would be duty-free by 2007.¹²⁹

Liberalisation of agricultural goods is taking place over a longer timescale. EU tariffs started being cut in 2000 with final reductions by January 2010. Mexico has a similar timetable for reductions.¹³⁰ Like the EU-South Africa trade deal, and any other bilateral/regional trade agreement negotiated by the EU, the talks with Mexico did not cover what many regard as the EU's main agricultural protection: subsidies. As already mentioned, this is because the EU can and will only negotiate legally binding agricultural subsidy rules in the WTO.

Although Mexico has increased its exports to the EU since the EU-Mexico trade agreement came into force, EU exports to Mexico have also risen to the extent that Mexico's trade deficit with the EU has increased from €9.5 billion in 1999 to €15 billion in 2006 (see Table 9 opposite).¹³³ Despite having a trade surplus with the US, overall Mexico has a trade deficit with the whole world. Whilst Mexico's total trade deficit has not been increasing over time, the EU now accounts for over-half Mexico's total trade deficit (see Table 10 over).

In Mexico's case, this trade deficit is being paid for primarily through foreign direct investment by multinational companies, rather than increasing government debt or short-term capital flows (See Table 11 over). This is more secure investment than short-term capital flows, which boomed and then left the country causing the 1994-95 peso crisis. However, it does make Mexico more dependent on the investment choices of multinational companies, and thus weakens the Mexican government's hand in regulating multinational corporations. Section 3.3.4 shows how the lack of regulation of

Table 9. Mexico-EU trade balance 1998-2006 (2005 prices)¹³¹

Year	Exports from Mexico to the EU (€ billion)	Imports to Mexico from the EU (€ billion)	Mexico-EU trade deficit (€ billion)
1998	4.8	13.6	8.8
1999	5.4	14.9	9.5
2000	7.8	19.0	11.2
2001	8.3	22.0	13.7
2002	7.1	20.9	13.8
2003	6.9	18.6	11.7
2004	6.9	18.7	11.8
2005	8.6	22.2	13.6
2006	9.7	24.7	15.0

Graph 11. Mexico-EU trade deficit, 2005 prices¹³²



European service companies as a result of the EU-Mexico trade agreement has affected Mexico.

One US academic argues that the trade liberalisation Mexico has pursued, such as the EU-Mexico trade deal, has led to increased imports which have

offset any benefits from increased exports. Increased imports mean Mexico has to use contractionary monetary and fiscal policy (high interest rates and no government borrowing for public spending) to prevent the trade deficit spiralling out of control.¹³⁶

Table 10. Mexican trade deficit (2005 prices)¹³⁴

Year	Mexico total trade balance [- = deficit] (US\$ billion)	Mexico trade deficit with the EU (US\$ billion)	Percentage of Mexico's trade deficit due to trade with the EU
2001	-33.7	-12.5	37.1
2002	-32.6	-13.2	40.5
2003	-27.9	-13.3	47.7
2004	-34.6	-14.9	43.1
2005	-29.8	-17.1	57.4
2006	-30.7	-18.3	59.6

Table 11. Mexican financial movements (2005 prices)¹³⁵

	Overall trade balance [- = deficit] (US\$ billion)	Increase in external public debt (US\$ billion)	Foreign direct investment (US\$ billion)	Short-term capital flows (US\$ billion)
2001	-33.7	14.0	29.9	0.2
2002	-32.6	6.1	20.6	-0.1
2003	-27.9	7.8	16.2	-0.1
2004	-34.6	2.0	19.5	-2.6
2005	-29.8	0.1	18.8	3.4
2006	-30.7	N/A	N/A	N/A

The trade deficit makes it more difficult for the Mexican government to lower interest rates or increase government borrowing for fear that this would lead to financial imbalances causing another financial crisis such as the peso crisis in 1994. Lower interest rates would provide more opportunities for productive investment in Mexico. Government borrowing can be used for public investment in infrastructure, skills or technology which would have benefits across the economy.¹³⁷

Lower interest rates can also allow more borrowing by local companies to invest in productive activities. Increased government borrowing can be spent on public infrastructure

projects which can create the conditions for more investment by local companies. Lower interest rates and increased government borrowing can also be used as countercyclical policies to maintain economic activity and employment in periods when the economy is struggling.

Economic growth in Mexico fell considerably in the period after the Mexico-EU trade agreement came into force, dropping from 3.6 per cent during the period 1994-2000 to 2.3 per cent from 2001-2006.¹³⁸ As already mentioned, for Latin America as a whole, growth was 3.4 per cent a year on average between 2001 and 2006, 1 per cent a year higher than in Mexico.¹³⁹

3.3.2 Agriculture

Unlike NAFTA, the EU-Mexico trade agreement does not appear to be having a significant impact on Mexican agricultural imports. If anything, Mexican imports of European agricultural goods have been decreasing since the trade agreement came into effect (see Graph 12 below).

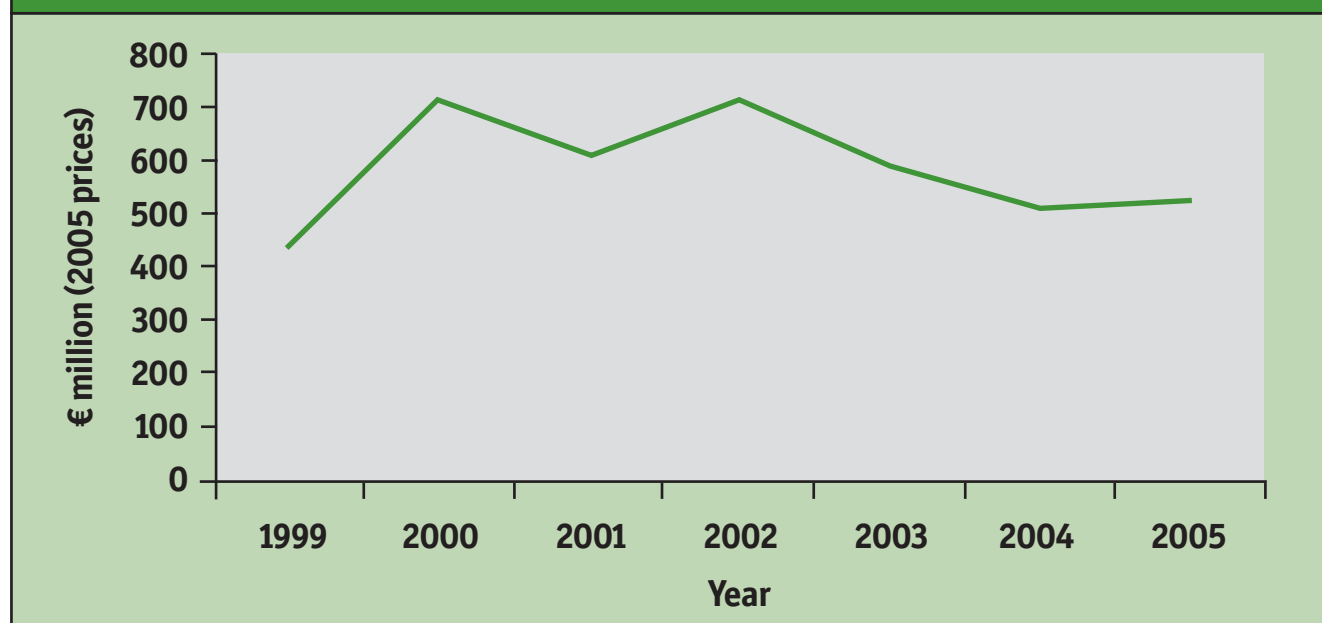
However, a new challenge has arisen in the form of EU and US demand for biofuels, and cuts in Mexican tariffs have left both Mexican farmers and consumers vulnerable to sharp rises and falls in food prices. In 2007, there were protests in Mexico at the high price of tortillas. World grain prices increased rapidly in 2007 due to drought in regions such as Australia linked to climate change, and the increased EU and US demand for corn-based biofuel.

In the absence of protection to ensure local food security, the continuing US and EU push for biofuels will exacerbate the competition between rich consumers in the EU and US wanting biofuels

for transport, and poor Mexicans wanting cereals for food. The more open market which has been created between the USA and Mexico, and the EU and Mexico means that poor Mexicans will have less access to food because it is sold to US and EU motorists who are willing to pay more.

Furthermore, the dominance in the biofuel production market of US agribusiness multinationals, and the fact that many poor farmers have already been forced off the land as a result of NAFTA and cannot simply return to agricultural production, means that higher prices for corn are more likely to be of benefit to multinational companies rather than poor farmers. Large companies were able to manipulate the market so that prices for tortillas rose even though corn prices fell. In the same way, multinational food and biofuel companies may be able to keep prices paid to small farmers low, whilst the price of processed food and biofuel rises due to increased demand.

Graph 12. Mexican agriculture imports from the 25 members of the EU in 2005 (2005 prices)¹⁴⁰



“A dual structure has been taking shape in Mexico’s manufacturing sector. On the one hand, there are a few very large firms whose links with transnational corporations (TNCs) and access to foreign capital have helped them to become important players in export markets; on the other hand, vast numbers of medium and small firms struggle to survive the intensified pressure from their external competitors.”¹⁴¹

Report for the United Nations Economic Commission for Latin America and the Caribbean

3.3.3 Mexico’s dual economy

As already mentioned, NAFTA helped create a ‘dual economy’ in Mexico with companies importing products for assembly to then be re-exported to the US. One of the aims of the EU-Mexico trade agreement was to give access to European companies to this market for re-export. Similarly, some US companies saw the EU-Mexico trade agreement as a way of accessing the EU via Mexico.

Of Mexican imports from the EU, 59 per cent are intermediate goods. Multinational companies import goods for assembly and then export the product to the US.¹⁴² This process of intermediate assembly has exacerbated the creation of the dual economy in Mexico, begun under NAFTA. The industrial zones operated by multinational companies producing goods for export to the US and EU have few links with the rest of the Mexican economy.

Regulations which could seek to make links – such as requirements on multinational companies to ensure skills and technology are transferred, to work with local firms, or to reinvest profits – are generally banned under NAFTA and the EU-Mexico trade agreement. One US academic has said: “value added in Mexican manufacturing has grown relatively little over the past decade, despite the apparently large growth in manufactured exports, and many export industries have weak or nonexistent linkages to the rest of the Mexican economy.”¹⁴³

The EU-Mexico trade agreement has contributed to the growth of the intermediate economy, seen through the growth of Mexican exports to the EU, which more than doubled between 1999 and 2006. In addition, between 25 and 30 per cent of Mexican foreign direct investment now comes from European multinational companies.¹⁴⁴

However, an even larger effect has been the growth in European imports into Mexico, by US\$17 billion (about Euro 10 billion) between 1999 and 2006. As with South Africa, these imports threaten the development of higher value industries and producers supplying the Mexican market. Producers for the domestic market are

far more likely to bring benefits of investment, technology and skills for the wider Mexican economy, and boost Mexico's overall production capacities. However, NAFTA and the EU trade agreement make the Mexican economy focused on production for export, which has, under NAFTA and EU-Mexico, neither improved the growth of the Mexican economy nor improved the lives of the Mexican poor.

Of particular concern is the liberalisation Mexico has undertaken in the high technology sector. Under its World Trade Organisation obligations, Mexico is permitted a maximum average tariff on higher technology goods of 35 per cent. The actual average of tariffs Mexico levies on goods from countries with which it does not have a trade agreement is 14 per cent. Under NAFTA, these tariffs were removed. And the trade agreement with the EU means that higher technology goods from Europe now enter Mexico duty free as well (see Box 3 opposite).

Box 3. Mexican higher technology goods tariffs¹⁴⁶

Average of highest tariffs permitted under WTO: **35 per cent**

Average of actual applied MFN tariffs: **14 per cent**

Average of permitted tariffs on imports from EU in 2005: **1 per cent**

Average of permitted tariffs on imports from EU in 2007: **0 per cent**

Not surprisingly, since the EU-Mexico deal was signed, the trend has been for rising imports of high tech products from Europe. Although import tariffs are certainly no 'silver bullet' for creating high technology production and employment they can be a useful tool. In 2000, the Mexican government of the time signed away the right of future governments to use this policy measure.

Graph 13. Mexican higher-technology imports from the 25 members of the EU in 2005 (2005 prices)¹⁴⁵



3.3.4 Profit remittances from Mexico

Both NAFTA and the EU-Mexico trade agreement free US and European multinational companies (respectively) from a series of regulations on whether and how they can operate in Mexico, such as requirements to keep a percentage of profits within the country. Graph 14 below shows profits made by multinational companies operating in Mexico and taken out of the country. Individual years depend on particular economic circumstances and decisions by multinational companies, but there is a clear difference between the period before (1990-1993) and after (1994-2005) NAFTA.

Since NAFTA began, profits made by multinational companies in Mexico, and taken out of the country, have risen from an average of US\$2.4 billion a year to an average of US\$4.5 billion a year. This is money generated from activities in Mexico which is not reinvested in Mexico, but is making profits for companies and shareholders elsewhere in the world.

Initial foreign direct investment provides foreign exchange for a country allowing it to increase imports more than exports. But, when the profit from this investment is taken out of the country, there is less money available for imports. Economist David Woodward has argued that if a country maintains its imports at the same level, it will need to attract more foreign investment, which will then send profit out of the country, creating a perpetual cycle which could lead to a financial crisis.¹⁴⁸

Graph 14. Profits made by multinational companies in Mexico and taken out of the country, 1990-2005 (2005 prices)¹⁴⁷



“Service subsectors such as banking and finance, transport and telecommunications, and medical, legal and accounting services, can play a strategic role in economic and social development. This is why many developed countries in the past and some even today, as well as developing countries at the end of the colonial period, have promoted domestic and often state ownership of such activities, and restricted foreign participation in such sectors.”¹⁴⁹

United Nations Conference on Trade and Development

“Around the world, countries that have opened up their banking sectors to large international banks have found that those banks prefer to deal with other multinationals like Coca-Cola, IBM and Microsoft. While in the competition between large international banks and local banks the local banks appeared to be the losers, the real losers were the local small businesses that depended on them.”¹⁵¹

Joseph Stiglitz, former Chief Economist at the World Bank

3.3.5 Services

As part of the trade deal, in 2001 the EU and Mexico concluded an agreement to remove a series of government regulations on service companies. The services and investment agreements have resulted in more European multinational companies locating in Mexico with now over 7,700 European companies operating in the country. The largest area of operations is financial services, followed by processed food and professional services.¹⁵⁰

The services liberalisation agreement applies to all service sectors in Mexico except audio-visual, maritime and air transport services. This means that European companies are free to operate in Mexico without limits on their number, and without regulations that do not apply to Mexican firms. Such regulations could include only being able to own a certain percentage of a local firm, having to use local suppliers and having to retain a certain percentage of profits within the country.

Financial services

In 1999, Mexico lifted all restrictions on bank ownership by companies from countries with which Mexico had trade agreements. There had previously been a regulation that foreigners were limited to holding a maximum share of 30 per cent in a commercial bank.¹⁵² The EU-Mexico trade agreement says that Mexico cannot put limits on the proportion of foreign shareholdings in a bank, or a limit on the total value of foreign ownership within the banking sector.¹⁵³

The growth in multinational companies operating in the Mexican banking sector has led to it becoming dominated by a few foreign-owned banks. The four largest banks are part of multinational financial groups: BBVA-Bancomer (Spain), Banamex-Citigroup (US), Santander-Serfin (Spain) and HSBC (UK). According to Standard and Poor's, the Mexican banking sector is highly concentrated, leading to higher interest rates.¹⁵⁶ Bank profits in 2006 were US\$6 billion, with US\$5.6 billion of this for the four banks above plus Scotiabank (Canada) and Banorte (Mexico).

Box 4. Mexican commitments on financial services at the WTO

Under the services agreement of the WTO, Mexico has made no commitments to open up its banking sector to foreign investment.¹⁵⁴ This meant Mexico was free to use whatever regulations were seen to be necessary to ensure the banking sector assisted in the development process.

However, NAFTA and the EU-Mexico trade deal do make use of certain regulations by the Mexican authorities illegal. For example, the EU-Mexico trade agreement says that Mexico cannot “put limitations on the participation of foreign [European] capital” in a Mexican bank.¹⁵⁵ Such provisions go well beyond the services liberalisation Mexico has signed-up to at the WTO.

The entry of the European banks into the Mexican market is a direct result of the EU-Mexico trade agreement. HSBC bought a controlling stake in Grupo Financiero Bital in November 2002, which, through its subsidiary Banco Internacional, operated commercial and personal banking services. HSBC now owns 99.7 per cent of Grupo Financiero Bital. As the fourth largest bank in Mexico, HSBC has 1,400 branches in Mexico and 6 million customers.¹⁵⁷

There is strong evidence that dominance by a few multinational banks has reduced lending for production and for small and medium sized companies. A paper for the UN-Economic Commission for Latin America and the Caribbean says that banking credits to productive activities in Mexico shrank by more than 15 per cent as a proportion of GDP between 1996 and 2005. This has exacerbated the dual economy where multinational firms producing for export to the US and EU can access credit, but domestic small and medium sized companies cannot.¹⁵⁸

The IMF has found that total bank lending in Mexico fell between 2000 and 2003. It rose between 2003 and 2005, but this was through an increase in loans to consumers, not because of loans for production. Furthermore, loans that are made to companies have increasingly been concentrated in larger companies, whilst small and medium sized companies have struggled to get loans from commercial banks.¹⁵⁹ More specifically, over recent years bank credit to small farmers

has collapsed, exacerbating the impacts of the growth in agricultural imports following NAFTA.¹⁶⁰

The negative consequences of opening up the Mexican banking sector to foreign banks fits with the evidence from around the world. A 2006 working paper for the IMF found that “in poor countries, a stronger foreign bank presence is robustly associated with less credit to the private sector ... In addition, in countries with more foreign bank penetration, credit growth is slower and there is less access to credit.”¹⁶¹ It concludes that foreign banks are “better at monitoring high-end customers than domestic banks” but a high number of foreign banks “may hurt other customers and worsen welfare.”¹⁶² The analysis includes “more advanced” poorer countries such as Brazil, South Africa, Russia, Egypt, India and Indonesia.

The lack of credit for small scale indigenous private enterprise is a major problem for the Mexican economy as this sector is critical for creating robust and more equitable development. This is compounded by Mexico’s over-reliance on, and weak regulation of, foreign direct investment which, as already mentioned, has failed to significantly boost growth and employment.

Electricity

Several campaigns in recent years led by unions and civil society have been successful in preventing electricity distribution from being privatised in Mexico.¹⁶³ The Mexican Federal Electricity Commission, a state-owned company, retains control of the distribution of electricity. However, NAFTA and the EU-Mexico FTA have led to the entry of foreign companies into the Mexican electricity generation market.

NAFTA stipulates that North American companies can establish, acquire or operate plants to generate electricity for their own needs, the needs of other companies, or to sell electricity to the Mexican Federal Electricity Commission.¹⁶⁴ The EU's demands for parity with NAFTA means that under the services agreement the same right applies to European companies.

The main way European companies operate in Mexico is to sign 25-year 'take-or-pay' contracts to sell electricity to the Mexican Federal Electricity Commission.¹⁶⁷ This means the Mexican public authority is committed to buying all the electricity produced, regardless of whether or not they want it, for 25 years. As with private-finance initiative deals, all the risk of any investment is born by the Mexican taxpayer rather than the European investors. At the same time, European electricity companies are able to make large profits.

Joseph Stiglitz has criticised take-or-pay contracts for electricity, saying: "the IMF and World Bank encouraged many countries to sign contracts for the construction of power plants that transferred all the risk of demand volatility to themselves; in these take-or-pay contracts, the government would guarantee to buy whatever electricity was produced, whether or not there was a demand for it."¹⁶⁸

The Spanish company Union Fenosa has three gas power plants in Mexico, totalling 1,550 MW, which have 25-year take-or-pay contracts with the Federal Electricity Commission.¹⁶⁹ In 2007, Union Fenosa won a contract to build another gas power plant in Mexico. Union Fenosa profits in Mexico were €130 million in 2006.¹⁷⁰

Another Spanish company, Iberdrola, has six gas power plants in Mexico with a capacity of 3,815 MW, with the largest plant so far in Mexico due to start operating in 2007. Iberdrola's profits in 2006 in Mexico were €273 million.¹⁷¹ Iberdrola also has a 25-year take-or-pay contract with the Mexican government to supply electricity to the Federal Electricity Commission. In 2006, Iberdrola refinanced its operations in Mexico by passing the debt it owes from the central Spanish company to its local subsidiaries.¹⁷²

The third European company running gas power plants in Mexico is French multinational EDF. In 2006, EDF's profits from Mexico were €150 million in 2006.¹⁷³ Again, these were paid back to the French parent company and on to shareholders. EDF's contracts in Mexico are also 25-year take-or-pay deals, such as the Rio Bravo gas-fired power plants, one of which is a joint investment with the International Finance Corporation, the part of the World Bank which lends to the private sector.¹⁷⁴

The total profit made by European electricity generating companies in Mexico in 2006 was €553 million. Under the terms of the EU-Mexico trade agreement, the Mexican government is no longer able to stipulate that some or all of these profits be re-invested in the country.

Box 5. Mexican commitments on energy services at the WTO

Mexico has made no commitments at the World Trade Organisation on energy services; it is free to regulate foreign investment in electricity. However, the terms of NAFTA and the EU-Mexico trade agreement do impose limits on regulation.¹⁶⁵

The EU-Mexico trade deal says that Mexico cannot limit the number of European energy companies operating in the country, limit the amount of European investment in a company operating in Mexico, or prevent any profit made in Mexico by a European company from leaving the country.¹⁶⁶

Box 6. Mexican commitments on water services at the WTO

Mexico has made no commitments at the WTO on water services; it is free to regulate foreign investment in water. However, the terms of NAFTA and the EU-Mexico trade agreement do impose limits on regulation.¹⁷⁵

The EU-Mexico trade deal says that Mexico cannot limit the number of European water companies operating in the country, limit the amount of European investment in a company operating in Mexico, or prevent any profit made in Mexico by a European company from leaving the country.¹⁷⁶

Water

European water companies started managing private water contracts in Mexico before the EU-Mexico trade agreement. However, the trade agreement now limits the extent to which the Mexican government can regulate the terms on which the private water companies are operating.

The EU-Mexico trade agreement does not include clauses on investment or investor protection. This is because negotiating investment promotion and protection remains a power of individual EU member states rather than the EU. However, the EU-Mexico trade agreement has acted as a catalyst for investment agreements between Mexico and EU member states since the trade agreement was signed.

Investment Promotion and Protection Agreements have been signed between Mexico and 15 EU member states since the EU-Mexico trade agreement came into force.¹⁷⁷ The UK-Mexico Investment Promotion and Protection Agreement means that if the Mexican government wants to nationalise any company run by a UK company, the UK company can sue Mexico through an international tribunal such as the World Bank's International Centre for the Settlement of Investment Disputes.¹⁷⁸

The Spanish company Aguas de Barcelona, part of the French group Suez, has an investment in Aguas de Saltillo, the privatised water company in Saltillo, Mexico. Since the trade agreement, both Spain and France have also negotiated investor protection agreements with Mexico.¹⁷⁹

Aguas de Barcelona took over joint running of Aguas de Saltillo in 2001 following a bid process organised by Arthur Anderson, Aguas de Barcelona's then accounting firm, where Aguas de Barcelona were the only bidder. Following increases in water rates, the imposition of new user fees and other charges, the State Congress ordered an audit of Aguas de Saltillo. The audit found that Aguas de Saltillo had been overcharging for water by US\$5 million. As of October 2004, none of this money had been returned to users.¹⁸⁰

Local campaigners have been calling for the dissolution of Aguas de Saltillo and the removal of Aguas de Barcelona.¹⁸¹ However, Mexican authorities are limited in their ability to do so for fear of being sued by the company under the terms of the investment protection agreement.

Tourism

In 1994, Mexico made commitments at the WTO on tourism services. For instance, under the General Agreement on Trade in Services, Mexico has committed to allow 100 per cent foreign ownership of hotel services. However, the Mexican government in 1994 did put some caveats on these liberalisation commitments at the WTO, such as an exemption that Mexico could still limit foreign ownership of restaurants, bars and nightclubs to 49 per cent, if it wanted to do so. The EU-Mexico trade agreement makes all such regulations on European companies illegal, and so it goes beyond Mexico's requirements at the WTO.

The Maya Riviera on the Caribbean coast is the main area for tourists coming to Mexico from the EU and US. European multinational companies now operate around 90 per cent of tourism services in the region stretching from Cancun to Tulum on the Yucatan peninsula. These include the Spanish hotel chains Riu Resorts, IberoStar, Melia, Oasis, Gala and the Italian company Viva.¹⁸²

Local civil society campaigners complain that the European companies have made local businesses bankrupt through effective monopolies they have been able to create. The 'all inclusive' tourism which the European companies sell means that services such as restaurants, bars, diving, shops, car rental and aquatic activities are all provided through European companies.

According to the Grassroots Cultural Movement, this means: "The local population is increasingly unemployed. This leads to pauperization, social breakdown and marginalization. As a result, vast sectors of the population turn to the informal, precarious and illegal economy or to organized crime and gangs in order to survive and find a social identity."¹⁸³

The influx of foreign companies and tourists has pushed up the cost of living in the area well beyond the scale of local wage rates. Tourism Concern say that: "In resorts like Cancun and the Maya Riviera, the cost of living is very high and is not matched by wages. Average salaries are rarely above four dollars a day, while a flat of one or two rooms in Playa can cost 150 dollars a month."¹⁸⁴

In addition, there are no requirements for any of the profit made by European companies to remain in Mexico. This means European and American tourists pay European companies for their all inclusive holidays, where the vast majority of services are provided by the European company. One estimate is that of the money generated by European tourism companies operating on the Maya Riviera, 92 per cent goes to Europe.¹⁸⁵

Box 7. Impacts of tourism on local people near Cancun¹⁸⁶

The World Development Movement visited the Cancun area in September 2003 during the WTO ministerial meeting. There we met Jose Aguillon, a local restaurant owner in a small fishing community. Jose said that tourism development has undermined the livelihood of 600 families in Puerto Juarez. Fish stocks have been depleted by the motorized sea transport and pollution which tourism has created. His people live in constant fear of displacement by ever-encroaching development which searches for land for larger restaurants and hotels.

Tourism development has not included the people of Puerto Juarez in its economy of leisure. Multinational restaurants do not take lobsters from surrounding communities. Foreign consumers have also brought with them corporate supermarket chains, not outlets for the Puerto Juarez fishing cooperative. Furthermore, supermarkets squeeze out the smaller stores and markets - which are the outlets for small community fishing cooperatives.

Half an hour up the coast live a community who were based near Puerto Juarez, but were displaced and relocated to the neighbouring Mujeres region. Having been displaced once, they were again under threat from restaurant developers when we met them. The community were also fighting for clean, uncontaminated water. The waste dump for 24,000 hotel rooms in Cancun is one mile away from their homes. Every day it releases toxic waste into their land, their sea and their ground water supply.

Although these outcomes cannot be specifically attributed to the EU-Mexico trade deal, the 'model' of development on which the EU-Mexico trade agreement is predicated - a high dependence on foreign investment, weak regulation and weak linkages to the domestic economy - is exactly what the people of Puerto Juarez are experiencing. The fact that this development model has been legally 'locked-in' through a trade deal with the EU makes it unlikely that the local population will be able to address their plight through normal democratic processes.

And because European tourists pay for their Mexican holidays in Europe, to a European company, much of the money never even enters Mexico in the first place.

The Grassroots Cultural Movement says it is “imperative to regulate the abusive activities of the multinationals to revert the serious damages caused to native indigenous populations and Mexican society in general.”¹⁸⁷ Regulations which might improve the situation while still facilitating tourism include restrictions on the number of hotels, limited access for retail stores, obligations to use local suppliers, joint ventures with local firms and requirements to retain profits within Mexico. However, the EU-Mexico trade agreement bans the use of such regulations on European companies.

3.3.6 Government procurement

The EU-Mexico trade agreement states that when awarding government contracts, Mexico should give European companies “treatment no less favourable” than that given to Mexican companies; in other words, be treated equally.¹⁸⁸ The treaty also says that the Mexican government cannot impose regulations on suppliers which effectively give better treatment to local suppliers, such as local content requirements and technology licenses.¹⁸⁹

In 2005, the Mexican public procurement budget amounted to US\$45 billion;¹⁹⁰ 6 per cent of GDP. Much of this spending is now available to European companies, rather than being reserved for Mexican companies. Whilst the agreement includes provisions for both parties to report on the nationality of companies awarded government contracts, in reality neither the EU nor Mexico produce such statistics, claiming that it is too difficult to do so.

The United Nations Conference on Trade and Development has said that governments awarding contracts to their own national companies is a vital tool of development, allowing local companies to grow and develop their skills: “Government procurement can be used to support weaker or

nascent domestic industries, whereas contracts to multinational firms can lose foreign exchange.”¹⁹¹

There currently exists a plurilateral agreement on government procurement in the WTO; in other words a voluntary agreement that WTO members are not required to sign. During the early years of the Doha Round, the EU attempted to kick start negotiations aimed at creating mandatory rules on government procurement that would apply to all WTO members but this, along with the EU's demands for a WTO investment agreement, was rejected time and again by many developing country governments, most famously at the Cancun Ministerial meeting in 2003. The government procurement provisions in the EU-Mexico trade agreement therefore go well beyond anything developing countries have accepted in the WTO.

4. Conclusions

“Almost all successful cases of development in the last 50 years have been based on creative – and often heterodoxⁱ – policy innovations. South Korea and Taiwan, for example, combined their outward trade orientations with unorthodox policies: export subsidies, directed credit, patent and copyright infringements, domestic-content requirements on local production, high levels of tariff and non-tariff barriers, public ownership of large segments of banking and industry, and restrictions on capital flows, including foreign direct investment.”¹⁹²

Dani Rodrik, Harvard University, Arvind Subramanian, IMF research department, and Nancy Birdsall, Centre for Global Development

4.1 The wrong conditions for successful development

As the quote above describes, most if not all countries which have developed industrial and services sectors have done so through various forms of government intervention in trade, such as the use of trade tariffs. This report has shown that the EU's bilateral trade deals with South Africa and Mexico are taking these countries in the wrong direction.

Under these bilateral trade agreements, Mexico and South Africa are agreeing, with the world's most powerful economic bloc, to liberalise well beyond their WTO commitments. This 'locked-in' liberalisation entails a significant reduction in 'policy space' and could undermine the ability of future governments to pursue effective development strategies.

With the South African deal, European companies are able to export higher technology products freely into SACU. Without government intervention, it is difficult to see how South Africa and other SACU countries will be able to develop higher technology industries. Any fledgling industries face stiff competition from the EU's more advanced producers of higher technology goods.

South Africa's increased trade deficit with the European Union has contributed to an increased overall trade deficit, which has made the country more vulnerable to international debt, particularly destabilising short-term capital flows. Imports of certain goods such as processed foods and electronics have also started to negatively affect South African producers. With unemployment already at 40 per cent, South Africa is struggling

i. Heterodox means 'not in agreement with accepted dogma'. The dogma referred to here is that of the IMF, World Bank, WTO and European Commission that developing country trade policies should be to remove government intervention in trade through: removing trade taxes, removing regulations on multinational companies, removing government subsidies, removing constraints on exports, liberalising capital flows and privatising state-owned industries and services, including public services such as electricity and water.

to replace any job losses in these industries with job creation elsewhere. Joseph Stiglitz, former Chief Economist at the World Bank, has said: "in many countries, unemployment rates are high and those who lose their jobs do not move on to higher-wage alternatives but onto the unemployment rolls."¹⁹³

The other members of SACU, Botswana, Namibia, Lesotho and Swaziland in particular, face a government revenue crisis over the coming years, when income from trade taxes declines. This will either mean large cuts in government spending, potentially on essential services, or large increases in government debt. In reality, it is likely to lead to both.

The EU's agreement with Mexico has exacerbated the creation of a dual economy of intermediate goods production separated from the rest of the country. It has also contributed to the Mexican trade deficit, which makes Mexico more dependent on the decisions of multinational companies and makes it more difficult for the Mexican government to lower interest rates or increase government borrowing for fear that this would lead to financial imbalances.

This restricts economic activity leading to negative impacts on jobs and wage rates across the economy – negative impacts which more than cancel out any gain from increased exports.

The services and investment parts of the trade deal have led to a large increase in European companies operating in Mexico. In banking, this has resulted in higher interest rates and lending focused on multinational companies and rich consumers. As predicted by the IMF, the presence of foreign banks has meant that small and medium sized local companies struggle to get credit to expand their operations. The EU-Mexico trade agreement has also restricted the ability of the Mexican government to regulate sectors where there have been negative consequences from the presence of European companies, such as water and tourism.

The theory behind two countries opening markets to each other is that it benefits both parties. However, across a range of industries with varying needs for investment, technology, and skills, the EU-South Africa and EU-Mexico trade agreements seem to have resulted in a one-way street; a large increase in imports from the EU. And this street does not have prosperity and development at the end of it.

Instead of trade agreements between unequal countries at very different stages of development, an alternative trade strategy is to develop regional trade cooperation between countries that are closer (both economically and geographically) whilst selectively protecting producers from imports from larger, wealthier economies like the EU. This

Box 8. A new colonialism?

During the late 19th and early 20th centuries, most developing country regions were forced to practice free trade, either due to colonialism, or free trade treaties pushed on nominally independent regions such as Latin America and Thailand by European colonisers. For example, Britain banned the use of taxes on imports in all its colonies. All Latin American countries had free trade treaties with European countries which did not allow trade taxes to go above a very low level.¹⁹⁴

If implemented, the areas the EU is now targeting as part of its 'Global Europe' strategy will either remove regulations on European companies (services, investment, non-tariff barriers), allow European companies to sell more of their goods or services (import tariffs on goods and agriculture, government procurement, services, investment), give European companies easier and cheaper access to raw materials (end export restrictions) or give European companies more strictly enforced property rights for ideas which they can earn vast profits from (intellectual property).

The 'Global Europe' strategy is about as close as it is possible to get to a plan for entrenching European economic dominance without using the military.

does not mean no trade between the industrialised and developing world but it may stimulate more equitable development than the model of north-south liberalisation being pushed by the EU.

4.2 Learning the lessons

As already mentioned, successful development requires policy space; access to different policy tools at different times. Bilateral and regional trade deals are a mechanism for restricting this space, the question is how much is acceptable? The World Development Movement suggests that the EU-Mexico and EU-South Africa trade agreements teach us the following important lessons:

- The EU is out to gain competitive advantage and will seek to negotiate tariff reductions that mean less in the EU and more in the target country (i.e. 'special treatment' for the EU).
- There is little point negotiating agricultural market access with the EU as this negotiation is biased because it cannot tackle the EU's agricultural subsidies meaning developing country producers (whether for domestic consumption or for export) are disadvantaged from the outset.
- Negotiating industrial tariffs with the EU will likely result in larger tariff cuts in the developing country and a subsequent increase in value-added and higher technology imports from the EU. This will likely create or exacerbate trade deficits and will hamper a developing country's own efforts to stimulate value added manufacturing industries.
- As South African clothing manufacturers have found, increased access to the EU market does not necessarily mean increased market share within the EU due to competition from other countries (in this case China). However, it does mean opening your own market to EU exports in return, with potential impacts on production for the domestic market.
- Trade taxes are easy to lose and hard to replace, particularly for poorer countries and no amount of unpredictable and conditional aid can compensate for the loss of stable government income.

- Agreeing to new rules (e.g. on investment and government procurement) that the EU has failed to negotiate in the WTO is a slippery slope with few obvious benefits for the development of businesses in the target country.
- The EU has a broad agenda for service sector market access but this is largely a one-way street and can lead to significant adverse impacts such as reduced access to credit for rural areas and small businesses, both of which are crucial for economic development.

It has been reported that the South African government would now like to revisit some of the more detrimental effects of the EU-South Africa trade agreement.¹⁹⁵ The World Development Movement would argue that this is a request that the EU should respond to. However, the European Commission has been more interested in expanding the trade agreement than reversing some of the market opening that has proved harmful. In a 2006 visit to South Africa, Trade Commissioner Peter Mandelson said "the [FTA] review should aim to create new market access, new business, new growth." This, he claimed, requires "a step-change into services, investment and procurement" and a greater focus on "technical barriers to trade, customs, trade facilitation and competition."¹⁹⁶

Of course no government official goes into a negotiation thinking that they are going to be hoodwinked or will come off worst. No doubt the negotiators from Mexico and from South Africa were confident of their ability to do a deal that would create economic benefits for their country and its people. However, there is every chance that in a situation of such economic and political asymmetry - as exists between the EU and most developing countries - the end result will be one-sided and potentially harmful.

The danger of trade agreements is that they lock-in policies beyond the scope of democratic control. Decisions are made to limit the use of policies such as trade taxes at one point in time, without knowing what the precise effects will be, or whether governments will need to use such policies in the future. And as the Trade Commissioner's comments suggest, the final lesson to learn is this: once a trade deal is done with the EU there is only one direction of travel, more liberalisation. There is no turning back.

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