EU Association Agreements with Latin America:
Good news for those in poverty?

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Summary

This Briefing focuses on the economic dimension of the Association Agreements under discussion between the European Union and Mercosur, Chile and Mexico. These accords will create free trade areas and cover related matters such as intellectual property rights, government procurement, trade in services and capital movements. After examining trade relations between Europe and Latin America in their global and regional context, the paper considers the likely impact of the agreements on poverty in Latin America. We conclude that the EU is not taking sufficient account of human development concerns in their design – a failure stemming from excessive confidence in the contribution economic liberalisation will make to growth, and in the poverty reduction that will flow from that growth. Finally, we consider how the agreements could better achieve economic development *and* equity. Many of these suggestions are relevant to EU policies towards other countries in Latin America, and to any future regional agreement with the Caribbean. Oxfam's recommendations are:

- The process by which the agreements are reached and then monitored should involve fuller public participation and an active role for national parliaments and the European Parliament.

- The economic agreements should define specific objectives within the framework of existing international commitments to poverty reduction. The EU and Latin American governments should research and monitor the social, environmental and gender impact of trade and investment liberalisation to better inform the design of agreements. Such assessments should be a pre-condition for approval by the EU.

- The favourable economic position of the EU justifies asymmetries in the agreements designed to benefit poorer people. The EU should allow Latin American countries to protect vulnerable, labour-intensive sectors, eliminate tariffs on Latin American exports of manufactured goods, agree more flexible rules of origin for inputs from non-OECD countries, remove non-tariff barriers used with protectionist intent, and control dumping.

- The terms should allow countries flexibility to regulate trade and investment in pursuit of human development goals and to take exceptional measures in moments of economic difficulty such as balance of payments crises. The EU should not use the agreements to pressurise countries to accede to intellectual property conventions that overprotect transnational firms.

- Economic co-operation from the EU should prioritise assistance to smaller enterprises, support redistributive domestic policies, and foster policies in regional economic associations that favour equitable development.

- The agreements should be conditional upon respect for basic democratic rights, the ILO conventions on Freedom of Association and Collective Bargaining, and minimum environmental standards, all of which should be verified independently on an annual basis.

- If a clause in a free trade agreement that seeks to benefit poorer people is considered problematic under GATT/WTO rules, the EU should be prepared to argue the case for its acceptance or work for revision of those rules at the next WTO Ministerial Conference.

Introduction

There are over 200 million people living in poverty in Latin America. This number will increase over the next year or two, and dramatically so if the economic difficulties of the region intensify. The consolidation of democratic gains could be threatened by social instability.

The European Union (EU)[1] is a major economic force in the region, rivalling the USA, and when its members act in concert, it carries considerable political weight. Moreover, the EU is a key actor in attempts to manage the world economic system – a system that continues to create more losers than winners. As the first-ever summit of Latin American and European heads of state draws near,[2] it is appropriate to ask whether European policy towards Latin America is consistent with its commitments to world-wide poverty reduction, and whether European institutions are honouring their obligation through the Maastricht treaty to pursue the goals of sustainable socio-economic development and poverty alleviation in all their actions.

The proposed Association Agreements with Mexico, Chile and Mercosur (Argentina, Brazil, Paraguay and Uruguay) are an important part of EU strategy towards the region.[3] The agreements will be comprehensive, covering economic relations (including free trade), political dialogue and development co-operation. The Mexico negotiations are well under way, and the others may follow suit within the year. Some of the innovative characteristics of these accords will appear in future agreements with Andean and Central American countries.

This paper is a contribution to discussion on EU/Latin America economic relations from a development perspective, and is intended for both civil society organisations and policy makers. It focuses particularly on how social considerations can be better incorporated into the design of the economic component of the Association Agreements. First, however, we look at the fast-changing international environment in which these regional negotiations are taking place.

1. Global context

Multilateral economic rules

The EU's relationship with Latin America is developing in the context of important modifications to the world-wide rules of economic conduct. Multilateral agreements, particularly trade disciplines set by the World Trade Organisation (WTO), impose restrictions on the scope and design of new free trade areas (FTAs). In the longer term, there may be a global investment agreement and even rules on the regulation, or deregulation, of private capital flows and currency markets. Developing countries are under great pressure to accede to these agreements, which consistently favour the interests of the advanced countries. The EU seeks to incorporate many of them, such as the intellectual property conventions and International Technology Agreement, into its regional pacts.

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[1] In this paper, the 'European Union' refers to both the EU institutions and member states.

[2] The summit meeting of Latin American, Caribbean and EU member-state heads of government will take place in Rio de Janeiro on 28-29th June, 1999.

[3] The scope of the paper does not include the Lomé Convention, which expires in 2000. The nature of the post-Lomé arrangements will have a significant impact on Haiti, the Dominican Republic and possibly Cuba, along with the English-speaking Caribbean. Many of the recommendations in this paper are relevant to the current Lomé negotiations, which may result in a Caricom/EU regional association agreement. See *The EU-ACP Negotiations: goals and challenges for 2000*, Eurostep, September 1998.

Multilateral trade talks

The December 1999 WTO Ministerial Conference may launch a comprehensive ‘Millennium Round’ of trade negotiations. Even if this is not agreed by the member states, the meeting will mark the start of several years of talks on agriculture and services. The former is a particularly thorny issue as there are regions, Latin America amongst them, which seek to liberalise trade, and others, notably Japan and the EU, which wish to maintain protection of their farm sectors. If the WTO succeeds in further reducing tariffs, this will diminish the value of existing preferential access to EU markets currently enjoyed by parts of Latin America under the Generalised System of Preferences (GSP), and of potential benefits from EU/Latin America FTAs. The imminence of major multilateral talks is one reason why some EU member states argue pragmatically for delaying FTA negotiations with Latin America, in which agriculture will also be the main bone of contention, arguing that it is better to make concessions to Latin America and seek the quid pro quo during the WTO horse-trading. To some extent, the discussions on the Free Trade Area of the Americas (FTAA) and EU/Latin America FTAs serve as rehearsals in which countries define the alliances which will give them stronger bargaining positions in global negotiation.

Changes in the EU that affect Latin America

The EU is absorbed in a challenging and contentious package of internal affairs. It continues to incorporate new members and to deepen internal economic integration, notably through monetary union and all that flows from it. On the external front, the priority is the ‘near abroad’ on eastern and southern flanks. The European Commission also has to deal with the WTO talks and other multilateral processes, as well as the revision of the Lomé Convention. All these issues push Latin America well down the EU agenda and make trade and aid concessions more problematic. Improved market access for Latin American exporters would increase demands on the Common Agricultural Policy budget, which will already be stretched to cover east European entrants, and would reduce the value of trade preferences granted to the ‘near abroad’ and Africa, Caribbean and Pacific (ACP) exporters. Revision to the EU’s GSP rules is already reducing the trade preferences for higher-income Latin American countries.

2. Regional Context

Faltering growth and social inequality

Marked inequalities within and between countries in Latin America, combined with faltering growth and vulnerability to international economic changes, characterise the context in which the EU is negotiating its new institutional economic relations.

The financial crisis that began in Asia in 1997 exposed the fragility of Latin America’s economic recovery from the ‘lost decade’ of the 1980s, and may have ushered in another period of stagnation in which the problems of fiscal and trade deficits are compounded by financial market instability. Sharp declines in per capita income are likely if commodity prices remain low and governments are forced to keep interest rates high to stem capital flow and check incipient inflation.

Even before the economic horizon clouded over, some 200 million Latin Americans lived in poverty. More than anywhere else in the world, deprivation is attributable to grossly unequal distribution of wealth and income - a class-based inequality compounded by factors of race and gender. In Brazil, the poorest 40% of the population share an 8% slice of the national income cake, while the wealthy 10% consume 48%. The scale of mass poverty and public squalor, which some politely describe as the ‘social deficit’ is both immoral and a serious obstacle to economic development. If economic difficulties and the policy responses to them drive down living standards, the trend towards democratic consolidation could be reversed.

Key features of EU/Latin America economic relations:

- in less than a decade, Latin America's trade surplus of $12 billion with the EU has become a deficit of $10.5 billion
- the EU has experienced a notable decline in its share of the region's trade though it still accounts for 15% of the extra-regional total
- the EU's share of foreign direct investment flows to the region has been increasing, though it still lags behind the USA
- European financial institutions provide two thirds of commercial lending to Latin America and are responsible for a significant share of potentially volatile flows
- half the EU's Latin America business is concentrated in Mercosur, where it is the principal external partner
- the EU is Latin America's major aid donor, accounting for about half total transfers.

Diversified economic relations

The USA remains the pre-eminent economic power in Latin America but both Asia and Europe are now important suppliers, consumers, investors, lenders and donors. At the same time, Latin America's trade with itself has increased rapidly. Thus the region, above all South America, can now court relationships to the north, west and east, and from a stronger bargaining standpoint. In the negotiations over the FTAA, the US position has to take into account Chile and Mercosur's option of trade liberalisation with the EU, as well as the relatively open access to European markets already enjoyed by the Andean Community and Central America. Similarly, the EU is aware that it has to offer Latin America as good a deal as hemispheric integration. The potential development of free trade areas within Latin America and the extension of Mercosur into a South American FTA are other cards in the Latin American hand when negotiating with the US and Europe. Clearly, all the different regional or inter-regional free trade arrangements are not mutually exclusive, but neither are they entirely complementary.

Regional integration in Latin America

There have been advances in Latin American economic integration, including a 200% leap in intra-regional trade since 1990. Progress in the creation of 'economic communities' has been stimulated by the need to band together to negotiate with third parties and has been facilitated by more peaceable relations between neighbours. These developments have conjured up the option of deepening economic and political integration, both within and between sub-regional groupings, though current economic difficulties are already creating tensions between members and threaten to paralyse the process. Regional integration can be seen as a complement to developing links outside Latin America, rather than as an alternative, though there are inevitably some trade-offs.

3. What the parties want from each other

What the EU wants in Latin America

The EU has a number of objectives in seeking closer ties with Latin America. Geo-political motives such as counter-balancing US influence are important, though secondary to commercial considerations. However, as the foreign and security policy of member states converge, the political role of the European institutions and the political dimension of regional agreements will assume greater importance. Spain and Portugal understandably give top priority to deepening the alliance with Latin America. Human rights and environmental issues are of particular concern to northern European states.

The EU's economic objectives include expanding exports, especially in advanced technology products and services, and increasing direct investment in privatisation programmes, manufacturing, extractive industries and, above all, services. On the import side, member states and the Commission are deeply divided on whether to ease access for agricultural products that compete with domestic producers. Free trade would mean lower food prices but farm sectors do not want the competition and governments do not wish to bankroll higher subsidies.

What Latin American governments want from Europe

Governments in the region feel that closer economic and political links with Europe give them increased standing and influence on the international stage and balance the considerable political influence of the United States – a particular concern of Mexico's. Economic ties offer healthy diversification of trade and investment flows, credit and aid. Latin American countries would like a reduction in EU protectionism, especially towards their agricultural exports, in order to correct the trade imbalance. Opinions differ over how much and how fast to open domestic markets to the EU.

Most Latin American governments want European direct investment in all economic sectors, though some have reservations about opening up energy and services. Portfolio investment has also been welcomed, both as a source of capital for companies and as a means of financing the public sector and current account deficits. Latin American countries have proposed the creation of an emergency fund to assist countries affected by currency crises, and would like to see more debt rescheduling. EU aid to Latin America is insignificant for the regional economy and is not a policy priority for the larger countries. However, it is of importance for the smaller, poorer countries.

4. EU agreements with Latin American countries

Central America

The EU has a Framework Agreement with Central America dating from 1993. The region has been a priority area for EU foreign policy and for development assistance since the 1980s, and has been granted tariff concessions on virtually all agricultural exports (except bananas), which are now being extended to industrial exports. The fact that these preferences, like all GSP arrangements, can be withdrawn at short notice is a deterrent to investment. However, a bi-regional FTA would almost certainly do more harm than good to Central America since it would mean opening up to EU manufactured products, with damaging consequences for domestic industry. For these reasons, an FTA is not actively discussed by either party.

Andean Community

The 1993 Framework Agreement with the Andean Community covers economic and development co-operation. As with Central America, it stops well short of the association-type agreement being considered with the bigger economies but could evolve in that direction. For the time being, the region is not seeking free trade with the EU as it faces no tariffs or quotas on 90% of its exports, thanks to EU concessions linked to combating the drug trade. The Andean Community has been negotiating free trade with Mercosur but there are serious obstacles to an agreement. Bolivia, however, is already an associate member of Mercosur.

Mexico, Chile and Mercosur

Mexico, Chile and Mercosur (Argentina, Brazil, Paraguay and Uruguay) are negotiating more comprehensive 'association agreements' with the EU which will contain:

- economic agreements covering free trade in goods and services, capital movements and payments, government procurement and intellectual property

- provisions for regular high-level dialogue on political and security matters
- commitments on economic and development co-operation.

The European Commission claims the agreements will boost multilateral processes by demonstrating that 'differing regulatory approaches between emerging economies and advanced industrial countries can be bridged', and by piloting 'new modes for future WTO rule-making and measures to liberalise services.' However, this appears to mean ensuring developing countries open up their service sectors to European companies and adopt the regulations designed by and for the advanced industrial countries, in areas such as protection of intellectual property and de-restriction of investment.

Considerable progress has been made in negotiations on the Mexico Interim Agreement - essentially an EU 'fast track' procedure for reaching deals on trade in goods, procurement, competition policy and intellectual property. The main trade issues are treatment of Mexico's agricultural exports, the rules of origin for Mexican exports, EU participation in the Mexican service sector and procurement, and access for EU industrial exports. An agreement seems likely this year, though implementation would probably take a further eight to ten years. In May 1999, the European Parliament rushed through approval of the full agreement, commonly known as the Global Agreement, though some components still have to be finalised. Endorsement by the EU Council and ratification by national Parliaments may take a year or two more.

In July 1998, after heated internal debate, the Commission agreed to seek a mandate from the Council of Ministers for negotiation with Chile and Mercosur. This now looks unlikely to be granted before the Rio summit at the end of June 1999. In Mercosur's case, the difficult topics will be EU protection of agriculture (notably beef, sugar and cereals) and Mercosur's protection of selected industries and services. These issues are present but less problematic in Chile's case. If Chile and Mercosur eventually move further towards a common market, the EU would be prepared to merge the two sets of negotiation. Full agreements are unlikely to come into force much before 2005, with FTA implementation spread over the ten-year period allowed under WTO rules.

The proposed agreements, though generally seen as desirable, are not a policy priority for most EU member states. In Brussels, the agreements are seen as a largely Spanish concern. However, some of this complacency may be shed if significant progress in FTAA talks threatens to leave the EU at a competitive disadvantage with the US. For the moment, such progress seems unlikely, given the refusal of the US Congress to grant the President 'fast track' negotiating powers and the strength of protectionist sentiment amongst the US public. Mexico, for whom the political dimension of the EU accord is particularly important, would like to sign as soon as possible. As it is already part of NAFTA, there is little to gain from waiting. Chile, too, would like to move forward with the EU talks, while Mercosur, notably Brazil, is taking its time. Mercosur's internal difficulties, especially after Brazil's devaluation, also hinder progress.

5. What is wrong with the proposed economic agreements?

According to the Commission's own Forward Studies Unit, international institutions should move from a 'narrow focus on growth and the preservation of trade, to the more complex goal of sustainable development, which means integrating economic efficiency, macro-economic stability, social justice and environmental sustainability'. Indeed, the Maastricht Treaty makes consideration of these objectives formal EU policy. Yet the economic agreements between the EU and Latin American countries, as currently conceived, have precisely that narrow focus. The 'complex goal of social development' to which the Unit refers is highly relevant to the middle-income countries of Latin America because of the economic instability and vulnerability of the region, the rapid rate of environmental deterioration and, above all, the huge social inequalities and correspondingly large numbers of people in poverty.

The economic centrepiece of the proposed agreements in Latin America is the creation of free trade areas. There are also clauses that seek to liberalise trade in services and investment flows. It is true that international trade and investment can bring benefits to poor people's lives through increased income and security, economic opportunity and resources to improve social services, but there is nothing automatic about it. Inappropriate liberalisation of trade and investment can also destroy poor people's livelihoods, ruin the natural environment on which many depend, marginalise vulnerable regions, and lead to higher rates of inequality. In the 1980s and 1990s, developing country barriers to the free flow of trade and investment have often been removed without putting into place new national or international measures to protect poor economies, citizens or the environment. If poorer countries and communities are to share more equitably in global prosperity, a more balanced approach to trade management is needed. The proposed agreements do not yet demonstrate that balance.

According to Commission officials, trade liberalisation with Latin America will produce growth, and growth will reduce poverty. However, the empirical case for this has yet to be made – indeed, there is some evidence that trade liberalisation in the region may have increased absolute poverty, at least in the short term. The 'growth reduces poverty' assertion is based on trickle-down theory and the apparent belief that a number of Latin American governments, amongst them Chile, Argentina and Brazil, are implementing domestic economic and social policies that actively work in favour of poorer people and ensure the fruits of growth are shared. While there have been some socially-positive measures introduced in the 1990s, such as improvements in run-down education systems, these do not add up to a policy framework that will secure adequate benefits for poorer people. It therefore remains a duty of the EU to consider poverty and distributional issues in the design of the economic agreements.

The Mexico agreement is an advance on earlier generations of agreements with Latin America, since it contains references to human rights and social rights, a formal commitment to democracy on both sides and a provision for suspension of the agreement should obligations not be fulfilled. However, these clauses do not go beyond a statement of principles and there are no effective monitoring mechanisms. The challenge of human development and poverty reduction is relegated to the co-operation programme rather than occupying centre stage in the design of the economic components.

Complementary domestic policies to ensure more equitable growth include:

- redistribution of wealth and income though fiscal policy, public spending on welfare and employment generation, pensions policy, etc.
- improved education, training, and better use of technology, targeted at rural and urban small/medium enterprises and women
- industrial policies to help companies compete with imports and export manufactures
- land tenure and agricultural promotion policies which improve access to factors of production for smaller producers
- regional development policies
- respect for labour rights so the workforce can negotiate better pay and conditions
- environment protection laws and measures to avoid a 'race to the bottom' in standards.

6. How could the economic agreements be better designed?

Oxfam makes the following recommendations on how the economic component of the Mercosur, Chile and Mexico Association Agreements could generate more benefits for poorer sectors in the community. Most of the points are also relevant to EU policies towards other countries in Latin America and to any future regional agreement with the Caribbean.

- **The process by which the agreements are reached and then monitored should involve public participation in all the signatory countries and an active role for national parliaments and the European Parliament.** This participation requires, inter alia, disclosure of all information that is not genuinely sensitive in the trade negotiations. The Commission's March 1999 statement in favour of democratising the EU/Latin America dialogue through civil society involvement needs to be backed up by concrete measures.

- **Both the EU and Latin American governments should research and monitor the social, environmental and gender impact of trade and investment liberalisation to better inform the design of agreements. Such assessments should be a pre-condition for approval by EU member states**. This requirement fits with the EU obligations under the Maastricht Treaty and the 1995 Council resolution on women and development. Similar assessments have already been carried out as part of the review of the Lomé Convention, and the Commission has now agreed to do an assessment of the environmental impact of the proposed Mediterranean FTA.

- **The economic agreements should define specific objectives within the framework of existing international commitments on poverty, environment, gender and labour rights.** These commitments include the development targets for 2015 agreed by OECD members. Agreements should also define their contribution to greater equity, as this is the key to poverty reduction in Latin America.

- **The favourable economic position of the EU justifies asymmetries in the agreements designed to benefit poorer people**. The EU should:

- allow Latin American countries to take advantage of the levels of protection permissible under GATT/WTO rules, in order to safeguard their vulnerable, labour-intensive sectors
- eliminate tariffs on Latin American exports of processed and manufactured goods, including leather goods and textiles and agree more flexible rules of origin for inputs from non-OECD countries
- remove non-tariff barriers used with protectionist intent and control dumping by EU-based companies
- provide special treatment for Fair Trade products
- avoid 'end-loading' – i.e. placing all concessions at the end of transitional periods.

- **The EU should not use the agreements to pressurise countries to accede to multilateral conventions which overprotect transnational companies or unduly favour the advanced industrial countries**. This is the case with agreements on information technology and intellectual property rights legislation, e.g. patenting of life forms and medicines.

- **The terms should allow countries flexibility to regulate trade and investment in pursuit of human development goals and to take exceptional measures in moments of economic difficulty such as balance of payments crises**. Multilateral rules and regional agreements are reducing the freedom of national governments to decide economic policy. Pooling sovereignty may bring benefits but only if the common policies are fair to poorer countries and poorer people, which is often not the case. The investment clauses in the agreements, as yet undefined, should not oblige countries to remove controls on their capital accounts, including outward flows, nor prohibit performance requirements on foreign direct investment such as skills and technology transfers.[4]

[4] According to FitzGerald (*The Development Implications of the MAI*, DfID, 1998), the investment provisions in NAFTA are, to date, 'the strongest standard with regard to investment liberalisation and protection'. NAFTA bans a

Economic co-operation from the EU, including the European Investment Bank, should prioritise assistance to small and medium enterprises and enable them to compete in a more open economy, encourage and support redistributive domestic policies, and foster policies in regional economic associations that favour equitable development.

- **The agreements should be conditional upon respect for basic democratic rights, the ILO conventions on Freedom of Association and Collective Bargaining, and minimum environmental standards, all of which should be verified on an annual basis by appropriate independent bodies**. [5] Non-observance could justify suspension of parts of the agreement or the imposition of countervailing duties. These ILO conventions, which have been ratified by virtually all Latin American countries, contain the 'enabling' rights which allow employees to negotiate a fair share of the benefits of growth. The conventions are less vulnerable to protectionist abuse since they do not prescribe minimum wage levels or conditions and thus do not, of themselves, raise production costs. In the case of democratic rights and environmental standards, defining breaches, the appropriate response and the verification mechanism is harder, but still possible. The EU should make every effort to achieve consensus through open dialogue with Latin American countries on the inclusion of these 'democratic, social and environmental clauses.'

- **If a clause in a free trade agreement that seeks to benefit poorer people is considered problematic under GATT/WTO rules, the EU should be prepared to argue the case for its acceptance or work for revision of those rules at the next WTO Ministerial Conference**. This might include revision of:

- GATT Article I, which establishes the principle of non-discrimination between countries, does not allow a country to alter its trading arrangements with another country, even if the other party commits gross human rights violations or serious breaches of democratic procedure [6]
- GATT Article XX, which only considers controls on imported products legitimate in a very narrow set of circumstances. Environmentally damaging production processes or the prohibition of trade unions, for example, are not considered grounds for restricting imports
- GATT Article XXIV, which is not sufficiently flexible regarding the design of trade agreements between countries and regions of different levels of development. Developing countries may require higher levels of protection and for longer periods than is currently allowed, including measures to ensure food security
- TRIMS, the Trade Related Investment Measures agreement, which does not allow countries to set local content or export performance conditions for foreign investors.

Conclusion

The EU is basing the economic component of the proposed association agreements on the unproven formula that trade and investment liberalisation equals growth in Latin America, which equals poverty reduction. Oxfam believes that the EU, instead of depending on articles of faith, should study the potential social and environmental impact of liberalisation and incorporate the findings into the design of the agreements, in pursuit of growth with equity, and in conformity with its own commitments to those in poverty. Human development objectives should not be tacked on in the form of 'development co-operation' but central to the economic heart of the relationship between the two regions.

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comprehensive list of performance requirements and thereby sets rules that go well beyond multilateral disciplines in GATT/WTO. Predictably, disciplines on subsidies and competition aspects are weak.

[5] Similar social and environmental clauses have recently been included in EU regulations on GSP.

[6] Unless mandated by the UN Security Council.

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