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# Remaking the Washington Consensus in Vienna

## The EU free trade agenda for Latin America

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### Summary

In recent years, Latin America has witnessed widespread mobilisations and popular struggles against free trade agreements with the US. Social uprisings have succeeded in stalling the conclusion of the Free Trade Agreement of the Americas (FTAA), which the LAC (Latin America and Caribbean) governments plan to conclude with the US in the near future. Across the continent, there are strong fears that opening markets to the US will lead to an erosion of indigenous cultures, social rights and standards and universal coverage and access to public services.

At the same time, Latin American governments are pursuing agreements containing similar free trade chapters with the European Union (EU). By contrast to the US approach, the EU has presented its free trade objectives within a broader framework of co-operation. The 'association agreements' the EU is negotiating with the various regional blocs in Latin America contain chapters on cooperation and development, and a focus on social cohesion and political dialogue. The EU also presents regional integration as a shared objective with LAC countries.

In its own words, the EU claims it is 'steering a course between protectionism and the unbridled opening of markets' and promoting a strategy for sustainable development aimed at 'reconciling economic growth, social cohesion and environmental protection.'

But a closer analysis shows that the European alternative is little different from the US free trade agenda. In this report, we argue that:

- EU 'association agreements' with LAC countries and regional blocs are conditioned by trade, over and above any social and political concerns. Whereas the commercial chapters of these agreements are fully fleshed out, the clauses on human rights and social and environmental standards include very few instruments for monitoring or enforcement.
- In promoting regional integration, the EU aims to ensure that markets 'attain critical size' to make them 'an interesting destination for FDI (foreign direct investment) from the EU.' But FDI is not a cure-all. Increased dependence on foreign capital makes developing markets more vulnerable to external shocks, and European-based transnationals have often acted with impunity in the region
- EU bilateral negotiations are weighted according to the state of multilateral negotiations (in the WTO), such that concessions in one arena tend to be 'clawed back' in another. For example, the EU is pushing for investment security and government procurement liberalisation in the LAC region – issues that were dropped from the agenda at the multilateral level following developing countries' protests that these threaten to undermine their capacity to shape their own policy trajectories.
- The evidence of existing 'association agreements' with Chile and Mexico – touted as the model for future EU-LAC partnerships – shows that development objectives have not been met.

### **From Washington consensus...**

Latin America embraced the neo-liberal policies of the Washington Consensus in the 1990s, engaging in unilateral market opening and privatisation of public enterprise. Sensing new market opportunities, EU member states increased foreign trade with the region. Between 1990 and 2004, trade between the two blocs more than doubled. The EU is now the number one trading partner for MERCOSUR and Chile. It is also the most important source of foreign direct investment for Latin America.

So when the US, as the dominant power in the region, began negotiating extensive free trade agreements, the EU could not afford to stay behind. In 1994, the North American Free Trade Agreement (NAFTA) was signed between the US, Canada and Mexico. Trade between the EU and Mexico subsequently fell. In 1997, three years after NAFTA came into force, Mexican exports to the EU had dropped from 13.3 per cent in 1990 to a mere 3.5 per cent in 1997. The EU's share in Mexican imports almost halved, from 17.4 per cent in 1990 to 9 per cent in 1997.

EU trade policy in the LAC region should be viewed against this backdrop – and, indeed, the EU has engaged in a series of free trade agreements in the region since the late 1990s, in parallel with US demands for increased market opening. Latin America's growing ties with Asia, and especially China, have made it an even more strategic market for the European Union.

### **... to Vienna Consensus?**

The EU-LAC Summits aim to set the agenda and create the conditions for deepening EU-LAC bilateral and regional agreements.

At the Rio Summit in 1999, the decision was taken to develop a bi-regional strategic partnership. Rio also established the mandate for Association Agreements between the EU and Chile, and the EU and Mercosur.

The Madrid Summit confirmed the partnership commitment, and saw the conclusion of the EU-Chile Association Agreement, liberalising all industrial goods and over 90 per cent of the two sides' agricultural and fisheries' products, and a free trade area in services. Madrid also witnessed the launch of Political Dialogue and Cooperation Agreements, plus proposals to strengthen cooperation on trade, investment and economic issues with Central America and the

Andean Community, anticipating a free trade agreement in future.

The third EU LAC Summit took place in Guadalajara in 2004. Regional integration was the key issue, with the objective of making LAC markets more commercially viable. In Guadalajara, the EU reiterated its intention to negotiate bi-regional association agreements with Central America and the Andean Community, but made this conditional on the level of regional integration.

The EU also announced assistance to boost completion of the Mercosur common market as a means to reinvigorate the negotiations for an association agreement. For the EU, the conclusion of a viable agreement rests on the completion of the Mercosur customs union, and a free circulation of goods and services and capital. Guadalajara also witnessed the launch of negotiations between the EU and the Caribbean for an Economic Partnership Agreement.

In the run-up to the Fourth EU-LAC Summit in Vienna, appeals to reinvigorate bi-regional relations have been issued from both regions. A meeting on 'Economic Relations between the European Union and Latin America and the Caribbean' organised by the Latin American Economic System (SELA) – a leading intergovernmental advisory body – declared the failure of the US-backed Washington Consensus, with its free-market liberalisation and deregulation, as a development model for Latin America.

Instead, SELA called for a new direction in EU-LAC relations, with a 'Vienna Consensus' aimed at achieving growth with equity through parallel bi-regional dialogues on commerce, social cohesion, regional integration and trade amongst Latin America's four sub-regions: Mercosur, the Andean Community, Central America and the Caribbean.

This appeal was reinforced by the European Parliament's Committee on Foreign Affairs, which also called for a stronger strategic partnership between the two regions. The Committee proposed the establishment of a Euro-Latin American Transatlantic Assembly (EUROLAT) - consisting of members of the European Parliament, the Latin American Parliament (Parlatino), the Central American

Parliament (Parlacen), the Andean Parliament (Parlandino) and the EU-Mexico and EU-Chile Joint Parliamentary Committees – to act as a parliamentary forum and bring to bear ‘parliamentary control on association agreements already in force or being negotiated or revised’.

The Committee called for a swift conclusion of the EU-Mercosur association agreement and the initiation of negotiations on association agreements with the Andean Community and Central America, and a deepening of the existing EU-Mexico and EU-Chile agreements, as essential steps towards reaching a comprehensive interregional association agreement. The aim is to achieve ‘a Euro-Latin America free trade area by 2010 (of failing that as near to that date).’ This is qualified by talk of social partnership and, indeed, joint action for sustainable development, but it is clear that opening markets remains at the top of the EU agenda.

The EU is likely to use the Vienna summit to try to reopen its negotiations with Mercosur –suspended in 2004 when the EU declared the EU’s agro-industrial proposal ‘unacceptable’. But with no conclusions likely in Vienna, the Summit now looks likely to present an EU-Central America Association Agreement as the major advance towards its free trade objectives. As with similar EU-LAC agreements, the failure to address effectively the asymmetries between the two regions means that this is likely to disproportionately benefit European multinationals.

### **Neo-liberalism ‘European style’**

In its negotiations with the LAC countries, the EU is challenging US hegemony in the region by offering a more comprehensive model of political and economic relations as an alternative to the USA’s strict bilateral policies of ‘trade not aid’. It also uses this model to give it an edge over Asian traders and investors, who form a growing presence on the LAC stage.

The broader focus on political dialogue, cooperation and regional integration rather than bare economics has earned the EU a reputation for advocating a softer form of neo-liberalism ‘with a human face’. The EU tends to cloak its free trade agenda in development jargon, claiming that trade liberalisation is a pillar for sustainable development and good governance.

According to the EU, ‘development is a fundamental tenet of the EU trade strategy which aims to support the gradual integration of developing countries in the world economy and the multilateral trading system’.

However, the question remains how much substance is being given to these governance and development issues. Whereas the commercial chapters of the EU’s agreements are fully fleshed out, the clauses on human rights and social and environmental standards include very few instruments for monitoring or enforcing the social paragraphs. This feeds the concern that these aspects are little more than sweeteners for the goal of market opening and investment protection. Yet according to the EU’s own figures, the consequences of market opening are that EU imports have tended to increase far more steeply than exports to the EU.

In the EU’s book, a level playing field means creating uniform, non-discriminatory market access for foreign and domestic suppliers alike. All the EU free trade agreements (FTAs) contain clauses on most-favoured nation treatment (MFN) – which does not allow countries to discriminate between trading partners - and national treatment - which stipulates that foreign suppliers not be treated any ‘less favourably’ than domestic corporations.

These demands severely limit governments in their scope to redress asymmetries between domestic and international suppliers and to pursue national development objectives. Restrictions on foreign participation in domestic firms, licensing and planning instruments to enhance universal coverage and/or requirements for joint ventures or employing a set minimum percentage of local workers are eyed with increasing suspicion if they are not banned outright.

This risks exacerbating the already glaring asymmetries between the EU and the countries of the LAC region, with development cooperation and political dialogue serving as instruments to preserve existing inequalities to the advantage of the EU and its business interests in the region.

In fact, the EU’s economic demands do not differ significantly from the US agenda in their scope and content. Both aim for significant market opening, liberalisation, deregulation and

privatisation, as well as investment protection for their transnational companies operating in the LAC region. In the European Parliament's recent proposal for a comprehensive bi-regional strategic partnership the creation of 'as wide a free trade area as possible' is key.

### **Foreign Direct Investment: financing for development?**

The EU is not just a leading trading partner for the countries of the LAC region, but also the most important source of foreign direct investment (FDI) for Latin America. In 2003, EU investments amounted to some EUR 237.9 billion. It goes without saying that FDI flows from LAC into the EU are negligible.

The 1990s witnessed a massive increase in FDI following successive rounds of services liberalisation in the LAC countries. In Brazil, services FDI rose from 43.4 to 83 per cent of total FDI. The majority of these FDI flows were of European origin, and concentrated in telecommunications, financial services and insurance, gas, water and electricity. The EU also became the main foreign services investor in Argentina and Chile. In 2000, 46.6 per cent of the 500 largest companies in Latin America were owned by foreign companies. European presence in many LAC economies is now so strong that in various services sectors it amounts to a 'Europeanisation' of domestic economies.

A similar, if less dramatic, pattern can be observed in the EU's relations with Central America, where FDI grew from EUR 150 million in 1994 to EUR 540 million. The EU is the second most important trading partner for the region (after the US), accounting for 12 per cent of total trade, although trade with the region accounts for just 0.4 per cent of total EU external trade, according to EU statistics.

It is in this highly asymmetrical economic constellation that the EU is pushing for reciprocal market opening. With its well-developed transnational corporate sector, the EU is clearly the better equipped to take advantage from trade liberalisation. This conclusion is borne out by the trade statistics. Between 1990 and 1997, LAC imports from the EU rose by a staggering 161 per cent, while LAC exports to the EU increased by only a modest 21 per cent. Furthermore, the structure of EU-LAC trade flows largely continues to run along the typical North-South divide. EU exports to the LAC region consist of

high value-added manufactured products, whereas the bulk of LAC exports to the EU are agricultural products.

In its trade packages, the EU promotes foreign direct investment as an instrument for development: 'We reiterate our conviction that the promotion of direct investment constitutes a fundamental goal of relations within both our regions and we therefore agree to foster the development of initiatives designed to increase interregional investment flows. We consider that financial flows and productive investment should be centred specially on projects designed to promote sustainable development and integration of regional infrastructures in Latin America and the Caribbean, and to encourage EU-LAC trade flows.'

But is enhancing FDI flows indeed the cure-all? There is no automatic link between an improved foreign investment climate and poverty reduction, and there is no automatic spill-over from foreign investment. When transnational corporations fail to establish spin-offs and linkages with the domestic economy, they contribute very little to development.

There is also a considerable risk that dependence on foreign capital creates liabilities for the future, whilst increasing the need for harmful policy competition and increasing a country's vulnerability to external shocks.

In view of the structural imbalances in the composition of trade and investment flows, it is difficult to see how FTAs promoting reciprocal market opening between such unequal partners as the EU and the LAC country blocks will contribute to the EU's professed aim of sustainable and equitable development in the LAC region.

None of the world's rich countries – and Europe is no exception – have developed without the use of selective government intervention in trade. In the interest of development, countries would do better to develop their small and medium-sized enterprises, which will generally generate more sustainable jobs, integrate larger segments of society into the economy and offer goods and services at rates affordable to the lower strata of society.

### **The EU-Mexico Global Agreement**

The EU-Mexico Global Agreement was the first of the comprehensive '4<sup>th</sup> generation' agreements between the EU and its LAC trading partners, which incorporated not only chapters on political and economic cooperation, but also a full-fledged free trade agreement (FTA). Mexico and the EU signed the preliminary agreement in December 1997. Negotiations on the trade liberalisation paragraph were concluded in 1999. The trade agreement - initiating a liberalisation process that is to be completed in 2007 - came into effect in July 2000.

The EU-Mexico Agreement is far-reaching in scope and extends well beyond the WTO framework. In services, it allows exceptions to full liberalisation only until the conclusion of the GATS negotiations. Within a year from completion of a WTO GATS agreement, Mexico is obliged to start negotiations to eliminate all remaining exceptions.

The EU-Mexico Agreement also includes provisions on market access for foreign direct investment, including a ban on imposing quantitative limits on service suppliers, no caps on the amount of foreign capital invested in domestic firms and no requirements to engage in specific legal entities such as joint ventures.

Although this Agreement (alongside Mexico-US free trade) was touted as a step forward for Mexican development, the promised increases in wages and working conditions in Mexico have not materialised. Unemployment has risen and workers are increasingly facing precarious labour conditions with temporary employment contracts, below-standard wages and no social security.

Inequality is on the increase. Average remuneration is now 25 per cent less than in 1994, and 15 per cent down from the level of 2000. Ten per cent of the population controls 50 per cent of the country's wealth and income.

Foreign investment has increased, but mainly in the form of mergers and acquisitions. Exports have gone up, but the increase must in large part be contributed to the *maquiladores*: the export processing zones Mexico has set up with extra incentives to lure FDI.

Ninety-five per cent of exports from the *maquiladores* are made with imports from

abroad and benefits to the domestic economy are minimal. The Mexican export structure is predominantly shaped by intra-company trade, with TNCs exporting to and from their own subsidiaries.

### **The EU-Chile Association Agreement**

The EU-Chile Association Agreement was signed in November 2002. Like the EU's 4<sup>th</sup> generation agreement with Mexico, it contains chapters on political dialogue and cooperation as well as a trade chapter. The trade chapter in the EU-Chile Agreement is the most comprehensive EU has signed with any third country.

Initially, the EU's focus was on securing access to the promising emerging market of Mercosur. The EU's engagement with Chile was a spin-off of the negotiations initiated with Mercosur, because of Chile's status as an associate member. In the event, an agreement with Chile proved easier to conclude. There were fewer stumbling blocks because of Chile's more open economy – a legacy from the Pinochet era -, a non-traditional agricultural sector and less developed industrial base than Mercosur. The EU-Chile Association Agreement was signed in 2002, whilst the EU Mercosur negotiations still linger.

Chile has actively enhanced its attractiveness for European business by pursuing a strategy to position itself as a 'gateway' to the Americas. Chile boasts a wide range of preferential trade agreements with countries all over the world, with the country promoting itself as a base from which to launch effective multinational insertion in the region.

Chile is often hailed as an example of a developing country that has followed a successful path of liberalisation. The EU-Chile Agreement is likely to serve as a blueprint for the agreements the EU is negotiating with Mercosur, the nations of the Andes Pact and Central America.

The EU-Chile Agreement transcends the WTO framework, in particular in services. The aim is progressive and reciprocal market access for goods and services, including financial services, and public procurement. But as the Alianza Chilena por un Comercio Justo y Responsable (Chilean Alliance for Fair and Responsible Trade) points out, the agreement predominantly serves to strengthen legal security for

(European) business, helping to consolidate the control that large (transnational) corporations exert in key sectors of the economy.

Eighty per cent of the Chilean economy is now external market-based, which makes the country very vulnerable to external economic shocks. The main European investors are from Spain, followed by the UK, France, the Netherlands and Italy.

But market opening has not benefited the Chilean population as a whole. Export-oriented policies have gone hand in hand with a widening gap between the rich and the poor, with wealth increasingly concentrated in the hands of a small elite, and glaring inequalities in access to basic services such as education and health. The EU-Chile FTA erodes the government's capacity to mitigate adverse impacts by means of social programmes.

In Vienna, the EU aims to further extend the terms of its Agreement with Chile, and is pushing for the abolition of Chile's restrictions on profit repatriation.

### **The EU trade negotiation arenas**

The EU negotiates trade liberalisation simultaneously in different arenas. Multilateral negotiations take place in the framework of the World Trade Organisation. The current round of negotiations – dubbed the Doha Development Round – deals with the progressive liberalisation of trade in agriculture, industrial goods and services in a single undertaking. The EU also engages in bilateral trade negotiations with individual states, but increasingly prefers to target regional blocs. This offers access to larger markets at uniform conditions, which beats cumbersome negotiations with member states individually.

Where the EU as a bloc fails to come up with a common negotiating mandate, the individual member states may engage in individual bilateral negotiations. A good example are the Bilateral Investment Treaties (BITs), negotiated with third countries by various EU member states. These BITs often contain clauses that go beyond WTO or EU mandates.

The EU treats all of its negotiations as mutually reinforcing, and has no qualms about switching between negotiating levels to increase pressure and further its free trade agenda.

For example, in its bilateral negotiations with the LAC region, the EU is pushing for incorporation of issues like investment security and government procurement liberalisation. These are all issues that were dropped from the agenda at the multilateral level, following protests from developing countries that they threatened to undermine their capacity to shape their own development policy instruments and trajectories.

All of the EU's bilateral and bi-regional negotiations are by nature 'WTO-plus'. EU free trade agreements with the LAC countries further tend to respect more far-reaching obligations in the area of trade and investment negotiated with its individual member states.

However, because of the disappointing outcomes of the WTO Sixth Ministerial Conference in Hong Kong in December 2005, the European Parliament's Committee on Foreign Affairs has now taken the position that "WTO conditionality" has become irrelevant for the purposes of the present brief to negotiate with Mercosur and even more so for the purposes of the future briefs for the negotiations with CAN and Central America' and 'calls for the briefs to negotiate the new association agreements with the Andean and Central American communities to omit any clause whereby conclusion of the agreements would depend on completion of the WTO-round negotiations, notwithstanding the guarantee that the future free trade area would in the end be fully compatible with WTO provisions'.

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