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# The European Window: Challenges in the Negotiation of Mexico's Free Trade Agreement with the European Union

Jaime Zabudovsky K.  
Sergio Gómez Lora

*Special Initiative on Trade and Integration*

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## CONTENTS

I.	INTRODUCTION	1
II.	REASONS FOR THE NEGOTIATION OF THE FREE TRADE AGREEMENT BETWEEN MEXICO AND THE EUROPEAN UNION	3
	A. Mexico's Reasons	3
	B. European Reasons	6
III.	CHALLENGES IN THE NEGOTIATION OF THE ECONOMIC PARTNERSHIP, POLITICAL COORDINATION AND COOPERATION AGREEMENT	9
	A. The Paris Declaration	9
	B. The Pre-negotiation Talks	11
	<i>The Scope of the Mandate for the Trade Negotiations</i>	14
	<i>The "Democratic Clause"</i>	15
	<i>The Negotiation of the EUMFTA, the Rio Summit and the Change in Commissions</i>	17
	C. Main Challenges of the Trade Negotiations	18
	D. Substance of the Negotiations	18
	<i>Tariffs on Industrial Products</i>	19
	<i>Agriculture</i>	20
	<i>Rules of Origin</i>	21
	<i>Investment and Services</i>	22
	<i>Outcome of the Negotiations on Investment</i>	23
	<i>Outcome of the Negotiations on Services</i>	24
	<i>Main Reasons for the Outcome of the Negotiations on Services and Investment</i>	25
	<i>Other Chapters of the Agreement</i>	25
IV.	OUTCOME OF THE FREE TRADE AGREEMENT BETWEEN MEXICO AND THE EUROPEAN UNION	27
	BIBLIOGRAPHY	



# THE EUROPEAN WINDOW: CHALLENGES IN THE NEGOTIATION OF MEXICO'S FREE TRADE AGREEMENT WITH THE EUROPEAN UNION

**Jaime Zabudovsky K.\***  
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*When "forging closer links" is mentioned, people start to smile (...) The best causes have been discredited in that way. Hispano-Americanism is more than a matter of "the power of blood": it is also the power of reason (...) Spaniards have to get used to the fact that they always have a window open to Latin America.\*\**

## I. INTRODUCTION

After more than six years of diplomatic activities and complex negotiations, on July 1, 2000 the provisions governing the liberalization of goods trade between Mexico and the European Union (EU) entered into force. Those provisions are part of the EU-Mexico free trade agreement (EUMFTA), which in turn is part of the Economic Partnership, Political Coordination and Cooperation Agreement (the "Global Agreement").

With its three components -political dialogue, trade liberalization and cooperation- the Global Agreement was in its time the most ambitious accord that the EU had concluded. The economic association component of the Global Agreement (the EUMFTA) was the first transatlantic free trade accord, and it set an important precedent for the EU's later negotiations with other Latin American countries.

The purpose of this study is to analyze the reasons why Mexico and the EU concluded the agreement; to describe the main challenges in the negotiations for the different parts of the Global Agreement; and to briefly review the results in the three years since the EUMFTA entered into force.

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\* Consultants in the Integration, Trade and Hemispheric Issues Division of the Inter-American Development Bank's Integration and Regional Programs Department. The opinions expressed herein are those of the authors and not necessarily those of the Bank.

\*\* Alfonso Reyes [1981].





## **II. REASONS FOR THE NEGOTIATION OF THE FREE TRADE AGREEMENT BETWEEN MEXICO AND THE EUROPEAN UNION**

### **A. Mexico's Reasons**

From an economic perspective there were three reasons to negotiate the EU-Mexico free trade agreement (EUMFTA):

1. To deepen and consolidate the process of economic modernization and trade liberalization.
2. To end discrimination in the Mexican market against European investors and exporters.
3. To improve conditions for Mexican exporters' access to the European market.

The first reason for the signing of the EUMFTA, and probably the most important, was to continue the processes of opening and economic reform that Mexico unilaterally undertook in the second half of the 1980s, and that deepened with the signing of the North American Free Trade Agreement (NAFTA) in the early-1990s.

The negotiation of an ambitious agreement with the European Union (EU), Mexico's second main trade partner, would make it possible to continue eliminating tariffs and non-tariff barriers in the framework of the reciprocity demanded by the Mexican private sector following the signing of NAFTA.

One of the most important reasons for NAFTA's acceptance by the Mexican business sector was that it offered preferential access to the United States and Canada. It would have been very difficult to promote the NAFTA-induced opening of the Mexican economy had preferential access to the US and Canadian markets not been one of the most attractive selling points. The unsought-for result, however, was that the criterion of reciprocity became one of the most important determinants of Mexican trade policy after NAFTA. This led to a significant lessening of maneuvering room to undertake unilateral opening. The latter, while clearly warranted from the viewpoint of economic efficiency, was politically unfeasible. The EUMFTA, then, would allow structural reform to continue while offering Mexico preferential access to the world's second main market.<sup>1</sup>

Additionally, and paradoxical though it may seem, the EUMFTA would also be an important means of strengthening NAFTA. By giving the Europeans treatment similar to that granted to Mexico's North American partners, the EUMFTA would raise the cost of reversing the Mexican opening, thereby helping to lessen NAFTA's vulnerability. As a result of these two agreements, more than 80% of Mexico's trade would be covered by formally-agreed and consolidated liberalization with the world's two leading trade powers.

The second reason for the negotiation of the EUMFTA was to continue fostering flows of foreign investment to Mexico. The agreement would allow the authorities to eliminate the bias, introduced

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<sup>1</sup> According to the World Trade Organization's 2002 Annual Report, the EU is the world's second leading importer (US\$ 933 billion that year) after the United States (US\$ 1.202 trillion). The EU accounts for about a fifth of world trade. In 2002 its total trade amounted to US\$ 1.873 trillion (excluding intra-EU trade).

by NAFTA, against users of European inputs and European investors in the Mexican market. As in any preferential agreement, NAFTA's provisions on trade in goods, investment, services and government procurement entailed discrimination against investors and exporters who were not part of the free trade area. NAFTA offered not only tariff exemptions to US and Canadian producers for their sales in Mexican market, but also allowed them to invest in sectors that were previously reserved for Mexicans.

It is true that much of the liberalization of Mexico's foreign investment regime agreed under NAFTA was extended, *erga omnes*, as part of the legislative package that brought the agreement into effect. In some sectors, however (mainly banking and insurance), exclusive preferences were retained for investors from those countries with which Mexico had concluded free trade agreements. Although European companies could enjoy some of those benefits through their affiliates in the United States and/or Canada, the lack of an agreement with the EU meant that primacy was accorded to Mexico's trade relations with its North American partners. Thus, for example, in the 1990s European banks and insurance companies (Spanish in the former case and Dutch in the latter) could secure control of the stock of Mexican financial enterprises, but they had to do so through their affiliates based in North America and covered by NAFTA.

As regards goods trade, the regime governing temporary imports and *maquila* would allow, at least for export activities, the elimination of tariff discrimination against inputs from Europe. Since the goods would enter Mexican territory without having to pay import tariffs (on condition that they were re-exported), these mechanisms isolated extra-NAFTA users of intermediate goods from the negative impact of the relatively high levels of Mexican protection.

NAFTA, however, introduced disciplines that obliged Mexico to alter those regimes. From January 1<sup>st</sup>, 2001, import tariff exemption for goods from third countries that would be incorporated into exports going to North America would be limited by new conditions. The entry into force of NAFTA's Article 303<sup>2</sup> threatened to affect the competitiveness of Mexican exports that used extra-regional inputs, and to become an additional disincentive to European investment in Mexico. The EUMFTA was seen as an appropriate means of tackling this problem, and of obviating the danger that producers in the United States or Canada using European inputs would be better placed to compete in the Mexican market than Mexican producers.<sup>3</sup> The EUMFTA would resolve both these problems comprehensively and pragmatically.

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<sup>2</sup> NAFTA Article 303 establishes rules for tariff drawback or exemption programs for inputs used in the production of goods to be exported to other NAFTA countries. Mexico agreed to end such programs on January 1, 2001. Thereafter, the tariff amount that a country can exempt or return cannot exceed the lower of: (a) the tariffs paid or owed on imported materials originating outside North America and used to produce a good that is later exported to another NAFTA country; or (b) the tariffs paid in the importing country of the manufactured goods with the extra-regional inputs.

<sup>3</sup> In general, the United States' and Canada's most favored nation (MFN) trade protection is substantially lower than Mexico's. Hence producers established in those two countries can use European inputs for manufactures that (since they comply with NAFTA rules of origin) can enter the Mexican market with the benefits established by the accord's preferences. Producers in Mexico, by contrast, have to pay higher tariffs on European inputs used in production for the national market.

The third reason for the negotiation of the EUMFTA was, of course, to improve Mexican exporters' access to Europe. The European integration process,<sup>4</sup> the proliferation of trade agreements that the EU had concluded with the former colonies of some of its member states and with former socialist countries, as well as the unilateral preferences granted through the Generalized System of Preferences (GSP), the Lomé Convention and similar accords, amounted to growing discrimination against Mexican exports. Mexican producers had to pay tariffs in the European market that applied neither to the then-15 members of the customs union,<sup>5</sup> not to the members of the European Free Trade Association (EFTA) or several countries in Eastern Europe, the Caribbean and North Africa.<sup>6</sup>

It is true that Mexican exporters enjoyed some degree of preferential access under the European GSP,<sup>7</sup> but this was limited and subject to possible unilateral modifications by the EU, as became evident in 1995. The new system that entered into force in that year obliged Mexico to pay a significant part of the most favored nation (MNF) tariff<sup>8</sup> for most of the exports that benefited from the GSP,<sup>9</sup> a circumstance that made the preferences practically irrelevant.

As a result of the changes to the GSP, only a fifth of Mexican exports fell under the category of "not sensitive" (tariff-free) compared to 70% under the previous system.<sup>10</sup> The other 80% was grouped into three categories: "highly sensitive" (paying 85% of the MNF tariff); "sensitive" (70% of the MNF tariff); and "semi-sensitive" (35% of the MNF tariff). Clearly, therefore, the GSP (being a unilateral tariff preference scheme) did not offer a solid grounding to build export platforms geared to Europe. The EUMFTA, by contrast, would establish a contractual basis for trade, one that offered certainty, permanence and legal security in access to the European market.

Beyond the economic arena, the agreement with Europe also had a political and diplomatic rationale. At a time when the EU was engaged in a process of enlargement and integration, and soon after the negotiation of NAFTA, there was a clear need for an instrument that would allow Mexico to diversify its external relations and strengthen its links with a partner that was increasingly important

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<sup>4</sup> The EU began 52 years ago with six original members; new members have acceded over time: three in 1973; another in 1981; two in 1986; and another three in 1995; this is the 15-member EU. In May 2004 10 other countries acceded to the EU, giving rise to a 25-member bloc.

<sup>5</sup> On May 1, 2004 the number of EU countries increased to 25.

<sup>6</sup> In 1995, when Mexico and the EU reaffirmed their willingness to seek an association agreement, the EU had customs union accords with four countries and 17 free trade agreements.

<sup>7</sup> Through the GSP, the EU, like other developed countries, grants unilateral tariff preferences to developing countries. These systems of preferences are consistent with WTO rules.

<sup>8</sup> The MNF tariff is that which the members of the WTO apply to countries to which they do not grant unilateral preferences or with which they have not concluded preferential agreements.

<sup>9</sup> A year before the modification of the GSP, 58% of Mexico's exports to the EU were manufactures, 30% were petroleum products, and 12% were agricultural goods and raw materials. Of the manufactured exports, about 70% entered the EU under the GSP that was then in force. If this figure is added to those products that entered the market free of the MNF tariff, practically all Mexican exports of manufactured goods entered the EU duty-free. For some sensitive products the EU's old GSP imposed tariff-free quantitative import restrictions. When those ceilings were reached, the MNF tariff was re-established. As Mexico normally did not fill the quotas, practically all the exports that benefited from the GSP entered the European market tariff-free.

<sup>10</sup> As a result of this change in Europe's GSP, Brazilian exports classified as "not sensitive" declined from 42% to 40%; Argentina's "not sensitive" exports fell from 56% in 1994 to only a third in 1995.

on the global stage. While Mexico had decided to exploit its proximity to the world's biggest economy in order to foster its own development, it was unwilling to relinquish its relations with other regions.

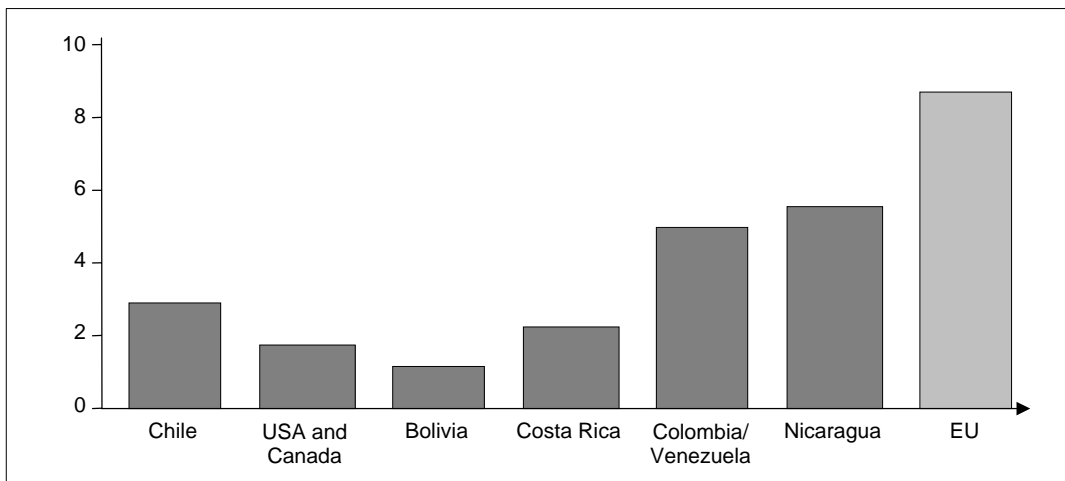
## B. European Reasons

Without question, NAFTA was the catalyst for European interest in negotiations with Mexico. From an economic perspective, the trade and investment discrimination arising from the agreement's entry into force triggered the interest of European exporters and investors in an agreement that could place them on the same footing as their North American competitors in the Mexican market.

In 1999, European exports entering Mexico paid average import taxes of 8.7%, with tariffs rising to 35% for some products (Figure 1). By contrast, tariffs for Mexico's preferential partners were close to zero because of free trade agreements. Because of discrimination against European exports, the EU's share of Mexico's total trade fell from 9% to 6.4% between 1993 and 1999. Figure 2 illustrates trends in Mexico's foreign trade in the 1990s. It is plain that trade with the EU was less dynamic than that with the country's free trade partners.

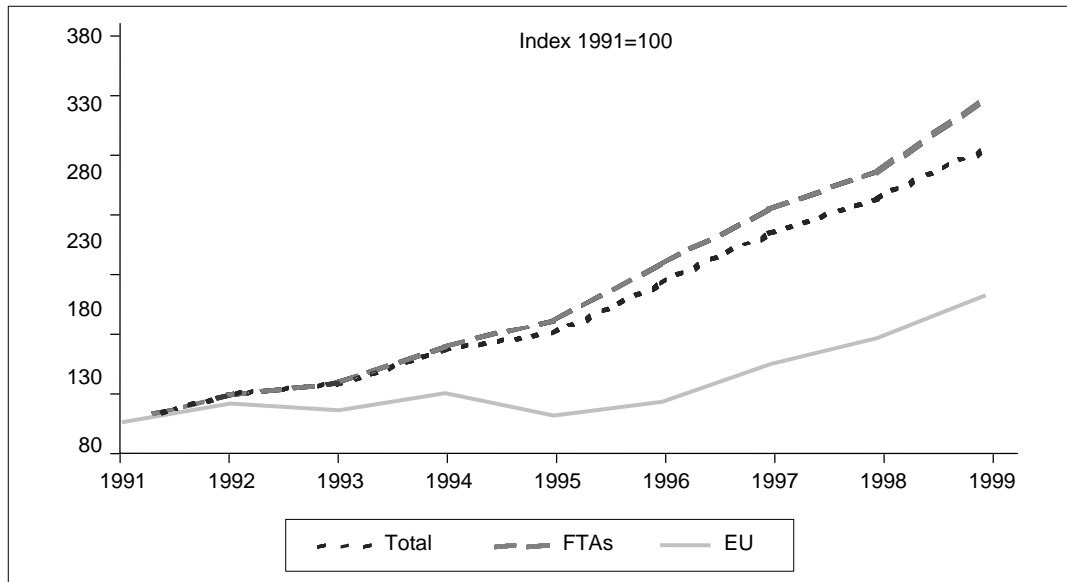
The disadvantage spawned by NAFTA was exacerbated by the additional risk that Mexico could unilaterally raise its protection levels. Hence, just as the changes to the European GSP in 1995 had highlighted Mexico's lack of a contractual framework guaranteeing access to the EU, so European exporters faced a similar circumstance in the Mexican market. The danger that Mexico would take unilateral steps worried the Europeans. That concern proved to be warranted. As part of the package of measures designed to increase fiscal income and tackle the 1995 macroeconomic crisis, the Mexican government changed the taxable base of non-preferential imports so as to include the cost of freight and insurance.

**FIGURE 1**  
**DISADVANTAGES OF THE EU RELATIVE TO MEXICO'S PARTNERS WITH AN FTA**  
Average Mexican tariff in 1999 (%)



Source: Mexican Secretariat of Trade and Industrial Promotion, 2000.

**FIGURE 2**  
**TRENDS IN MEXICO'S FOREIGN TRADE**



Source: Mexican Secretariat of Trade and Industrial Promotion, 2000.

Moreover, as part of an emergency program for the textiles, clothing and footwear industries, Mexico exploited the gap between the applied MNF tariffs and the maximum "consolidated" levels to which it had a right in the WTO.<sup>11</sup> The aim was to raise import taxes on those products from 15%-20% to 25%-35% for five years, according to the original thinking behind the measure.<sup>12</sup> This initiative increased the European unease that had been triggered in 1993 and 1994, when Mexico introduced a certification of origin system for products imported into the country - a system designed to avert triangulation of imports from China that were subject to antidumping quotas.

Mexico accounted for only a small share of total European trade,<sup>13</sup> but the Mexican market was very attractive for some European companies (especially those in the vehicles, chemicals and financial services sectors). The prospect of losing it to North American competitors prompted enough concern to justify negotiation of a free trade agreement.

Beyond economic considerations, there were at least two other reasons for the European interest in a new accord with Mexico. First, Mexico's accession to NAFTA, to the Asia-Pacific Economic Cooperation (APEC) forum in 1993 and the Organization for Economic Cooperation and Development (OECD) in 1994, made the country an increasingly important interlocutor for the

<sup>11</sup> The "consolidated" tariffs are the maximum levels that the members of the WTO have contractually agreed to impose. In some cases, such as Mexico, in the late-1980s and early-1990s the import duties actually applied could be lower than the consolidated tariffs. Mexico's average consolidated tariff in the WTO is about 35% for manufactured goods.

<sup>12</sup> This measure, for countries with which Mexico has not concluded free trade agreements, had been in force for eight years in mid-2003.

<sup>13</sup> In 1994 the EU's bilateral trade with Mexico accounted for only 0.95% of total extra-EU trade.

EU. Conclusion of an ambitious agreement with a country so close (geographically and politically) to the United States was clearly an attractive idea.

Following the fall of the Berlin Wall, the EU's main goal had been eastward enlargement. For reasons of military security and economic stability, it was urgent to send a signal of openness to the former socialist countries that, in the not-too-distant future, could be part of the great European family. Obviously, for France and the newly reunified Germany, this was the medium- and long-term goal. The other member countries shared a belief in the strategic importance of eastward enlargement, but the more Atlanticist countries -the United Kingdom, Spain and Portugal- feared that this could entail a loss of their relative influence in the EU. Hence the United Kingdom promoted its interest in maintaining a preferential relationship between the EU and the United States, and sought to strengthen the Atlantic alliance. Spain and Portugal, in the same measure, sought to establish a similar agenda with Latin America.<sup>14</sup> The initiative launched at the 1994 Summit of the Americas to create a hemispheric free trade also attracted European interest in Latin America. If it were to materialize, this undertaking (although incipient in its early years) threatened to place the EU at a commercial disadvantage to the United States in the Western Hemisphere.

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<sup>14</sup> The then-Vice President of the European Commission, a Spaniard, exerted all his influence to foster closer relations between the EU and Latin America.

### **III. CHALLENGES IN THE NEGOTIATION OF THE ECONOMIC PARTNERSHIP, POLITICAL COORDINATION AND COOPERATION AGREEMENT**

#### **A. The Paris Declaration**

The Solemn Joint Declaration was signed by Mexico and the EU on May 2, 1995 during the French presidency of the EU. The two sides thereby pledged to negotiate a new accord that would include: strengthening the political dialogue between the two sides; improving economic, technical, scientific and cultural cooperation; and the progressive and reciprocal liberalization of trade in goods and services, in line with WTO rules.

Although it is very important, the signing of the declaration was nothing more than the starting signal for a long and complicated process. In the five years between the Paris Declaration and the Lisbon Declaration (March 23, 2000) that marked the conclusion of the negotiations, resistance had to be overcome both in Mexico and Europe.

For Mexico, the agreement with the EU demanded persistent and complex diplomatic activities and a huge effort at inter-institutional coordination between the authorities responsible for trade policy and those responsible for the country's external relations.<sup>15</sup> Mexico had to work with ten Council presidencies<sup>16</sup> and two European Commissions<sup>17</sup> in a period that included an institutional crisis between two Commissions, in order to argue for the benefits of the initiative, keep it alive, complete the negotiations, and secure legislative approval both at the Community level and in the member states.

Domestically, there were conflicting positions. On one hand, large sectors of Mexican society looked very favorably on wide-ranging negotiations with Europe. In particular, among the various political forces there was a consensus that negotiations with the EU constituted the only possible diplomatic counter-balance to NAFTA.<sup>18</sup>

Among the Mexican private sector, however, there was no great enthusiasm for negotiations with Europe, for several reasons. First, tackling the macroeconomic crisis of late-1994 was understandably

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<sup>15</sup> These endeavors were led by the then-Secretary of External Relations and the then-Secretary of Trade and Industrial Promotion during the five years of negotiations with the EU.

<sup>16</sup> An institution comprising the representatives of the governments of the EU member countries.

<sup>17</sup> The executive arm of the EU. Comprises a president and 19 commissioners, each of the latter responsible for a portfolio. Currently, there is a commissioner for external relations and another for international trade.

<sup>18</sup> Additionally, and particularly attractive for the Mexican left (the *Partido de la Revolución Democrática*, PRD), was the prospect that the agreement with the EU would entail not only trade liberalization similar to that of NAFTA, but also a mechanism for political dialogue and an ambitious cooperation program. During the NAFTA negotiations some of the criticisms from the left were precisely, that the agreement was confined to trade and investment. The PRD hoped that the EUMFTA would tackle such constraints and thus voted in favor of the Global Agreement in the Senate on April 23, 1998, thereby enabling the accord to be approved unanimously. Some 23 months later, when the executive presented the results of the trade negotiations to the Senate, some PRD senators voted against, on the grounds that the cooperation chapter was not ambitious enough, since it did no more than list the different areas in which activities had yet to be undertaken. They also argued that the powers given to the Joint Council were excessive, since the agreed terms could be changed without the approval of both sides' legislatures. The PRD senators' vote was distributed as follows: 84 in favor, 11 against, and 2 abstentions.



the main priority for Mexico's business sector. This situation, in tandem with the challenges arising from NAFTA's recent entry into force, demanded all its attention and resources. Second, Mexican exporters' low profile in the European market was not conducive to making the negotiation of the EUMFTA a priority. Nonetheless, a small but influential group of entrepreneurs recognized the strategic significance of the negotiations and the need for Mexico to continue its reform process. This group took the leadership and, for this new initiative, reactivated the consultation mechanism used in NAFTA, through the Coordinating Agency of Foreign Trade Business Organizations (COECE).

The agreement also faced resistance in Europe. There was no consensus on the scope and timeframes of negotiations with Mexico among the member states, nor even among the Commissioners responsible for the EU's foreign and trade policy. Within the Commission there were clearly two positions. On the one hand, the British Commissioner responsible for multilateral trade negotiations and the EU's external relations with the United States, Canada and Asia naturally favored a transatlantic free trade agreement between the EU and the United States. He gave particular support to efforts aimed at launching the WTO's "Millennium Round".

The Commission's other vice president (a Spaniard), who was responsible for external relations with Latin America, Africa and the Middle East, sought to safeguard relations with those regions, and most particularly with Latin America. Although in the end it was possible to further the process begun by the Commissioner for relations with Latin America, the task was not simple. The absence of a shared vision among the Commissioners responsible for external relations made a difficult project even more complex.

A similar situation prevailed among the member states. On the one hand there was a group of countries, led by Spain and Portugal, which insisted from the outset of the process, and throughout it, on the importance of closer relations between Europe and Latin America. On the other hand there was France. The initiative had been launched formally under the French presidency, but in subsequent years France's enthusiasm for a free trade agreement declined significantly.

The reasons for France's change in attitude had little to do with Mexico, but they did substantially affect the Mexico-Europe initiative. Probably the most important reason for the shift in the French position was "trade negotiations fatigue" arising from the end of the Uruguay Round in December 1994. The political inertia attendant on having finally accepted the inclusion of agriculture in multilateral trade disciplines curbed France's appetite for further liberalization. This was undoubtedly combined with a fear of the precedent that negotiations with Mexico could set for later discussions with MERCOSUR (and, especially, the United States) at a time when Commissioner Brittan was promoting a transatlantic free trade agreement. Although it was clear that an agreement with Mexico posed no threat to the common agricultural policy (CAP), the same could not be said of talks with the South American and US agricultural powers.

The other European countries were in an intermediate position. They were sympathetic to the idea of deepening relations with Mexico and Latin America, but obviously the issue was not among their priorities. Because of this lack of internal consensus, both within the Commission and among the member states, the process of defining the scope and timeframe of the negotiations between Mexico and the EU was long and complicated.

The Solemn Joint Declaration of May 1995 spoke, in principle, of the three issues to which the two sides sought to accord primacy (political dialogue, cooperation and foreign trade), but it did not define the schedules for the entry into force of each of these matters, nor their scope.

For Mexico, the priority was to secure a free trade agreement. Without underestimating the value of cooperation and political links with the EU, the Mexican authorities believed that these two issues could be advanced without the need for a new agreement; the 1991 framework agreement could be used for those purposes. Hence Mexico's emphasis was on the trade negotiations, and in particular on securing a free trade agreement similar to NAFTA.

## **B. The Pre-negotiation Talks**

The language of the Paris Declaration made such a thing possible, but did not guarantee it. The "progressive, reciprocal, bilateral liberalization of trade in goods and services, consistent with WTO rules" could of course mean a free trade agreement. It could also, however, mean something much less ambitious, such as an *erga omnes* liberalization in the WTO framework. For Mexico, therefore, it was crucial to ensure that there was a very clear negotiating mandate in order to give substance to the Paris Declaration of 1995. The aim was to be nothing less than a free trade agreement, consistent with Article XXIV of the General Agreement on Tariffs and Trade (GATT) and Article V of the General Agreement on Trade in Services (GATS).<sup>19</sup>

The second important issue for Mexico was to ensure that the negotiation and entry into force of the free trade agreement would not be subordinated to the chapters on cooperation and political dialogue. Mexico was concerned that the two-stage approach proposed by the Europeans posed a danger that trade negotiations would be deferred indefinitely.

Both concerns, about the negotiating mandate and the timing of the different agreements' entry into force, proved to be warranted. At the same time that Mexico was seeking its agreement, Chile and MERCOSUR were engaged in similar processes with the EU. In those cases, the EU was insisting that an explicit commitment to negotiations for a free trade agreement should be avoided. Europe pushed for the adoption of the sequential approach offered to Mexico, whereby the trade negotiations, in the best of cases, would take place after the negotiation and entry into force of the chapters on cooperation and political dialogue.

In December 1995, during the Spanish presidency of the EU, MERCOSUR and Chile signed their agreements with Europe in Madrid.<sup>20</sup> At the time, Mexico made plain that a format similar to that used for the negotiations with the South American countries was unacceptable, since it did not guarantee free trade between the two sides and it established fewer specific deadlines for the negotiations. Mexico feared that the approach accepted by Chile and MERCOSUR posed a risk that, once the political coordination and cooperation agreements had been concluded, Europe would lose interest in the negotiations. The signing of those agreements, which were substantially

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<sup>19</sup> These articles, XXIV of the GATT for goods and V of the GATS for services, establish the requirements that preferential agreements must meet in order to be consistent with multilateral trade rules.

<sup>20</sup> Grisanti [2004] offers a very comprehensive description of relations between Latin America and Europe.

ambiguous as regards trade liberalization and set no date for its realization, made it possible to satisfy political pressure to give European-Latin American relations a new instrument, without the latter having much real substance.

Resolving these differences with Europe called for time and imagination to secure, within the EU's institutional restrictions, the legal apparatus that enabled Mexican goals to be met. The preparatory phase of the negotiations for the free trade agreement finally ended on December 8, 1997 with the signing of three instruments at the ministerial level:

1. Economic Partnership, Political Coordination and Cooperation Agreement between the European Community and its Member States, on the one hand, and the United States of Mexico on the other (Global Agreement).
2. Interim Agreement on Trade and Trade-related Matters between the European Community, on the one hand, and the United States of Mexico, on the other (Interim Agreement).
3. Joint Declaration between the European Community and its Member States and the United States of Mexico (contained in the Final Act).

These three instruments had to be devised in order to attend to Mexican concerns. The Global Agreement contained the specific provisions that would govern bilateral relations in the areas of political coordination and cooperation. Included in the latter field were the institutional mechanisms through which the two sides would develop joint collaborative activities in about 30 areas, ranging from industrial cooperation and the information society to joint efforts in the fight against drug trafficking and the elimination of poverty.<sup>21</sup> In the trade field, the agreement set up the necessary institutional body (the Joint Council) and established the mandate to negotiate the EUMFTA.

The Interim Agreement replicated the trade mandate, so that once this instrument was approved by the European Parliament and by the Mexican Senate the two sides could negotiate those aspects of trade that fell under Community competence (goods trade),<sup>22</sup> without the need to await approval of the Global Agreement by the legislatures of the 15 member states and the EU itself.<sup>23</sup> Similarly, the Joint Declaration authorized the European Commission to negotiate those issues that fell under the competence of the member states (services, investment and intellectual property) without the need to await approval of the Global Agreement.

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<sup>21</sup> The fields for cooperation are as follows: industrial; investment promotion; financial services; small and medium-size businesses; technical regulations and conformity assessment; customs cooperation; the information society; the agricultural sector; the mining sector; the energy sector; transport; tourism; statistics; public administration; the fight against drugs trafficking, money-laundering and control of precursor chemicals; science and technology; training and education; culture; audiovisual; information and communications; the environment and natural resources; the fisheries sector; social issues and the eradication of poverty; regional cooperation; refugees; human rights and democracy; consumer protection; data protection; and health.

<sup>22</sup> Authority in the area of trade policy is shared among the EU institutions. Goods trade is a matter of Community competence, which means that the European Commission has the authority to negotiate these issues. Services, investment and intellectual property are the responsibility of the member states.

<sup>23</sup> The Interim Agreement was approved by the Mexican Senate on April 23, 1998 and by the European Parliament on May 13, 1998; it entered into force on July 1 of the same year.

Additionally, the Global Agreement established that the application of the chapters on political dialogue and cooperation would be suspended until the decisions on trade issues had been taken - that is, until the results of the negotiation of a free trade agreement had been adopted.<sup>24</sup>

Once ratified, the Global Agreement would govern relations between Mexico and the EU in the three dimensions: political dialogue, trade and economic links, and cooperation.<sup>25</sup>

In practice this system meant that the disciplines related to issues perceived to be of European interest (cooperation and political dialogue) were agreed upon before those that were of interest to Mexico (trade). Importantly, however, the negotiations for the free trade accord were simultaneous to the long and complex process of securing approval of the Global Agreement in the parliaments of the then 15 member states.<sup>26</sup> The foregoing was complemented with a clause that stipulated that the rules on cooperation and political dialogue could not enter into force before those on trade.

In fact, the trade agreement was negotiated and approved by the European Parliament and the Mexican Senate before all the provisions of the Global Agreement had been ratified by all 15 legislatures of the EU members. This is why the free trade agreement entered into force in July 2000, eight months before those on political dialogue and cooperation (March 2001).<sup>27</sup> Table 1 summarizes this complicated juridical apparatus, as well as the respective approval processes.

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<sup>24</sup> Article 60 of the Global Agreement establishes that "the application of titles II (political dialogue) and VI (cooperation) will be suspended until the adoption by the Joint Council of the decisions foreseen in articles 5 (goods trade); 6 (services trade); 9 (capital movements and related payments); 10 (government procurement); 11 (competition); and 12 (intellectual property).

<sup>25</sup> Ramón Torrent, former Director of International Relations in the Legal Service of the Council of the EU, and currently Director of the University of Barcelona's Observatory on Globalization, took part in designing the institutional structure that made possible the negotiations with Mexico; he has recently drawn up a statement on the process. For Ramón Torrent [2004] "(a) the new Spanish government of José María Aznar supported from the outset, within the Council of the European Union, trade liberalization with Mexico; by contrast, the government of Felipe González had not given the slightest support to the proposal for a free trade agreement with MERCOSUR presented by the Commission, and had settled for the possibility of organizing a colorful ceremony for the signing of the framework agreement in Madrid during its presidency of the Council; (b) Spanish officials in Brussels fought very tenaciously, on instructions from their government, to ensure that the framework agreement with Mexico, given that it did not include trade liberalization, was at least better, from the institutional viewpoint, than the agreement with MERCOSUR; (c) the German government gave some degree of support to the Spanish government's positions; (d) in the agreement with Mexico, officials of the Commission and the Council's Legal Service invented the institutional novelty of a Joint Council with decision-making powers (adapted for the Ankara Agreement with Turkey)".

<sup>26</sup> Since most trade issues fall under Community competence (except investment, services and intellectual property), they do not have to be approved by the member states of the EU. The institution responsible for ratifying Community-competence trade issues in the EU is the European Parliament. Cooperation and political dialogue, meanwhile, fall under the competence of the member states and therefore do have to be ratified in each of the national parliaments.

<sup>27</sup> The Global Agreement was ratified by the last member state 18 days after the EUMFTA entered into force. Hence the results of the trade negotiations in those areas that fall under the competence of the member states (services, investment and intellectual property) could not take effect at the same time as the rest of the free trade agreement. The trade disciplines in which the member countries have competence entered into force on March 1, 2001 and were incorporated into the other rules of the EUMFTA, which had been ongoing since July 1, 2000. According to Article 60 of the Global Agreement, application of the political dialogue and cooperation chapters remained suspended until all the trade rules were in force - that is, March 1, 2001.

**TABLE 1**  
**LEGAL STRUCTURE FOR RESOLVING THE CHALLENGE OF THE NEGOTIATING SCHEDULES**  
**AND ENTRY INTO FORCE OF THE THREE ASPECTS OF THE AGREEMENT**

Instrument	Objective	Substance	Approval procedure	Approval date	Entry into force
Global Agreement	Govern trade, political and cooperation relations between Mexico and the EU	<b>Three dimensions: political dialogue, cooperation and trade.</b> Unlike cooperation and political dialogue, the trade section does not contain the results of the negotiations, but solely the mandate to negotiate the EUMFTA	European Parliament Mexican Senate Parliaments of the 15 EU members	May 6, 1999 March 20, 2000 February 2001	<b>July 1, 2000</b> (trade rules in areas of Community competence)  <b>March 1, 2001</b> (trade disciplines under the competence of the member states: cooperation and political dialogue)
Interim Agreement	Allow the start of trade negotiations in areas of Community competence without awaiting approval of the Global Agreement	<b>Trade dimension.</b> Mandate for negotiations on: tariffs, rules of origin, technical, sanitary and phytosanitary norms, safeguards, antidumping, government procurement, competition and dispute settlement	Mexican Senate European Parliament	April 23, 1998 May 13, 1998	July 1, 1998
Joint Declaration	Allow negotiations in the areas of member state competence, at the same time as the Interim Agreement	<b>Trade dimension.</b> Mandate for negotiation of: trade in services, investment and intellectual property			
Results of the Trade Negotiations					
Interim Agreement	Give substance to the Global Agreement in areas of Community competence	Results of the trade negotiations in areas of Community competence. Negotiations from November 9, 1998 to November 24, 1999	Mexican Senate European Parliament	March 20, 2000 March 16, 2000	This instrument disappeared, its substance was incorporated into the Global Agreement and entered into force on July 1, 2000
Global Agreement	Give substance to the Global Agreement in areas of member state competence	Results of the trade negotiations in areas of member state competence. The negotiations ended in November 1999. Nonetheless, the approval process was slower because of the need for approval by the national parliaments of the EU member states	Mexican Senate European Parliament Member states	March 20, 2000 May 6, 1999 February 2001	March 1, 2001

This, then, is how the challenge of the schedule for negotiations on the agreement's entry into force was resolved. Still to be addressed was the scope of the mandate for the trade negotiations.

### *The Scope of the Mandate for the Trade Negotiations*

Mexican and EU goals in the area of the trade negotiations' substance were reconciled in the following way. In order to attend to the European concern that there should be no explicit mention that the aim was a free trade agreement, and at the same time to safeguard the Mexican aim that such an accord was indeed the goal, the Global and Interim Agreements used the language of the 1995 Paris Declaration and added the word "preferential" to the goal of "(...)

promoting the development of trade in goods and services, including the bilateral and preferential, progressive and reciprocal liberalization of tariffs and non-tariff barriers to goods trade (...).<sup>28</sup> The text of these agreements also indicated that such liberalization would be undertaken "(...) in conformity with relevant WTO rules, particularly Article XXIV of the GATT and keeping in mind the sensitivity of certain products".<sup>29</sup>

The unequivocal description of the liberalization as being "*preferential*" and consistent with Articles XXIV of the GATT and V of the GATS removed any suspicion that this was not a free trade agreement although, in order to accommodate European concerns, an explicit mention of such an agreement was avoided.<sup>30</sup>

### *The "Democratic Clause"*

The third important issue in the negotiating process was the definition of the "democratic clause". At the time there was a perception that Mexico opposed this clause, but in fact the difficulties had more to do with its wording than with its inclusion in the agreement and its substance. At the beginning of the discussions, Mexico's trade authorities certainly looked with suspicion on any attempt to establish a link between trade issues and non-trade issues. Because of its recent experience in negotiating NAFTA's supplementary labor and environmental agreements with the United States, Mexico suspected that the democratic clause could be used to mask protectionist inclinations and at some point could become a source of commercial harassment.

In the talks with United States, it was clear that some of the groups that most vehemently opposed the NAFTA negotiations in 1992 saw the negotiation of the parallel agreements as a chance to reopen the trade accord and introduce measures that, *de facto*, would undermine the opening secured by NAFTA. When the Mexican authorities came to understand the scope and motivation of the democratic clause, however, and that its inclusion was a common practice in all the agreements concluded by the EU, Mexico decided to accept the substance of the clause in full.

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<sup>28</sup> Article 4 of the Global Agreement and 2 of the Interim Agreement.

<sup>29</sup> Article 5 of the Global Agreement and 3 of the Interim Agreement.

<sup>30</sup> Article 5 of the Global Agreement later indicates: "This decision shall address, in particular, the following matters: (a) coverage and transitional periods; (b) customs duties on imports and exports and charges having an equivalent effect; (c) quantitative restrictions on imports and exports and measures having equivalent effect; (d) national treatment including the prohibition of fiscal discrimination in respect of taxes imposed on goods; (e) anti-dumping and countervailing measures; (f) safeguard and surveillance measures; (g) rules of origin and administrative cooperation; (h) customs cooperation; (i) customs valuation; (j) technical regulations and standards, sanitary and phytosanitary legislation, mutual recognition of conformity assessment, certifications, marks systems, etc.;(k) general exceptions justified on grounds of public morality, public policy or public security; the protection of human, animal or plant life or health; the protection of industrial, intellectual and commercial property, etc.;(l) restrictions in case of balance of payments difficulties".

The perception that Mexico opposed the clause stemmed from the fact that, in the final session of the negotiations for the Global and Interim Agreements, Mexico sought a slight change in the wording of the text originally presented by the EU, a text that is traditionally included in Europe's association agreements.<sup>31</sup> Additionally, Mexico included a unilateral declaration that made reference to the constitutional principles underlying Mexican foreign policy, and therefore its relationship with the EU.<sup>32</sup> The European Commission accepted the Mexican proposal, and in principle agreed to the closing of the negotiations.

Just a few days later, when the EU Council's Committee of Permanent Representatives (COREPER)<sup>33</sup> reviewed the text, the member states refused to make any change to the European wording because of the precedent that this could set, and because the democratic clause was already included in a significant number of prior agreements. After almost a month of intense diplomatic activity, Mexico finally agreed to withdraw its proposal and to include the original European text. These exchanges leaked to the press, and what had been changes of wording (understandable and natural in any negotiating process of this kind) were interpreted as substantive differences that in reality did not exist.<sup>34</sup>

The three instruments became the new legal basis for relations between Mexico and the EU. The Global Agreement, the Interim Agreement and the Joint Declaration were signed on December 8, 1997. On April 23 and May 13, 1998, the Mexican Senate and the European Parliament, respectively, approved the Interim Agreement, thereby smoothing away for the start of the free trade negotiations between Mexico and EU.

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<sup>31</sup> The text proposed by Mexico for the "democratic clause" differed from the language that the EU traditionally includes in its association agreements, since it did not include the words "inspire the internal and international" policies. The text advanced by Mexico stated: "respect for democratic principles and fundamental human rights, as enshrined in the Universal Declaration of Human Rights, inspire the policies of the parties and comprise an essential element of the present agreement". Mexico's amendment stemmed from the fact that its foreign policy, for constitutional reasons, is based on seven principles that, while not incompatible with the Universal declaration of Human Rights, include a series of concepts that go beyond the protection of human rights.

<sup>32</sup> The text of Mexico's unilateral declaration on the democratic clause stated:

*"Mexican foreign policy is based on the principles enshrined in its constitution:  
the self-determination of peoples;*

*non-intervention;*

*the peaceful settlement of disputes;*

*proscription of the threat or use of force in international relations;*

*the legal equality of states;*

*international cooperation for development; and*

*the struggle for peace and international security.*

*Because of its historical experience and the supreme mandate conferred by its constitution, Mexico expresses its firm conviction that only full observance of international law is the basis of peace and development. It also affirms that the principles of coexistence of the international community as expressed in the Charter of the United Nations, the principles stipulated in the Universal Declaration of Human Rights and democratic principles are a permanent guide to its constructive participation in international endeavors and serve as the frame of reference for its relationship with the Community and its member states, governed by the present agreement, or its relations with any other country or group of countries".*

<sup>33</sup> COREPER comprises the EU countries' ambassadors to the European institutions.

<sup>34</sup> This interpretation is wholly consistent with that of Ramón Torrent, who experienced the process from the other side of the table as Director of International Relations in the Legal Service of the Council of the EU (see Torrent [2004, p.5-6]).

### *The Negotiation of the EUMFTA, the Rio Summit and the Change in Commissions*

In order to negotiate the EUMFTA, Mexico and the EU agreed on a very ambitious negotiating schedule with a start date of November 9, 1998 and a target date of mid-June 1999. The aim was to take advantage, for the purposes of concluding the process, of the first Summit of the heads of state and government of the EU, Latin America and the Caribbean on June 28-29, 1999 in Rio de Janeiro.

For various reasons, however, the negotiations were extended; they could not be concluded at the Rio Summit as originally planned. The first reason was the position of some member states that had originally accepted the EUMFTA, but that wanted to avert the danger that the summit would revolve around trade and, in particular, that it would provide an arena for other Latin American countries to demand an agreement similar to that being negotiated by Mexico. In order to prevent this concern from becoming an obstacle to the negotiation of the EUMFTA, Mexico decided to change its original position that trade, and particularly the EUMFTA, should be the central issue at Rio; its importance at the Summit was played down.

The second factor that impinged on the negotiating schedule was the European Commission's institutional crisis of March 1999. As a result of an investigation into corruption in the Commission, the President and the Commissioners all resigned on March 16, 1999. Although the new Commission did not take office until September 20, 1999, the outgoing administration's last six months were those of an institution weakened by crisis, and lacking in the capacity and leadership to take the necessary decisions to conclude the negotiations.

The replacement of the Commission turned out to be positive for the conclusion of the EUMFTA. This was partly because the Commission was new, at the start of a five-year mandate, unlike the previous administration which (even when the crisis had passed) was weakened in its last year in office. It was also because of the very significant restructuring of the Commissioners' responsibilities. The new President ended the ambiguity in the division of Commissioners' responsibilities to lead trade negotiations with Latin America. With a clear separation of the external relations portfolio from the trade negotiations portfolio, authority in the area of foreign trade fell clearly and unarguably on the French Commissioner, Pascal Lamy, while British Commissioner Christopher Patten remained in charge of external relations.

The new Commission inherited an EUMFTA negotiating process that was already advanced and that had a clear mandate, one that was renewed by the European Council of Cologne on June 4, 1999.<sup>35</sup> The Trade and External Relations Commissioners worked together to comply with the Council's instructions.

Commissioner Patten gave political momentum to the negotiations from the start of his mandate, while Commissioner Lamy took the reins of the trade negotiations, taking part personally in the consultations with the member states during the final phase of the process, leading the European

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<sup>35</sup> As a result of the Mexican government's diplomatic endeavors with the Spanish government, the latter sought to ensure that the Cologne Declaration of the heads of state of the EU member countries gave a mandate which stipulated that the negotiations should be completed, at the latest, before the end of 1999. Because of this mandate, in the transition between the Commissions the negotiations with Mexico became one of the priority instructions given by the European Council to the new Prodi Commission.



delegation, and concluding the negotiations with Mexico's Secretariat of Trade and Industrial Promotion on November 24, 1999. Hence the change in the European Commission, which had threatened to imperil the negotiations, ultimately contributed to their successful conclusion.

### **C. Main Challenges of the Trade Negotiations**

The negotiation of the free trade agreement with the EU represented a new challenge for the Mexican government.

The NAFTA experience was undoubtedly a very important asset for the negotiation of the EUMFTA, but there were significant differences between the two processes and those differences called for new tactics and fresh strategies.

First, the complexity of dealing with a supranational institution, the European Commission, as well as its interrelation with the then 15 member states, called for an approach which differed from that used for the negotiations with the United States and Canada, wherein the relationship was among three countries and their negotiating delegations.

A second difference was that for the NAFTA negotiations there were no significant precedents to delimit the substance and structure of the agreement. On the contrary, NAFTA broke new ground in several areas by including - for the first time on the trade agenda - ambitious disciplines in areas such as services, intellectual property and investment, some of which became important precedents for the multilateral agreements reached in Marrakesh in April 1994.

When the trade negotiations with the EU began in late-1998, the situation was very different. Europe not only had a score of trade agreements in force, but those accords were based on the legal apparatus used to liberalize intra-Community trade, as enshrined in the 1958 Treaty of Rome. While they shared with modern agreements (such as NAFTA) central concepts for the regulation of goods trade, they did so with a different legal structure. In this context it was unrealistic to expect that the EU would depart from these traditional formats at the request of a distant and relatively unimportant trade partner.

Thus Mexico decided that although NAFTA had become the model for its agreements with Latin American countries, progress in the negotiations with the EU would require abandonment of that format and adoption of the European approach. The texts that Mexico presented in the first round of negotiations, in Mexico City in November 1998, were based on the agreements that the EU had already concluded, although of course with the modifications necessary to recognize Mexican interests and to secure bargaining leverage.

### **D. Substance of the Negotiations**

The prime challenges in the EUMFTA negotiations were concentrated in four main areas:

1. Tariffs on industrial products.

2. Agriculture.
3. Rules of origin.
4. Services and investment.

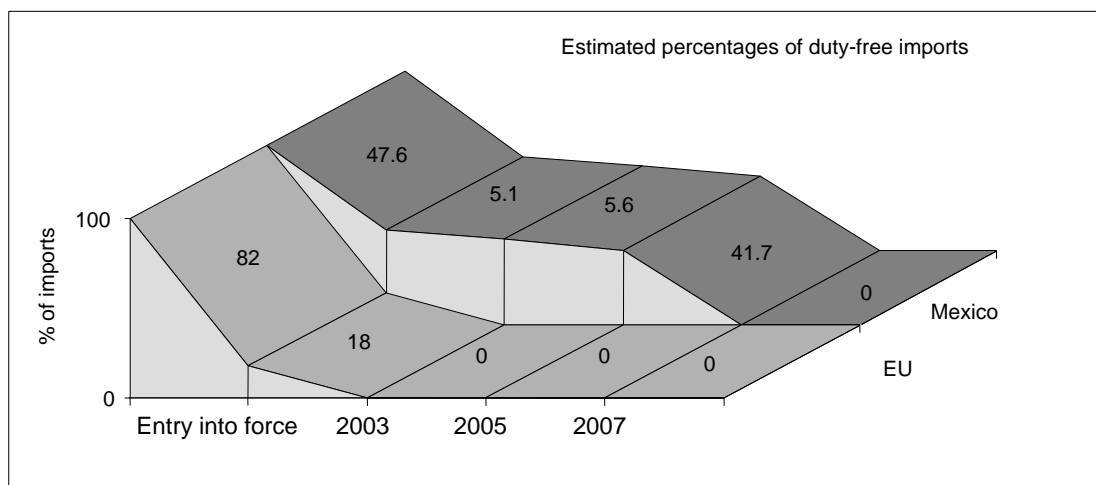
### *Tariffs on Industrial Products*

The EU's initial position on the liberalization of industrial tariffs sought to ensure that European exporters would be placed on the same footing as US and Canadian competitors in NAFTA. In particular, the EU sought the total elimination of tariffs on industrial products in the Mexican market in 2003, when the removal of industrial tariffs was to end in NAFTA. This aim of securing "NAFTA parity" is unsurprising, since the trade discrimination arising from NAFTA was a powerful motivation for Europe's interest in negotiations with Mexico. Additionally, "NAFTA parity" was very useful in enabling European negotiators to discipline consultations with the member states, thereby obviating the danger that the door would be opened to exceptions to the tariff-reduction schedules for industrial products.

From the outset of the negotiations, Mexico expressed an interest in longer tariff-reduction schedules for some sensitive sectors. By the end of the 1990s, the adjustment of the Mexican economy (and of the industrial sector in particular) to NAFTA-induced liberalization was very advanced, but for some industries the additional effort needed to face European competition called for agreement on tariff-reduction deadlines that extended beyond 2003.

These two goals were met in the negotiations. The EUMFTA establishes different tariff-reduction calendars for the two sides. For the EU, liberalization ended on January 1, 2003; for Mexico it will end in 2007. The agreed schedules were as follows:

**FIGURE 3**  
**ELIMINATION OF TARIFFS ON INDUSTRIAL PRODUCTS**



Source: Mexican Secretariat of Trade and Industrial Promotion, December 1999.

## *Agriculture*

In any trade negotiation, the agricultural sector is one of the most delicate; the EUMFTA negotiations were no exception. In both Mexico and the EU, some significant factors made universal and NAFTA-like liberalization of the agricultural sector difficult.

The first obstacle was Europe's CAP.<sup>36</sup> The EU's use of export subsidies to offset the CAP's high level of trade protection made it very difficult for Mexico to accept the dismantling of tariffs on the most sensitive agricultural products: mainly cereals, dairy goods and meat products. The EU, for its part, faced resistance in granting free access for some products that were of interest to Mexican exporters, including citrus fruits, honey, sugar, avocados and flowers.

Nonetheless, during the negotiations the two sides were able to reach a compromise on their offensive and defensive interests. First, they agreed on a special category for exceptionally sensitive agricultural products, particularly cereals, dairy goods and meat products that benefited from EU export subsidies under the CAP. There was also a proposal to establish a liberalization calendar up to 2003 (when the EU was expected to have completed revision of the CAP) and then decide if it were possible to include these products in the liberalization program. The CAP has not been reformed, however, so thus far these products remain, *de facto*, excluded from liberalization under the EUMFTA.

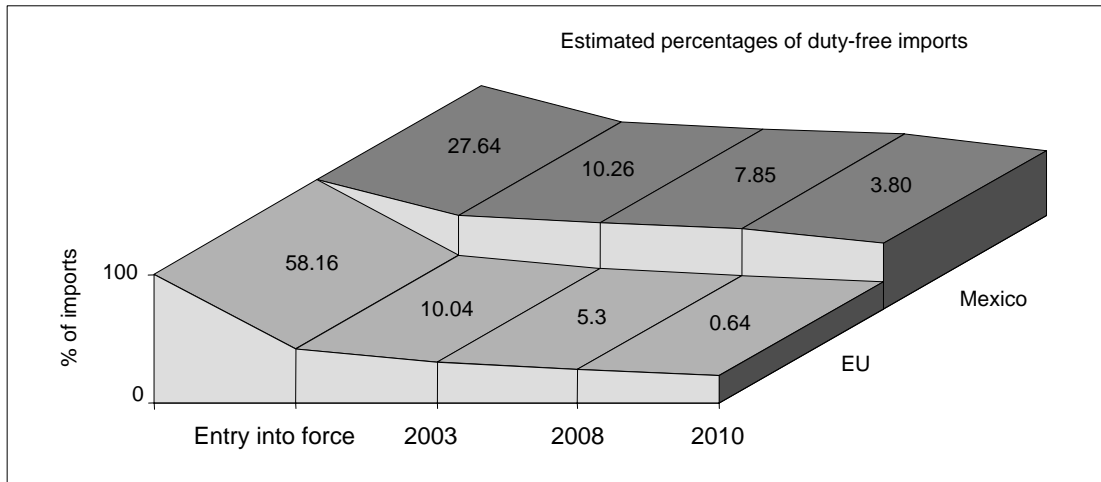
Second, to accommodate Mexican export interests while securing an agreement acceptable to the EU member states, the two sides agreed to establish permanent preferential quotas and seasonal windows for Mexican exports. This approach served Mexico's export potential, while at the same time guaranteeing European producers that there would be no market destabilization as a result of the EUMFTA. From the perspective of Mexican imports, the fact that a large proportion of dairy goods, meat products and grains would be excluded (because of European subsidies) meant that the significant sensitivity of those sectors in Mexico did not have to be addressed.

The agricultural trade liberalization arising from the EUMFTA negotiations recognizes the sector's special conditions. Tariff-elimination is gradual, over 10 years; there are four calendars for elimination and, as mentioned earlier, there is a waiting list of products to which the EU grants significant production and export support.

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<sup>36</sup> In order to place its production surpluses in the international market and thus maintain stable prices in the internal market, the EU has created a mechanism of "export reimbursements". By means of this mechanism, the EU grants subsidies to European exporters of certain agricultural products for a value close to the difference between the international price of the product in question and its reference price (established by the member states' 15 ministers of agriculture) in the Union.

**FIGURE 4**  
**ELIMINATION OF TARIFFS ON AGRICULTURAL PRODUCTS**



Source: Mexican Secretariat of Trade and Industrial Promotion, December 1999.

Additionally, quotas and seasonal windows provide preferential access for 21% of Mexican exports to Europe in products such as fruit juices; cooked, frozen or preserved fruits; natural honey; avocados; albumins; asparagus; flowers; eggs; peas; tuna; gum and molasses. In sum, Mexico gained preferential access for 95% of its agricultural exports to the EU.

### *Rules of Origin*

Rules of origin set out the requirements<sup>37</sup> that must be met by products if they are to benefit from the tariff preferences established in a free trade agreement. Hence they are the other side of the coin of tariff liberalization. Unlike tariff-reduction schedules, however, which are by definition temporary, rules of origin are permanent. In practice, such rules (together with tariffs) determine the real degree of openness in the free trade area.

The negotiation of the EUMFTA's rules of origin posed greater difficulties than those normally encountered. On the one hand, the European Commission's negotiators had an explicit mandate from the EU member countries to replicate, in all preferential trade negotiations, irrespective of the partner at hand, the rules of origin set out in the "single European list of rules of origin". As part of this effort at homogenization, since 1997 the EU has been unifying all preferential rules of origin, and has even been replacing the protocols related to trade agreements concluded before that date. The reason was to facilitate European exporters' operations in view of the multiplicity

<sup>37</sup> The rules of origin are established in minimum terms of combined value-added to be met by goods. They normally use the method known as "tariff jumping" in the context of the harmonized system of tariff classification. In general terms, this method consists of defining rules based on the degree to which an input in a certain tariff category must undergo in order to become another product, one that is classified in another tariff line; the latter must be "sufficiently different" from the former to indicate that implicitly there has been a process of "substantial transformation".

of preferential agreements that the EU had signed and would sign in the future.<sup>38</sup> The existence of this "single list" substantially reduced the European negotiators' maneuvering room.

The second difficulty concerned the nature of trade relations between Mexico and the EU. Mexico's productive structure was different from that of most of the EU's preferential trade partners - mainly countries in Eastern Europe or North Africa that were relatively integrated into the European bloc. Consequently, the "single list" rules called for a level of regional content or a degree of transformation that was unduly high. Mexican products (and even, on occasion, some European goods)<sup>39</sup> could not comply with the rules, and hence there was a risk that they would not benefit from the tariff-elimination established in the agreement.

An additional difficulty in the negotiations stemmed from Mexico's substantial economic integration with the United States. The close links between the productive structure of Mexico's industrial sector and the United States was a further challenge in discussions of this issue, since the Europeans were concerned that very lax rules of origin might, albeit partially, extend the preferences of the EUMFTA to the United States through the incorporation of US value-added in those Mexican exports that benefited from the EU-Mexico accord.

The combination of these factors made the negotiation of this chapter probably the most decisive issue in the EUMFTA.

A compromise was finally reached through both temporary<sup>40</sup> and permanent flexibility in those European rules that are most relevant to Mexico. Those rules are in the automotive, chemicals, electronics, textiles and clothing, and footwear sectors.

### *Investment and Services*

Discussion of services and investment amounted to one of the great paradoxes of the negotiations. In the years before the start of the talks with Europe, Mexico had opened its economy to the participation of foreign service providers and investors, but such liberalization had been consolidated<sup>41</sup> only for its preferential trade partners through free trade agreements. This meant that all foreign service providers and investors faced the same conditions in the Mexican market in general terms, but that those from countries with which Mexico had concluded free trade

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<sup>38</sup> In 1999 the EU had more than 25 preferential trade agreements.

<sup>39</sup> While the "single list" was created in 1997, it includes a large number of rules of origin established in preferential agreements in the 1970s. Consequently, some of the rules on the list did not take account of changes in Europe's productive structure.

<sup>40</sup> As a result of the commitment in the negotiations, the regional content of some rules is modified over time, such that the productive structures in the exporting country have a reasonable amount of time to adapt to the rules of origin established in the EUMFTA.

<sup>41</sup> Consolidation here means the obligation not to reverse the prevailing level of openness.

agreements had a guarantee that the current opening would not be reversed. The others, including those from Europe, did not have the same certainty.<sup>42</sup>

In some sectors, moreover, such as financial services, Mexico had undertaken an additional unilateral liberalization after NAFTA's entry into force. This opening was extended only to those partners with which the country had preferential agreements, not to the rest of the world.

Consequently, the EU was the *demandeur* in the negotiations on services and investment. This was clear from the start of the talks for the Global and Interim Agreements, wherein the Europeans insisted that services (including financial services) and investment should be an integral part of the trade accord.

### *Outcome of the Negotiations on Investment*

Paradoxically, and at Europe's request, the investment chapter did not include the traditional disciplines contained in a most-recent generation chapter on investment-protection, such as fair and equitable treatment, national treatment, rules on expropriation and compensation, the handling of transfers, and a system for settling disputes between an investor and one of the parties. Neither was there any commitment to consolidate the existing level of investment openness in the two sides' territories, known as "standstill" in the jargon of international trade.<sup>43</sup>

This section confined itself to calling on the member countries to develop a legal framework conducive to investment on the basis of the negotiation of reciprocal investment -promotion and-protection agreements. Responsibility for the negotiations falls on each EU member state, not on the European Commission.

In practice, Mexico has such agreements with 13 of the then 15 EU members.<sup>44</sup> These instruments have modern disciplines on investment-protection (such as fair and equitable treatment, national treatment, expropriation and compensation, transfers, and the settlement of disputes between an investor and one of the parties), but like the EUMFTA they do not include a commitment to consolidate the existing level of opening or standstill.

The investment chapter also indicates that, no later than three years after the agreement's entry into force, the two sides will review the corresponding legal framework, with a view to moving towards the progressive liberalization of investment flows. Nonetheless, there is no explicit indication of the scope of this review and, in particular, there is no stipulation that it will involve the inclusion of traditional international rules on investment-protection and a list of sectoral

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<sup>42</sup> While they do not benefit from the legal certainty offered by an FTA, European investors and service providers are not completely unprotected in the Mexican market. They are sheltered by the commitments to liberalization that Mexico has assumed through the OECD Codes of Conduct and the WTO's most favored nation clause.

<sup>43</sup> As regards commercial presence for service providers, the agreement includes the commitment to consolidate national legislation. Nonetheless, this issue is dealt with in the services chapter.

<sup>44</sup> The United Kingdom and Ireland have not concluded agreements on the reciprocal protection and promotion of investments with Mexico. The accession of 10 new countries to the EUMFTA as a result of EU enlargement means, among other things, that the number of partners without such accords has increased from 2 to 11.

reserves detailing the agreement's coverage. The original deadline passed in 2003, but this review has not been carried out. The officials responsible for managing the agreement have decided to defer compliance with this commitment until 2005.

### *Outcome of the Negotiations on Services*

Unlike the investment chapter, that on trade in services does include the basic principles contained in any last-generation international agreement, such as national treatment, MNF treatment, and a commitment to maintain the level of openness prevailing at the time when the accord enters into force - that is, the consolidation of national legislation or standstill.

The agreement with the EU, however, does not include a list of reserves: those economic sectors and activities in which the participation of the other side's service providers is restricted. In contrast to other agreements that Mexico has signed, such as NAFTA (in which, for reasons of transparency, each country specifies the sectors and activities excluded from the agreement's commitments), the EUMFTA confines itself to guaranteeing that neither side will adopt legislation that is more restrictive than that currently in force, without indicating which regime prevails on each side.<sup>45</sup>

The provisions of this section apply to the four modes of service provision: (a) from the territory of one party to the territory of the other; (b) in the territory of one party to a consumer of services in the other; (c) by a service provider of one party through commercial presence in the territory of the other; (d) by a service provider of one party through the presence of individuals in the territory of the other.

The agreement makes no provision for liberalization that goes further than that prevailing in the parties' national legislation at the time of the agreement's entry into force. In this regard the EUMFTA indicates that three years after its entry into force or (through a decision of the Joint Council) one year after the conclusion of the current WTO negotiations on services, the two sides will exchange lists of commitments, including the possibility of negotiating a further opening of the sector. Because of the delay in the Doha Round, these lists have still not been exchanged.

Finally, the section on financial services makes provision for disciplines in the area of access to banking services, insurance and insurance-related services, as well as other financial services. In this field, Mexico and the EU guarantee that no country will adopt legislation that is more restrictive than that which is currently in force. Additionally, and in contrast to the rest of the chapter on services, this section does include a list of activities that are excluded from the general commitments. In practice, in the field of financial services, Mexico gave its European partners the same level of opening as it has conceded to its NAFTA partners.

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<sup>45</sup> In the event of a dispute, it would have to be determined within the framework of the EUMFTA which relevant legal provisions were in effect in July 2000. By contrast, in agreements that involve a reserve list, the task is confined to verifying if the activities in dispute are part of the agreed list of exceptions.

### *Main Reasons for the Outcome of the Negotiations on Services and Investment*

The negotiations for the EUMFTA were the first free trade discussions in which the EU had engaged that included services and investment. That circumstance gave rise to two factors that might explain Europe's defensive position in the definition of specific commitments in these areas. The first concerns the division of authorities between the member states and the European Commission; the second concerns strategic considerations related to negotiations other than those with Mexico.

As mentioned earlier, of the 11 issues covered by the EUMFTA, eight are of Community competence and three (trade in services, investment and related payments, and intellectual property) fall under the competence of the member states. A possible explanation of the EU's position in the discussions with Mexico, mainly on the investment chapter, lies in the fact that the EU member countries are not yet willing to set a precedent that the European Commission (which is responsible for the EUMFTA negotiations) should assume responsibility for negotiating an issue that falls under the competence of the member states.

A second reason for Europe's cautious position concerns the rules on services, specifically sectoral coverage. Europe's refusal to establish lists of the sectors and economic activities that are excluded from the commitments on services and investment (reserve lists) might be explained by the fact that the EU has no precedent for these kind of reserves in a bilateral agreement. The problem, aside from being technical (it is a complex matter to identify and codify the prevailing legal provisions) seems to be strategic.

If the EU were to specify in an international agreement the economic activities that the union is unwilling to include in a trade accord, this would provide evidence of its sensitivities for future negotiations on other fronts. Since the negotiations on services are pending in the Doha Round of the WTO, drawing up reserve lists with Mexico would reveal Europe's cards in the talks on this matter in Geneva.

These are two of the main reasons why Europe's position changed: from being the *demandeur* before the start of discussions on the services and investment chapters to a more defensive position, in which it settled for "modest" disciplines compared to other, more recent trade agreements.

### *Other Chapters of the Agreement*

The agreement's chapter on dispute settlement is particularly important. This is an instrument through which the two sides guarantee compliance with the provisions stipulated throughout the accord. In the EUMFTA, Mexico and the EU agreed to a flexible dispute settlement procedure that offers certainty to both sides on the basis of equity, legal security, and neutrality. The agreement makes provision for a conflict resolution mechanism that seeks to prevent or settle disputes arising from the interpretation or application of the agreement's provisions, or when one of the partners judges that a prevailing measure is incompatible with the provisions of the EUMFTA.

The procedure is in two stages. The first, non-litigious, consists of consultations in the Joint Committee, the institution responsible for administering and supervising the agreement. The



second consists of the establishment of an arbitration group to determine if there is a violation of the EUMFTA's provisions. There are clear rules for the establishment of the panels: the procedure for choosing the judges; the timeframes for consultations in the Joint Committee and for the arbitration group to submit its reports; the procedures for complying with the ruling of the arbitration panel; and procedures for suspending benefits in the event of non-compliance with the panel's decision.

The mechanism is similar to that used in other free trade agreements that Mexico has signed. For the EU, however, this is the first bilateral trade agreements in which the Union has accepted a mechanism with short timeframes and in which benefits are suspended if the party against which a complaint has been lodged does not comply with the arbitration panel's ruling.

The EUMFTA establishes disciplines in 11 areas, as follows:<sup>46</sup>

1. market access;
2. rules of origin;
3. sanitary and phytosanitary measures;
4. measures related to standardization;
5. safeguards;
6. government procurement;
7. competition;
8. trade in services;
9. investment and related payments;
10. intellectual property; and
11. dispute settlement.

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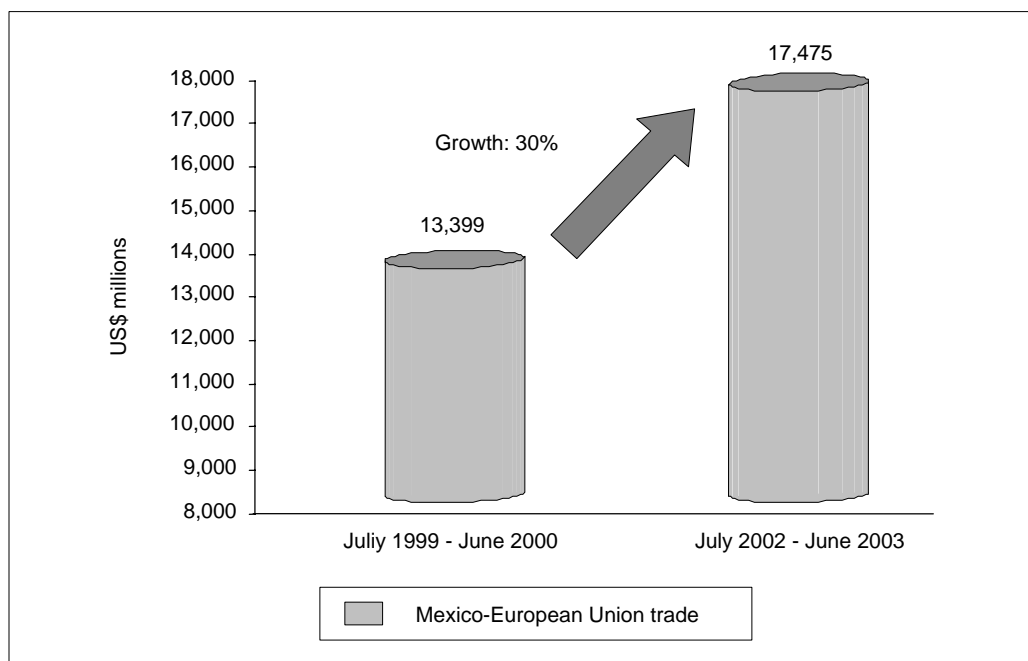
<sup>46</sup> A detailed description of each of these disciplines is provided by Zabludovsky [2000].

#### IV. OUTCOME OF THE FREE TRADE AGREEMENT BETWEEN MEXICO AND THE EUROPEAN UNION

Three and a half years after the agreement entered into force, bilateral trade has increased by 27%.<sup>47</sup> European exports to Mexico have risen by 30%, while Mexican sales in Europe have grown by 19%.<sup>48</sup> In the same period, Mexico's exports to the world rose by 18%.

The reasons for the relatively low growth rate of Mexican exports could include the fact that in the early months following the agreement's entry into force, the euro was relatively weak relative to the dollar, while the peso was relatively strong; that Mexican exporters were unfamiliar with the European market; and that many of the export decisions made by multinational enterprises established in Mexico are taken in the companies' headquarters, irrespective of the comparative advantages of their plants' different locations.

FIGURE 5  
EUMFTA: GROWTH OF BILATERAL TRADE



Source: Secretariat of the Economy, using Banxico data.

As regards the liberalization of the Mexican market, the agreement has met its goal. First, it has allowed those companies established in Mexico that use European inputs to successfully face the

<sup>47</sup> Since the agreement entered into force on July 1, 2000, the reference for its performance in the first three years of its life is the period July 1999-June 2000, relative to the period July 2002-June 2003. Figures on imports from each of the parties are used (Banxico for Mexican imports from the EU, and Eurostat for EU imports from Mexico).

<sup>48</sup> An average monthly parity of the euro relative to the dollar is used to determine the value of European imports from Mexico.

entry into force of NAFTA's Article 303. If no agreement had been signed, the change to the *maquila* regime would certainly have had a negative impact on those firms' competitiveness.

Additionally, the EUMFTA has allowed Mexico to consolidate its process of trade opening. Although it is always hard to make counterfactual arguments, there is enough evidence to suggest that if no agreement had been signed, trade with Europe would not have been liberalized<sup>49</sup> and that, at least for some products, Mexico's level of trade protection would have risen. Between 1993 and 2000, the average MNF tariff applied to Mexico's non-agricultural imports rose from 13.3% to 16.5%.

The EUMFTA has also served as a tool to promote the liberalization of the Mexican economy for trade partners other than the EU, particularly Japan and the members of EFTA. To avoid discrimination against their exporters and investors, relative to those from the EU, the EFTA members have sought to negotiate free trade agreements with all those countries with which the European Community has concluded accords. In that context, Mexico and EFTA concluded a free trade agreement on July 1, 2001.

As regards Japan, the latter's interest in signing an agreement with Mexico should come as no surprise, since US and European exporters and investors enjoyed preferential conditions in the Mexican market. Just as NAFTA was an incentive for Europe to negotiate with Mexico, the EUMFTA has given Japan a strong motivation to change the terms of its trading relationship with the country, thereby helping to further the opening of the Mexican economy.<sup>50</sup>

As well as helping to foster the liberalization of Mexico's economy, the agreement has had a strategic value from at least two viewpoints. The first is its contribution to the strengthening of Mexico's negotiating position in the WTO. Together, NAFTA, the agreement with Europe and the other 11<sup>51</sup> free trade accords that Mexico has concluded in the last decade cover the bulk of trade with 34 countries that account for half of world trade,<sup>52</sup> among which are the most important partners on the international trade scene.

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<sup>49</sup> As mentioned in Chapter II, in the section "European Reasons", on the eve of the first negotiating session the Mexican delegation had to deal with its counterparts' irritation at the generalized rise in tariffs for tax purposes in December 1998.

<sup>50</sup> The Agreement to Strengthen the Economic Association between United States of Mexico and Japan was signed on September 17, 2004.

<sup>51</sup> Chile (1992); United States and Canada (NAFTA, 1994); Colombia and Venezuela (G3, 1995); Bolivia (1995); Costa Rica (1995); Nicaragua (1998); EU (15 countries, July 2000); Israel (July 2000); Switzerland, Norway, Iceland and Liechtenstein (EFTA, 2001); Guatemala, Honduras and El Salvador (Northern Triangle, 2001); and Uruguay (2003).

<sup>52</sup> Total world trade amounted to US\$ 10.1 trillion in 2002, of which about US\$ 5 trillion was accounted for by the trade of those countries with which Mexico has free trade agreements (WTO [2003]).

**TABLE 2**  
**MEXICO: FREE TRADE PARTNER WITH THE WORLD'S LEADING ECONOMIES**  
 Total goods trade

Rank	Country or group	Value*	Share
1	<b>United States</b>	\$ 1,896.0	18.8%
2	<b>European Union</b>	\$ 1,870.0	18.5%
3	<b>Japan</b>	\$ 752.4	7.4%
4	China	\$ 620.8	6.1%
5	<b>Canada</b>	\$ 480.1	4.8%
6	Hong Kong	\$ 408.6	4.0%
7	<b>Mexico</b>	\$ 337.3	3.3%
8	<b>New EU members</b>	\$ 335.5	3.3%
9	South Korea	\$ 314.6	3.1%
10	<b>EFTA**</b>	\$ 270.5	2.7%

Note: \* Billions of dollars, 2002.

\*\* European Free Trade Association, comprising Switzerland, Norway, Iceland and Liechtenstein.

Source: WTO.

The second strategic consideration is related to the EU enlargement process. The accession of 10 new countries to the European economic area means that Mexican exporters have an additional market of 74 million people with a combined GDP of more than \$400 billion.

Finally, the agreement between Mexico and the EU has had a positive effect on Europe's relations with other Latin American countries. Shortly after the conclusion of the negotiations with Mexico, Chile was able to sign a similar agreement and, although beset by difficulties in the agricultural sector, Europe and MERCOSUR have embarked on trade talks. It would have been difficult for these initiatives to prosper had there not been an agreement with Mexico. In fact, Chile and MERCOSUR probably would not have been able to move further than the provisions of the framework agreements that they signed at the Madrid Summit in December 1995.

In addition to the favorable precedent that the EUMFTA represents for the prospect of new trade negotiations between the EU and Latin American countries, the agreement could also be a means of furthering negotiating processes that are currently stalled. In particular, the Central American countries have expressed their interest in negotiating a trade accord with the EU. One route to free trade between those countries and Europe could be the agreement between Mexico and the EU, by means of Central America's accession to the EUMFTA. A second and less ambitious option is to explore the possibility of using diagonal accumulation<sup>53</sup> to allow the inclusion of Central American inputs in Mexico's preferential exports to the EU. The same could apply to the Andean countries. These, because of their geographic proximity to Chile and the attendant economic integration,

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<sup>53</sup> Diagonal accumulation is a concept used by the EU in various trade agreements. It allows some of its partners in free trade agreements to use inputs from third countries as if they originated in the partners' territory, as long as the country providing the input adopts the rules of origin of the free trade agreement.

could use the agreement between Chile and EU to secure access to the European market, either by acceding to the EU-Chile agreement or through diagonal accumulation.

In the area of cooperation, although the agreement is very ambitious, the results to date have been unsatisfactory. With the benefit of several years of hindsight, one can speculate as to whether the approach adopted in the Global Agreement was suitable. The enumeration of some 30 areas for the agenda of joint collaboration was probably too ambitious. Perhaps it would have been preferable to concentrate on a couple of issues and to do so in greater depth. To move forward in all the areas covered by the Global Agreement is probably unrealistic, and surpasses the European Commission's resources and capacity.

Four years after the Global Agreement's entry into force, it is clear that, for Mexico, the negotiations represented the exploitation of a window of opportunity to continue the process of economic reform begun in the mid-1980s; to gain preferential access to the European market; to establish a new institutional framework for deepening diplomatic relations with the EU; and to seek new channels for bilateral cooperation.

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