

**POSITION PAPER
TRADE SUSTAINABILITY IMPACT ASSESSMENT (SIA)
OF THE ASSOCIATION AGREEMENT UNDER NEGOTIATION BETWEEN THE
EUROPEAN UNION AND MERCOSUR**

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1. Introduction

This paper provides the reaction of Commission Services to the Trade Sustainability Impact Assessment (SIA) of the Association Agreement under negotiation between the EU and Mercosur. This study was carried out by a consortium of independent consultants led by the Institute for Development Policy and Management of the University of Manchester.

The SIA was finalised in March 2009 in advance of the completion of the negotiations. It consists of an overview report and of five sectoral studies on agriculture, forestry, automobiles, financial services and trade facilitation.

The views expressed in this report are those of the consultants.

The report can be downloaded on the Commission's and on the consultant's websites:

- http://ec.europa.eu/trade/issues/global/sia/studies_geo.htm#mercosur
- <http://www.sia-trade.org/mercosur/index.shtml>

2. Objectives of the SIA

The European Commission has been engaged in conducting Trade SIAs as part of its trade policy-making process since 1999. The purpose of the Trade SIA programme is to inform trade negotiators and other interested parties on the potential economic, social and environmental impacts of the EU's trade negotiations, both in the EU as well as in EU's trading partners.

The European Commission has defined the objective of its SIA studies as a means of integrating sustainability into European trade policy:

- by analysing the issues of a trade negotiation with respect to sustainable development;
- by informing negotiators of the possible social, environmental, and economic consequences of a trade agreement as a basis for defining the respective negotiating positions;
- by providing guidelines to help in the design of possible preventive, mitigation and enhancement measures, the sphere of activity of which can exceed the commercial field (internal policy, capacity building, international regulation), and which makes it possible to maximise the positive impact and to reduce the negative impact of the trade negotiations in question.

The final Trade SIA report is available publicly and the process leading up to it included extensive consultation both in the EU and in the partner region. The public availability of this

report means it can also serve as an orientation tool for Mercosur negotiators, as well as being accessible to stakeholders and civil society in both regions.

3. Summary of the impacts identified by the consultants and Commission views on them

Methodology:

The methodological framework for Trade SIA is described in the EC's Handbook for Trade Sustainability Impact Assessment¹. The methodology for a Trade SIA is generally based on a four-step approach². At the very beginning of the exercise, a screening process identifies the sectors and issues that are relevant in the context of the ongoing trade negotiations. The sectors and issues are selected by applying a core group of quantitative and qualitative indicators with social, environmental, and economic components. In a second stage, the terms of reference are determined by deciding what appraisal methods and consultations procedures should be used. Then the potential impacts of each measure and of the agreement as a whole are assessed. In the fourth stage, flanking measures are identified that could mitigate any negative impacts or enhance any positive impacts on sustainable development as a result of the foreseen trade liberalisation.

The scenario used in this SIA is that of full liberalization of trade between the EU and Mercosur, covering tariffs as well as non-tariff barriers. Even if it is unlikely that such a scenario will be the outcome of the negotiations, it was considered that it would provide some useful elements about the potential benefits of an ambitious agreement. This element should be taken into account when discussing the potential effects of an EU-Mercosur FTA, as described in this SIA

Given that this SIA was started in 2005, one must take into account the fact that the consultants had no means to foresee the unfolding of the global financial crisis and the consequences it could have on the economic context in which an EU-Mercosur agreement is to be negotiated. Nevertheless, an attempt was made in the SIA by the consultants to outline the potential effects of the global economic crisis on the EU-Mercosur agreement.

Economic

Overall, the economic impact of an FTA is estimated to be positive both for the EU and for Mercosur countries. Given that the Mercosur region is economically much smaller than the European Union, this naturally implies that the relative effects on real income for Mercosur are expected to be larger.

In the EU, the manufacturing and services sectors are predicted to benefit most from an FTA, while there would be important adjustment costs for agriculture, particularly on the short term which would require suitable transition periods and mitigations measures. However it should also be taken into account that the EU could reap some benefits from better market access to Mercosur for some vegetable products via an FTA, as well as from a better protection of Geographical Indications. In Mercosur, the economic benefits of an FTA are expected to be felt throughout the whole economy and especially in the agricultural sector. Economic gains

¹ http://trade.ec.europa.eu/doclib/docs/2006/march/tradoc_127974.pdf

² As described in the EC Position paper on the trade SIA of the negotiations of a Partnership and Cooperation Agreement between the EU and China.

are expected to increase over time in Mercosur as the increased exposure to competition is predicted to induce efficiency and productivity gains. Gains from science-driven innovation may even be higher than directly trade-related benefits. The increased exposure to competition of the manufacturing and the services sector could however generate some adjustment costs in the short term unless they are appropriately addressed by mitigation measures.

Social

In the EU the only sector where social impact would be felt is agriculture and rural areas where short to medium term social adjustment costs could occur during a transition period and could add to the underlying downward trend in baseline agricultural sector employment in the EU. This adjustment process could be mitigated by appropriate support programmes or other policy measures

In Mercosur, the social impacts are expected to be positive over the long term while some adjustment costs on the short term could occur in the manufacturing sector. The Commission services however do not agree with the opinion of the consultants that the EU–Mercosur agreement could generate some potentially adverse social effects in the form of non-adherence to decent work standards in some parts of the agricultural economy in Mercosur. It is not to be contested that such problems may currently exist but the negative impact associated with further development for the agricultural sector in Mercosur is contestable. One could just as well assume that the new opportunities for this sector generated by an agreement with the EU could give additional margins to enhance social standards.

The SIA also stresses that the expansion of agriculture in Mercosur, which follows an internal trend in this region, could cause social problems to the "traditional agriculture". Transitional adverse effects could impact on employment, and result in "loss of livelihoods for indigenous people". It is also mentioned that small scale farmers could be the losers of that process, including women.

The full liberalisation of the agricultural sector and the likely expansion of this sector in Mercosur, consecutive to a possible Association Agreement, have to be seen as a contributing factor to this tendency and the EU services agree that careful consideration should be given to this issue.

Environmental

Both positive and negative environmental impacts in the EU and Mercosur countries could arise depending on the policy measures that are taken to accompany the Agreement. These are not expected to be very significant in the context of the EU's regime and depending on the mitigating measures that are taken. Increased imports of raw materials could potentially induce land abandonment in the EU.

In Mercosur, full trade liberalisation in the agriculture and the forest sector could result in added pressure and potentially significant adverse impacts on natural resources, forest coverage and biodiversity, which would require adequate measures.

On the positive side, Mercosur is expected to benefit from an increased access to environmental services.

4. Discussion and Views of the Commission services on the Trade SIAs Findings and Policy Recommendations

Introduction

The Consultants makes various recommendations, some of a general nature, especially in the field of environment and social standards, and some of a more sectoral one. On a general note, the Commission services agree with the importance of ensuring that the FTA is negotiated and subsequently implemented in such a way as to integrate the concept of sustainable development. Thus, the opinion of the Commission services is that sustainable development should be considered one of the FTA's overarching objectives, to be reflected both in a specific Trade & Sustainable Development chapter as well as in other parts and chapters of the trade pillar of the agreement (e.g. market access for environmental goods and services, investment, trade facilitation) and indeed also in the political and cooperation pillars of the Association Agreement.

In addition it should be noted that the potential benefits for both partners could be further enhanced by stepping up collaborative research and efforts in innovation and technology transfer in relevant areas for sustainable development. Collaborative research may be helpful in strengthening the evidence base for planning, decision making and implementation of both parties.

Sustainable Development Chapter

Against the background of its general approach in FTA negotiations, the Commission services agree with the recommendations to include a Sustainable Development Chapter in the Trade pillar of the Association Agreement. In this chapter, EU and Mercosur could among other things commit to implement core ILO labour standards and fundamental conventions, as well as multilateral environmental agreements to which they are parties, and to establish an EU-Mercosur forum to monitor the social and environmental impacts of the EU-Mercosur FTA.

The Chapter should set out the strategic objectives of promoting sustainable development elements while also recognising each party's right to regulate and set its own sustainable development priorities.

It could also include new and more specific provisions, for instance in relation to trade in natural resources such as forests, fish, mining products etc.

The Commission services believe that a Trade and Sustainable Development chapter would offer an opportunity to underline the value of multilateral labour and environmental agreements and reaffirm in a bi-regional context the commitments taken therein.

Regarding the monitoring mechanism, it should aim to review shared commitments to trade and sustainable development and have strong transparency provisions. While the exact modalities and institutional settings are still to be discussed, the establishment of impartial and transparent mechanisms is important. The suggestion to foresee a bi-regional forum appears as a positive element.

Support for Regulatory policy Capacity Building

In the Cooperation pillar of the Association Agreement, the Consultants suggest that EU-Mercosur cooperation should in particular focus on support for regulatory policy capacity building in Mercosur and support for capacity building in regulatory and public policy analysis and design. In this context the Commission services would like to underline that the choice of focal and non focal sectors for cooperation and of priority activities is a joint

exercise to be carried out by the EC and Mercosur member States, represented by the Presidency. The existing Regional Strategy Paper (RSP) 2007 – 2013 and its annex Regional Indicative Programme (RIP) for 2007 – 2010³ include as focal sectors the "support for Mercosur institutionalisation" and "support for the deepening of Mercosur and the implementation of the future EU Mercosur Association Agreement". This regional strategy paper is currently the object of a Mid-term review exercise to be jointly carried out by the EU and Mercosur authorities during the first semester of 2010.

Environmental Regulation

In the Domestic Policy Pillar the Consultants note the need for Mercosur countries to strengthen their environmental regulation in order to offset adverse impacts of forest conversion and expansion in agricultural production, while exploiting potential gains. The Commission services fully support these objectives and recall that the results of the Trade SIA are available to Mercosur policy makers which have the responsibility for the strengthening of their national and regional legislations in this area.

Sectoral and Horizontal Studies

Agriculture and Forests

In the EU, the Consultants recommend to establish a timetable for phased reduction in tariff to allow for an orderly adjustment period. The Commission services note that the standard procedure for negotiating tariff liberalisation is for both partners to prepare tariff offers in accordance with agreed modalities. These modalities should set the general framework for the discussion, ensuring the WTO compliance of the future agreement and streamlining further discussion on the sequence of market access liberalisation of traded goods. During the negotiations, both partners, taking account of the findings and recommendations of the SIA, may identify some sensitive products for which a more extended market protection would apply. The exact extent of this market protection (products concerned, length of transition periods) will be one of the key elements of the discussions in the negotiating process.

Similarly, the Consultants suggest that the timing of reductions in tariffs and opening of tariff quotas for environmentally/biodiversity sensitive products should be conditional on compliance with a set of sustainability criteria.

The Commission services agree on the need to address the potentially significant impacts of trade liberalisation of environmentally sensitive goods and will discuss these issues with Mercosur countries. Negotiators should take into account that in some areas appropriate policy frameworks are being put in place. The Commission services recall that for biofuels for example, the EU Renewable Energy Directive (RED) 2009/28/EC lays down comprehensive sustainability criteria for the production of bioliquids, as well as a review clause: in order to benefit from financial support and to be counted towards Member States' target of renewable energy in transport, all biofuels used in the EU, both domestic and imported biofuels, will need to comply with the mandatory sustainability criteria in the Renewable Energy Directive.

In their comments on recommended domestic measures, the Consultants also advise to strengthen environmental regulation in Mercosur countries to offset adverse impacts of forest conversion and expansion in agricultural conversion. The Commission services recall that the results of this Trade SIA are also available to Mercosur national authorities who have the direct responsibility to implement these measures. With respect to biofuels, it is worth

³ http://ec.europa.eu/external_relations/mercotur/rsp/07_13_en.pdf

recalling that the issue of land conversion will be covered by the certification scheme that the RED has put in place.

On *Forestry*, a sector which was also covered by a specific sector study, the Consultants estimate that technical assistance measures and cooperation in order to strengthen institutions, the legislative framework and enforcement in relation to environmental protection and safeguarding areas of natural forest should be implemented. The Commission services agree with these recommendations but recall that the preservation of forestry resources is also a prime responsibility of each Mercosur country itself, also taking account of obligations under Multilateral Environment Agreements to which they are Parties. Mutually beneficial technical assistance in this sector where the EU has a significant experience, including through its FLEGT Programme, is certainly to be promoted.

Manufacturing

As with agriculture in the EU, the Consultants note the importance of setting appropriate transition periods for the sectors in Mercosur where adjustment costs could occur: motor vehicles and parts, transport equipment, textiles and clothing, and machinery. For the Commission services the reasoning applied for agricultural products is valid here: both sides will have the possibility in the course of the negotiations to identify some sensitive products for which more extended forms of market protection could apply, as long as it is compatible with WTO requirements and in line with the negotiations modalities that would be agreed beforehand.

Regarding the specific recommendation by the Consultants to strengthen systems to help Mercosur exporters to comply with REACH requirements, the Commission services would like to stress that interested parties from industry from third countries were allowed to provide their input from the early stages of the legislative process establishing REACH, and that the European Chemicals Agency (ECHA) already offers numerous support activities to industry from third countries through its help-desk. Potential concerns of Mercosur exporters might therefore better be addressed via existing general mechanisms rather than by setting up a new Mercosur specific advisory system.

For the *automotive sector* (also covered by a specific sector study), the Commission services endorse the conclusion of the Consultants that the economic impacts of liberalisation would be positive both for the EU and for Mercosur. The Consultants also recommend the establishment of an EU-Mercosur Automotive Sector forum with the aim of strengthening public-private cooperation and the production of a detailed impact assessment of the impact on the international competitiveness of the automotive sector in both regions of replacing of regional level regulations by international automobile technical standards (UN-ECE). While the exact modalities and institutional settings of the forum and the exact scope of the study would first need to be examined in details, the Commission services support these proposed measures and note the importance of standards and technical regulations to avoid non tariff barriers to trade in this sector.

The Consultants also recommend developing EU-Mercosur cooperation on the development of measures to reduce particulate and CO₂ emissions from automobiles focusing particularly on technology development. The Commission services stress the important role already played by EU legislation in this sector and acknowledge the necessity to promote cooperation in this sector.

Services

As with agriculture and manufacturing, the Consultants recommend a phased liberalisation of some financial, retailing and distribution services sectors in Mercosur, to allow for an orderly adjustment period. The Commission fully supports the conclusion of the consultants that liberalisation in services would bring significant economic benefits to both partners and that, in the case of Mercosur, it could in particular offer large potential benefits through dynamic effects on overall economic performance and generate significant gains in terms of sustainable development and poverty reduction.

Concerning the need for transition periods in some sectors, the Commission services recall that finding appropriate solutions to such needs, taking account of the findings and recommendations of the SIA, will be an integral part of the negotiations with each Mercosur country.

For *financial services* (also covered by a specific sector study), the Consultants make the following recommendations:

- Technical support and training for the development of improved systems for evaluating the suitability of collateral offered by SMEs
- Joint EU-Mercosur development of guidance on implementation of the Basel principles
- Implementation of the European Commission's Economic and Financial Committee (EFC) recommendations for strengthening international and cross-sector co-operation, particularly in monitoring cross-border financial institutions in the context of EU Mercosur cross border cooperation.
- Fuller implementation in both Mercosur and the EU of the Basel Core Principles for Effective Banking Supervision, and implementation of any revisions to the Basel Principles that may be agreed in response to the current global crisis.

The Commission services agree with the Consultants' findings that financial services liberalisation could bring significant economic benefits to both region and could generate a long term contribution to reducing poverty in Mercosur. They also agree with the need for effective regulatory mechanisms to avoid risks of financial instability and points out to the efforts currently undertaken in this direction by the EU and in Mercosur both internally and via their participation in international fora and organisations.

The value of international governance and agreements as a response of the international community to tackle financial instability, in particular following the global crisis is also to be recognised. The EU-Mercosur agreement could also offer an opportunity to underline the value of internationally agreed standards and reaffirm the commitments taken.

However, the Commission services also regret that the recommendations made by the consultants for this sector seem to reflect rather general considerations and situations and are not more adapted to the specific situation of each Party and of their bilateral relations.

In particular it is clear that while the economic crisis has shown the need for better financial regulation, one should keep in mind that this should best be done at the multilateral level and that an EU-Mercosur agreement is not the appropriate framework for this. This is notably so because, as the consultants rightly point out, regulatory aspects such as the prudential regulation of financial services is clearly outside the scope of the EU Mercosur Association Agreement. The recommendation by the Consultants of a Joint EU-Mercosur development of

guidance on implementation of the Basel principles appears therefore not as the most opportune solution and any consideration of possible actions on such an issue in the context of the agreement should be kept within the framework of the bodies foreseen for the implementation of the agreement.

Environmental Services

The Commission services agree with the Consultants' finding that further liberalisation in the sector of environmental services would bring environmental benefits. It is also to be noticed that significant commitments taken by both partners in the framework of the EU-Mercosur Association Agreement would help fulfilling the Consultants' recommendation to promote trade in environmental goods and services.

Rule based measures: investment, public procurement, trade facilitation

Investment

Regarding investment, the Commission services share the Consultants views that an agreement on investment would bring economic benefits to the EU and Mercosur in terms of economic growth and employment. At the same time, while it is recognized that increased foreign investment could contribute positively to environmental quality by introducing improved environmental control technology, it should also be noted that in certain sectors (e.g. extractive industries, forestry) it may put additional pressure on the natural resource stock capital in Mercosur countries.

Public procurement

The Commission services agree that an agreement on greater transparency in Mercosur governments' procurement procedures may generate gains from increased competition for government contracts and that further economic efficiency gains might be expected to result from the improvement in the quality of public sector governance. However, it is also the Commission services' opinion that an ambitious agreement on public procurement that would not only focus on greater transparency but would also further liberalise access to some public procurements would bring even bigger long term beneficial effects to Mercosur countries on employment and business.

Trade facilitation

In terms of trade facilitation, the Consultants note the importance of this element to develop trade relations between the EU and Mercosur and stress that the static efficiency effects over the long term could be extremely important. They recommend agreeing on a programme of trade facilitation measures including the following ones:

- establish a joint Customs and Trade Facilitation committee
- de facto harmonisation of customs procedures through adoption of international standards.
- extend the use of risk management techniques
- provide up-to-date information on all trade and customs procedures from a single source

Regarding the recommendation to set-up a joint Customs and Trade Facilitation Committee, the Commission services note that EU Joint Committees already existing with each Mercosur countries already offer fora of discussion for trade facilitation issues, but any proposal aiming at efficiently reinforcing the EU-Mercosur cooperation in this sector should be welcome.

In principle, the Commission services agree with all efforts that could result in significant improvement for trade operators, in particular in terms of international harmonisation. One could however regret that the recommendations made by the Consultants are mostly of a general nature and do not focus enough on specific measures in different sectors in the specific context of EU- Mercosur FTA.

5. Conclusion

The SIA study suggests that an EU-Mercosur agreement would bring significant benefits for both the EU and Mercosur. However, the study also highlights a number of concerns, for instance in relation to the agreement's potentially significant adverse impacts on the environment. The Commission services share many of these views including with respect to the need for avoiding such adverse effects. They note that while beneficial impacts could be expected in many different fields, only a balanced and ambitious agreement which takes duly into account economic, social and environmental impacts and provides a basis for appropriate preventive, mitigation and enhancement measures, has the potential to bring maximum benefits to both partners and be conducive to sustainable development.