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A GLANCE OF THE FREE TRADE AGREEMENT BETWEEN MEXICO AND THE EUROPEAN UNION

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Mexico has had a notable trade performance in the last years as result of a process of economic liberalisation and internal structural reforms that started in the mid-1980s and consolidated in the 1990s by establishing a network of Free Trade Agreements. The Free Trade Agreement (FTA) between the European Union (EU) and Mexico is a consequence of many advantages for all the involved countries among others: to open up a bigger markets, same legal footing as their competitors and new potential investments. The liberalisation is phased until 2007. Mexico has had a big jump in exports through NAFTA, and nowadays has a preferential access to the world's largest market, the EU. In addition, Mexico offers better conditions for investment because the labour and the private sector during the past 9 years (since NAFTA) have learned to compete efficiently against the American and Canadian firms. Actually, the free trades agreements have enabled to obtain gains from globalisation and market diversification through regional and bilateral negotiations being a powerful instrument for Mexico's economic growth and development. In conclusion, the new FTA instead of dispiriting the distribution of income will promote (in the long-term) equality for the Mexicans, because of the productivity and the access to new opportunities. On the other hand, the EU has an excellent chance to be closer to the USA and take advantages of one of the most important emerging markets in the world with a high potential of growth.

Introduction

Since 1985 Mexico began a huge and ambitious process of economic transformation. The steps which have followed are focused on international competitiveness, optimal allocation of resources and most importantly, on governmental modernisation. Towards the end of the 70's there were deep changes in the markets, caused by communications dynamics and new information technologies, which called to a process of Globalisation. This event demanded to pose a new organisation of the economy to put the country again in the way of growth built under a solid base.

The structural reform of the Mexican Economy has been based on the commercial liberalisation and promoting the investments through more flexible laws. Likewise, the sold of non priorities companies, the control of the Government size, redefining the new role of the State in the Economical and Social fields, the fomentation of entrepreneurs and keeping a stable economic atmosphere based on the fiscal and monetary discipline have allowed a better expectations of Mexico.

In particular, the opening of the economy to the world has contributed to the country's growth as well as a gradual and crescent integration of the productive chains with the result of more productivity. The modernisation of the productive systems and the international standards of quality adopted have permitted a bigger participation of Mexico in the world markets.

This economic liberalisation has been completed with an increasing participation of Mexico in several International Organisations and because of an aggressive commercial strategy that have pushed to expand the country with the most important economic regions of the world. In first plane: North America and after the European Union. Nowadays, Mexico has 11 Free Trade Agreements with 32 countries in the world in 3 continents with 860 millions of potential consumers and are in process 3 more with Argentina, Japan and Brazil.

Among the most important steps that Mexico has followed on this process of liberalisation has been the adoption of new technologies, taking advantage, in this way of its developed trade partners. In the structure of the trades the developed countries have made special emphasis in the negotiation of property rights because Mexico had had problems in the safeguard and vigilance this issue through its history. However, in the last years has shown a significant advance against this big problem.

On the side of the EU, we know that the integration and expansion of the number of State Members have delivered half a century of stability, peace and economic prosperity. It has helped to raise standards of living, built an internal market, launched the euro and strengthened the Union's voice in the world(1); as well as they rule in the basis of law and democracy. It is neither a new State replacing existing ones nor is it comparable to other international organisations. Its Member States delegate sovereignty to common institutions representing the interests of the Union as a whole on questions of joint interest. All decisions and procedures are derived from the basic treaties ratified by the Member States(2) giving this policy outstanding growth and steadiness.

The Free Trade Agreement between the European Union and Mexico

The President of Mexico, Dr. Ernesto Zedillo and his European colleagues, signed the historic Free Trade Agreement with the European Union at Lisbon on March 24th, 2000 resulting as the first FTA signed by the EU as a whole with any other country in the world.
The European Union and Mexico's FTA was phased in between July 2000 and 2007. By that time, all existing trade barriers will have been removed with the exception of the agricultural sector, which will have tariff-free import and export benefits to a limit of 62 percent.
On July 2000, the agreement eliminated tariffs on 82 percent of Mexican goods entering Europe and the remaining 18 percent by the 1st of January of this year. On the other hand, tariffs on 71 percent of European products exported to Mexico will end by 2007. In other words, the agreement has an ambitious schedule to reduce tariffs, since this year, all European industrial goods will have a maximum tariff of 5% and by January 1st, 2007, will be nothing. Nowadays, Mexico and the EU are in negotiations to accelerate the process of liberalisation after proof that there not exist important impacts in the protected sectors of their economies.

European Perspective

There are several reasonable thoughts why the European Union was interested on this Agreement with Mexico.
It's very attractive for its State members to open up a market of 100 million people and give to the European investors the same legal footing as their U.S. and Canadian competitors. Furthermore, it is of great importance for the EU to strengthen economic relations with Latin America, which, with abundant raw materials and labour, is regarded as one of the potential growth centres of the world economy in the 21st century. In particular, Mexico expects to achieve significant growth in the future, based upon economic infrastructure consolidated through structural reforms over more than 15 years.
Others advantages are that Mexico has a great importance as a production and export centre in the Americas, owning to its domestic market and its network of Free Trade Agreements.
In addition, Mexico and Europe have been building friendly relations in both the historical and social aspects. There are no political barriers between the two, and the atmosphere toward Europe is generally friendly in Mexico. It has been and especially important element for successful negotiations that both parties expressed willingness to continue and accelerate the process of liberatisation of their products, as well as the increment of their trade and investment between them.
Therefore, Europe promote the FTA with Mexico since its benefits appear to outweigh its damages or costs.

Mexican Perspective

While economic and population growth in Mexico, there have been created new export opportunities, trade agreements have also been a determinant factor. Mexico's trade

policy has been beneficial in the deep transformation of its economy by attracting investment, consolidating a manufacturing export base and diversifying exports markets trying with this, to have less dependency from the US market.
Likewise, these trades have enabled Mexico to obtain gains from globalisation and market diversification through regional and bilateral negotiations being a powerful instrument for Mexico's economic growth and development.
In particular, Mexican exporters have access to 379.2(3) million consumers in the Euro-zone, which has an annual gross domestic product of US$8.5 trillion, opening the way for greater European investment and technology.
In addition, between the 25 most important countries for Mexico in trade and investments 10 are from the European Union, leading Germany.
The most important agreement historically signed by Mexico is the North American Free Trade Agreement (NAFTA) among the United States, Canada and Mexico and which one has inevitably altered the Economy of Mexico throughout the last 9 years.

Mexico in its Way to Modernisation

Mexico based on its agreements is looking for the technological change among other things. The technological changes often bring the capability of using fewer inputs to produce a good (for example, the introduction of the personal computer reduced the hours necessary to type and edit a manuscript) or lower input prices (technological improvements in transistors have led to price reductions in the transistor component of calculators). In either case, technological changes of this variety lower variable costs, and consequently, lower average variable cost, average total cost, and marginal cost.
Technological advances usually come as a result of companies, and a country, investing in Research & Development and Mexico is still far away from this. Less than 1% of the GDP is invested in R&D and it would be reached only with physical capital and human capital. The property rights play a crucial game in the R&D, because with a range of laws, rules, and regulations that define rights for the use and transfer of resources, the individuals will invest more, because these property rights structure allow them to keep more of the fruits of their investing, risk taking, and labour.
Although economic development depends on technology, among other things, many of the less developed countries like Mexico do not simply adopt the technology of developed countries. It does not necessarily follow that everyone is going to use advanced technology just because it exists. First, not everyone may know how to use it. Education may have come first. Second, even if the knowledge of how to use the technology exists, it may not be used because people are too poor to afford it.
Finally, even if the knowledge of how to use the technology exists and it is affordable – in other words, people in less developed countries could purchase and use it if they wanted- still, they may not use it. The old ways of doing things may be cheaper. To illustrate, in developed countries, workers use earthmoving equipment to clear the land on which houses will be built. In less developed countries, workers may use axes, shovels, and other hand tools to clear land. Why use axes and shovels when earthmoving equipment exists and is affordable? The wages of the people working in less developed countries may be so low that it is cheaper to hire a lot of workers than to buy an expensive (yet affordable) price of equipment.
In addition, Mexico cannot feel apart of the technology cycle because its trade partners are capital-abundant and high-wage countries where there is both a cost incentive and sufficient market demand to warrant new saving-technology and new product

development. The capital-abundant countries thus produce a flow of new products and innovations, with firms often protected by a temporary monopoly via patents to produce for home market. Since the new saving-technologies are not consistent with the relative factor abundances in the abundant-developing countries initially have little economic incentive to acquire the innovations. Consequently, capital-abundant countries export the new products utilising new technologies. Eventually, however, as incomes start to rise in developing countries and even newer technologies are produced in the developed countries, the machines embodying the original new technology are exported by capital-abundant countries. Later, as in product cycle theory, the machines themselves may be produced in the developing countries and exported from them.
In Mexico, the Maquiladoras lies in this issue because the United States, European countries and Asian countries have installed in Mexico many plants to assemble their products because Mexico is intensive in cheap labour offer. However the wages have been raised in the last years as result of the specialisation of producing those goods.

Results from the North American Free Trade Agreement

Since the first year the NAFTA took effect, the results were better than predicted, benefiting from strong economic growth and growing trade among all three countries.
Mexico has increased its exports to the United States and Canada in an annual average of 15% and 10%(4) respectively from 1993 to 2002, likewise the Mexican's imports has risen 11% and 17% respectively. In resume the trade between Mexico with its partners has growth 183% in the same period.
In addition, the US has invested in Mexico since 1994, US$73,495 millions and Canada US$3,912 millions and this capital inflows have enabled the modernisation and transformation of Mexico's economy from an assembler of goods into a reliable producer and exporter of sophisticated products.
Despite of these advantages, NAFTA, like any other trade agreement has also provoked negative effects and high transitional costs for Mexico. Firstly, NAFTA has given birth to disputes among all three countries. Secondly, NAFTA has created dependency of the Mexican export sector on the United States. Thirdly, NAFTA created a huge impact on Mexico's microeconomy, promoting the disappearance of small and medium companies. Fourthly, NAFTA has not been successful in distributing income equally and is still unable to compensate the losers. Finally, NAFTA has affected adversely the labour issue, promoting high rates of unemployment and/or lowering salaries and wages.

The trade off among the outcomes of NAFTA is an important point for the analysis. It is fundamental to understand the magnitude of the FTA between the EU and Mexico; not only to analyse Mexico's unique position to expand its trade with the world's two richest economic blocs, but also, to consider the possible implications.

Implications

Mexico is becoming a key exporter in the world's economy. In the last years, Mexico has had a big jump in exports to the United States through NAFTA, and now has preferential access to the world's largest market, the European Union. In this sense, Mexico offers excellent investment opportunities because of the Mexican's cheap

labour and private sector during the past 9 years have learned to compete efficiently with new markets having the experience of NAFTA.
The FTA between THE EU and Mexico only has 3 years of life, so there are not many visible results, however we can appreciate some relevant advances. For example, Mexico expects to attract 30% of its total investment for this year and at least 9% of its total foreign trade from this region. The European investments have gone towards the manufactures aimed primarily at the US. Given that, many European companies may recapture a piece of the US market.
However, it is important to emphasise that this agreement is not NAFTA and it will not provide the same boost to the Economy of Mexico that came along with NAFTA. In fact, one of the biggest differences from NAFTA that Mexico faces is that unlike its massive trading partner to the north, the European Union is an ocean away and in addition, 34 countries of the Americas are negotiating Regional Free Trade for the 2005. Furthermore, other important implications are that the European community has sources of cheap labour that are in Eastern Europe and some of the most important multinational companies have already set up a manufacturing base there to supply the EU or vice versa.
The new free trade agreement instead of dispiriting the distribution of income will promote (in the long run) equality for the Mexicans, because of the productivity and the access to new opportunities supported by an increasing investment and implemented policies by the Mexican government in education, competitiveness, investment in some techno niches, searching new markets, closer links with competitors and merging the Mexican Economy with its principal commercial partner, the USA.

Conclusions

- Mexico's notable trade performance is the result of a process of economic liberalisation that started in the mid-1980s and consolidated in the 1990s by establishing a network of free trade agreements.
Mexico's open trade policy along with its network of free trade agreements has contributed to increased trade and investment flows. This has placed Mexico in a strategic position by securing access for its exporters to markets in North America, the European Union and Latin America. Consequently, Mexican-made products have proven their competitiveness in the global marketplace.
- NAFTA and the New Free Trade agreement are different in order of magnitude. The New free trade agreement will increase Mexico's exports but will not have the same boost to Mexico's Economy as NAFTA did. However the experience of NAFTA makes things easier for Mexico (lower transitional costs, less political weight, etc.)
- Free trade is far from being perfect and protectionism is far from the global reality. However, the signed free trade agreement seems to be the correct decision for a country with many years of free trade experience (NAFTA, 1994), with a growing economy fighting for a strategic independence and acting as an agent to minimise risk from a social crisis. Furthermore, by analysing the market imperfections and the downsides of playing a role in the global economy, the Mexican Government has to evaluate the benefits and pitfalls of NAFTA. Then, make the best decisions by restructuring and monitoring their policies and enhance the compensation of the resulting losers from the implementation of a free market.
- At the same time, Mexicans (government, citizens, policy makers, social groups, institutions, etc.) cannot simply ignore unequal forces from integration into the global

economy. There is considerably more to the trade-wage. Therefore, the commitment to open trade needs to go hand in hand with a commitment to a whole array of domestic policies that help ensure that society evolves in an equitable rather than inequitable direction.

- One important challenge to Mexico is the investment in human capital. The government must contribute with more resources in Education if they don't want to be displaced by other emerging countries. With new technology the demand of skill-workers will increase while the demand of low-skill workers will decrease. The consequences will that the wages of skill-workers will increase and the GDP per capita will trend to increase too.
- Mexico must look for promoting investment in Research and Development trying to avoid a long-term decline in its exports. The technical change has worked to reduce the growth rate of demand for primary products. This reduction in the growth of demand has therefore, other things equal, resulted in less upward pressure on primary-product prices. It is also suggested that newer production processes in manufacturing industries industrialised countries have economised on the use of raw materials. In the case of petroleum in which Mexico base 32% of its exports, have been important advances in new energy-saving technologies and nowadays are big investments in the search for alternative, economically feasible sources of energy such as a solar power of safe nuclear power that will reduce further the growth of demand for primary products like this one.
- Finally, it is possible that trade liberalisation will recover Mexico's economy as a result of NAFTA and the new free trade agreement with the European Union. Nevertheless, it would be a mistake to interpret that a success from a global perspective in the world economy. Among other things, the Mexican government views free trade agreements as a means of attracting foreign investment. To some extent they have succeeded, however, some of what will appear to be a success can also be a failure.

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