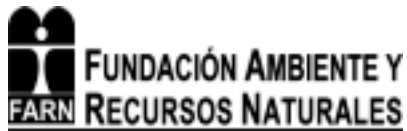




CLAES
Centro Latino Americano
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Comments on the Proposed Methodology:

**“EC Sustainability Impact Assessment of the trade
aspects of the EU-MERCOSUR Association
Agreement - Draft Inception Report”**

Introduction

The European Commission has committed itself to conducting sustainability impact assessments (SIAs) for the negotiations of all of its major bilateral and multilateral trade agreements. It has embarked on an ambitious programme of SIAs. WWF, FARN, CLAES and IDEA welcome this commitment and encourage the Commission to step up its efforts to make EU trade policy more sustainable.

The EU and MERCOSUR are currently negotiating an Association Agreement which will influence trade between the two blocs. The SIA for this agreement was launched in 2002 and is divided into two distinct phases. The first phase is a "Global Preliminary SIA" to identify the areas where there are potential for impacts on economic, social and environmental sustainability. The second phase will involve a more detailed assessment of these sectors and areas. The inception report outlining how the Global Preliminary SIA will be conducted was published in February 2003.¹

This document focuses on the methodological approach proposed in this inception report. It has been prepared by CLAES (Uruguay), FARN (Argentina), WWF European Policy Office (Belgium), WWF Brazil (Brazil) and IDEA (Paraguay). A second document addressing stakeholder involvement and content issues is also being prepared to complement this response and will be complete by the end of April 2003.

¹ Planistat (2003) *Sustainable Impact Assessment (SIA) of the trade aspects of negotiations for an Association Agreement between the European Communities and MERCOSUR – Draft Inception Report (February 2003)*

Summary

- The two **scenarios** proposed for the SIA are inadequate and further complementary scenarios should be developed to allow a fuller analysis. This will facilitate the assessment on non-tariff barriers and the cumulative effect of other trade agreements being negotiated in parallel. Stakeholders should be more involved in the construction and selection of the scenarios.
- The SIA should adopt a **sustainability rather than a trade** focus. This would allow the identification of trade policies which will support sustainable development, rather than flanking measures which are aimed at solving the problems stemming from an unsustainable agreement.
- The SIA needs to set out a clear **temporal framework**, identifying what is meant by long-term and short-term impacts. Short-term economic impacts should not be discounted as they can have long-term environmental and social consequences.
- The criteria chosen for **screening** significant impacts are inadequate and have an economic bias. They should be supplemented with other criteria reflecting social and environmental concerns. Excluding indirect effects from the analysis is a particular failing.
- The list of proposed **indicators** should be expanded and some more specific indicators selected. Process indicators should be included in the study.
- Data deficiencies in MERCOSUR countries make it inappropriate to rely heavily on **economic modeling**. In particular the application of CGE models at the level of the MERCOSUR bloc is unsuitable. Wide economic, social and environmental variations make it important to disaggregate the analysis to at least the country level.
- There is little indication as to how the SIA will promote **policy coherence**. It is essential that the study identifies flanking measures which can be delivered through EU actions and does not rely solely on action in MERCOSUR nations.

General Comments

The methodology for conducting the SIA is based on the framework developed for the Commission by the Institute for Development Planning and Management (IDPM) at Manchester University.^{2,3,4} This framework has only been used in a handful of studies so far, yet despite its limited application, it has evolved and improved considerably since 1999. The MERCOSUR inception report has benefited from recent earlier SIAs. It highlights some of the commonly encountered obstacles in a *macro* undertaking such as an SIA, where to date there is no such thing as a commonly accepted concept of best practice. These difficulties include issues such as the lack of reliable data (very common in developing countries), particularly in social and environmental areas, or the inability to consider questions arising from the existence of an important informal economy, and weaknesses in the enforcement of regulations.

Scenarios

Scenarios are at the heart of the analysis. The inception report proposes two scenarios for analysis – with or without the trade agreement. Given that the measures which will appear in the final trade agreement are uncertain and positions of both parties are not public, there is a great deal of uncertainty attached to the construction of these scenarios. What is more, it is also unclear how the baseline “non-trade” will be developed as all countries have different trading patterns. The general approach proposed by the consultants to tackle this issue is logical, nevertheless all efforts should be made to obtain as detailed information as possible about the trade measures which are under negotiation.

There appears to have been no stakeholder involvement in the selection and construction of the scenarios. This is particularly regrettable for the establishment of the baseline scenario. Stakeholders could play a useful role in informing the construction of a realistic baseline – issues such as the informal economy and governance need to be handled with care. For example, the inception report makes no reference to enforcement capabilities within the individual countries. This is an institutional sustainability indicator which is generally not well dealt with in SIA's. It is assumed that if a regulation is on the statute book, it is enforced and bears significance. Experience has demonstrated that this is not always so.

An additional complication is the economic crisis in MERCOSUR countries at present. This makes it difficult to set a baseline scenario. Under this uncertain situation, a number of alternative scenarios should be analysed and stakeholders consulted to determine which could be taken as the most realistic.

One means of dealing with the lack of information available would be to increase the number of scenarios for analysis reflecting alternative formulations of trade

² Kirkpatrick, Lee and Morrissey (1999) *WTO New Round – Sustainability Impact Assessment Study (Phase One Report)*

³ Kirkpatrick, Lee and Morrissey (1999) *WTO New Round – Sustainability Impact Assessment Study (Phase Two Report)*

⁴ Kirkpatrick and Lee (2002) *Further Development of the Methodology for a Sustainability Impact assessment of proposed WTO Negotiations (Final Report)*

measures. Indeed, the refinement of the methodology presented by IDPM in 2002 proposed increasing the number of scenarios for analysis.

There are two other crucial arguments for increasing the number of scenarios for analysis:

1. The assessment of non-tariff barriers and rules is not adequately addressed through the use of two scenarios representing extremes of liberalisation. The utility of this approach is restricted to modelling tariff changes. The assessment of rules and non-tariff barriers can only be conducted on a case by case basis.
2. The SIA considers the impacts of the negotiations in isolation from other events. It does recognise the need to assess the effects of interactions between different trade measures in different trade agreements, but this can only be done by increasing the number of scenarios for analysis. In the EU-MERCOSUR case, the relationship with two other sets of trade negotiations are crucial: the WTO Doha Round and FTAA. This adds an additional element of uncertainty to the development of the scenarios, since all three agreements are being negotiated simultaneously and their influence on each other are significant. The potential for interaction between these agreements drastically increases the combination of possibilities for trade scenarios and makes just two scenarios inadequate.

Sustainability, not trade, first

Causal chain analysis is the dominant technique in the methodology's toolbox. This approach follows a logical progression beginning with economic effect. It identifies the cause and effect linkages between the trade measure and its consequent economic effects and then the social and environmental impact of this economic change. An alternative approach would be to start with the desired end result first and work backwards towards the appropriate trade measure. This would involve establishing sustainability objectives in their different dimensions and identifying which scenarios or groups of trade measures would be most likely to reach those objectives. This approach could better inform and guide trade negotiations in such a dynamic context.

The rationale of this approach is to reverse the causal chain: first the definition of sustainability objectives for each dimension, identification of changes on production systems within cross-sectors and in general, identification of trade measures that would enhance reaching the objectives. Such an approach would be most useful at an early stage of the negotiations and would be particularly helpful in formulating sustainable negotiating positions.

Multicriteria analysis is an alternative tool which fits in with this approach. For that is important to have established a set of sustainable objectives. The results allow for the estimation of the contribution of each of the proposed alternatives (scenarios-trade measures) to sustainability. This approach has already been successfully

employed in various occasions, for instance to test agriculture and conservation scenarios in an area of wetlands with high diversity.⁵

We recognize that EU has a policy on sustainable development (and the SIA is an expression of its commitment to sustainable trade). Obviously the “sustainability policy” (including sustainability aspects of economic, technology, agriculture, social and environment policies) is or should be one of the conditions for the EU negotiators in establishing their positions.

On the other hand, MERCOSUR still does not have such a common policy on sustainable development, so there is a very important asymmetry in this aspect. The proposed new approach should contribute to the definition of a MERCOSUR sustainability policy. This is also the only way to avoid the criticism that the sustainability objectives for the South are determined by the North.

Scope

Establishing a temporal framework is essential to any sustainability analysis. The report frequently mentions the need to differentiate between long-term and short-term consequences or sustainability impacts of measures or the long term nature of indicators.

Nevertheless, it is not clearly established which time period has been or should be considered long or short term. This will lead to uncertainty in establishing which impacts are long or short term. Furthermore “long term” may have different significance for social, economic or environment dimensions, particularly when considering biodiversity and aspects like species extinction, which need to be considered in centuries. Thus, establishing the time frame for the analysis and long-term and short-term significance at the outset of the study is essential.

On a related point, the economic focus of the analysis could lead to the discounting of environmental or social impacts associated with short-term economic shocks experienced by countries as they adjust to the effects of the agreement. It is essential to recognise here that while an economic effect may be short-term, and/or minor, the associated environmental and social consequences may well be more significant and last far longer.

Indicators

The methodology adopts the common set of indicators proposed by IDPM. This has many advantages and allows the comparison with other SIAs conducted on the Commission’s behalf. However, the value of regional or even country or sector-specific indicators should not be dismissed. The use of pollution indicators may not be as relevant in measuring the impacts on biodiversity in agriculture, for example. Neither do there appear to be strong indicators for measuring social exclusion – other than unemployment or education. Some work has been done in this field for example for determining access to sanitation, drinking water, sewage, etc., which

⁵Evia (2000) *Un ejercicio de aplicación de indicadores de sustentabilidad de diferentes alternativas productivas en los Humedales de la Laguna Merín*, Claes Temas Clave

may be relevant, particularly when addressing concerns such as FDI, a chapter supposed to be included within the terms of the SIA. These indicators may be extremely useful, given the impact of some of the direct investments in services in MERCOSUR countries (water, electricity, garbage disposal).

The Inception Report notes that the consultants will only consider introducing an alternative indicator if an impact is not captured by existing indicators. This ignores the issue of appropriateness. Some indicators may only capture a partial picture of an impact, while others may be inappropriate. Indicators should be developed which can fully capture and reflect the nature and magnitude of the impact. For example it would be irrelevant to consider the impact on endangered species in a region where there are no endangered species, or to consider real income for indigenous people who subsist from wildlife.

The economic, social and environmental indicators could also be more specific. For example, water quality indicators. Which quality? Eg. Levels organic materials, dioxins, polychlorinated biphenyls, and pesticides, just to mention some. Maybe these are not cited because they will be chosen for every specific sector?

We urge the consultants to reconsider their decision to exclude process indicators from their analysis. The introduction of these indicators in the refined methodology in 2002 was warmly welcomed by NGOs.⁶ The consultants argue that these are a recent innovation and prefer to wait until they have been further tested. As stated earlier, the methodology is evolving and each SIA stretches the experience and understanding of the tool. The MERCOSUR SIA is an ideal opportunity to experiment with these process indicators particularly given the importance of institutional concerns such as enforcement capabilities in the MERCOSUR region. Process indicators should be more fully addressed in the inception report, even if it is just to highlight their shortcomings.

Screening

The report emphasises the trade measure starting point of the causal chain, but there is no reference to impacts related to “no adoption” of some trade measures. This may be particularly relevant for market access considerations, as the lack of liberalisation in some sectors (e.g. agriculture) may have significant sustainability impacts. Therefore, the analysis of the “No-adoption” hypothesis should be taken into consideration to inform the negotiation process.

The four criteria for selection of issues for analysis are inadequate and too economic focused. The adoption of a sustainability first approach would address this problem, but failing that, the addition of criteria which more directly address social and environmental dimensions should be considered. For example, it is important to clarify the concept of *direct environmental impact*; what is direct and what is not. A very strict definition of this criterion will exclude many relevant, but indirect impacts. For instance, the expansion of cultivated crops into cattle grazing areas would not be considered a significant direct environment impact. However, it is well recognised

⁶ WWF and Oxfam (2002) *Response to the final report by Manchester University on phase III SIA methodology (May 2002)*

that such expansion can lead to deforestation with very high environmental impacts in other regions as cattle ranchers seek alternative grazing areas.

Precaution should be taken when establishing a reference year. The issue is the high variability existing between years. So the question is: What is a normal year? We suggest the consultants a well defined and measurable indicator for each criterion.

Most importantly, stakeholders are not given a meaningful role in the screening of impacts. The consultants plan to consult with the Commission alone when prioritising issues for analysis. Stakeholders should be fully involved in this process too.

The appropriateness of economic modeling

Economic modeling is data hungry. It requires large amounts of accurate figures. However, collecting reliable data will be difficult in MERCOSUR. A particular obstacle will be the large informal sector. The Paraguayan economy, for example, is considered to have a significant informal sector, which is not captured by official statistics. Taking into account that economic modelling requires solid and abundant data to provide a sound output, previous studies about informal sector estimation would be necessary to avoid a bias in the model output. An illustration of the scale of the problem: According to an agricultural import/export study undertaken in year 1999 by the Ministry of Agriculture and Livestock of Paraguay, the country imported tobacco at a FOB value of US\$ 332.939.967 and exported for an equivalent of US\$ 8.694.504 FOB value during the same period. The tobacco import value represents 15,6% of total Paraguayan good imports. If we treat tobacco as an agricultural product, the share of tobacco value on the total agricultural import during year 1998 is equivalent to 51 per cent. These figures give a distorted reality about tobacco consumption in Paraguay. Paraguayan trade experts explain this issue by what it is call "Triangulacion", which means that most of the tobacco entering in Paraguay return to other countries without been recorded by customs. A similar situation occurred with electronic goods.

One approach to estimate the magnitude of informal trade – at least at the level of international trade – would be to compare for the national statistics of the trading partners involved, i.e. to check the records for the importing and exporting countries and see if they match up.

Computable General Equilibrium models are well tested tools. However, CGE models are most appropriate in countries were data consistency and availability is not a constraint. Data availability will be a problem in the MERCOSUR context. Computable General Equilibrium Models can also be used to analyse a multiple country situation, however, this is not recommended for MERCOSUR because of the large asymmetries among countries. Thus, CGE should be restricted to the country level.

Geographical and social distribution of impacts

The report tends to group MERCOSUR countries together as a homogenous unit, and neglects the important differences between countries and sectors within countries.

Although this may be a practical approach addressing the need to economise on resources or avoid excessive detail, it also tends to misrepresent impacts on a sector specific basis. For example, scale production levels are considerably larger in Brazil and in Argentina, than in Paraguay and Uruguay. This issue is understandable considering that Brazil, Argentina, Uruguay and Paraguay are ranked as the ninth, sixteenth, fifty-ninth and ninety-third economies of the world respectively. Any CGE modelling should be conducted at a country, rather than and regional, level.

With this in mind, some attempt should be made to consider or identify those regions within individual countries most likely to be affected by the potential implications of the MERCOSUR-EU agreement. More detail and attention should be paid to defining the geographical scope of potential impacts. The diversity in ecosystems and local conditions are simply too great to be ignored. Industry is not the same in the north east of Brazil as in the western provinces of Argentina. The geographical and regional differences also have very important consequences from an equity perspective, particularly in agriculture.

The SIA plans to concentrate on large heterogeneous sectors, supposedly to avoid excessive detail. Other similar studies have shown, however, that in grouping together such broad categories for classification can be misleading. For example, agricultural production covers a broad range of goods, some of which are exported, some of which are imported. Lumping these together can mask “winners and losers” in this context. Furthermore, in the various country tables, it would appear that different levels of aggregation have been used, which may be misleading (cases of Paraguay and Uruguay). It might be a good idea to suggest adopting a common definition using the harmonised system, giving a balanced perspective of sectors most likely to be impacted by the agreement.

In addition, the description of the methodology appears to be rather short on references to local sources of information, particularly stakeholders and interested parties in each of the countries. It is to be assumed that this deficiency will be addressed during the development of the final report, through the next stages of the SIA.

Irreversibility of Impacts

One of the principles of sustainability strategies is that of “zero irreversibility”, that means reducing to zero cumulative interventions and irreversible damage. This criteria should be the guiding principle for the acceptability of a trade measure independently of the possible positive effects on other dimensions.

The report states that economic impacts tend not to be irreversible (Page 32). This is a debatable statement. Lack of infrastructure investment or underfunding of social programs such as education can have long standing consequences, which may be for all practical purposes irreversible, depending on the time scale used as a standard of measurement. This point should be clarified.

When considering the direction and magnitude of change from baseline to scenarios in column D “Potential for irreversibility” (page 32) the indicator could be best represented as a direct indicator; that is more value, more sustainable. If you put a symbol ↓ to a change that introduces more potential to irreversibility is confusing,

because it could be interpreted as meaning less potential for irreversibility. In other words if the indicator is potential for reversibility instead of potential for irreversibility the symbol ↑ is directly visualized as more sustainable.

Policy coherence

The report fails to address the issue of policy coherence adequately. Trade is a cross-cutting policy area and has the potential to undermine or support goals in other policy areas. A central aim of the study should be to identify potential conflicts and synergies with existing EU policies. Yet the inception report gives little insight into how this will be achieved.

Policy coherence is of particular importance in the formulation of mitigation and enhancement – or flanking – measures. The proposal of flanking measures which focus on action to be taken by MERCOSUR nations alone will do little to build the trust of trading partners. Effort has to be made to identify opportunities in domestic and external EU policies to deliver sustainable trade.

The study has been commissioned by the EU, therefore any constraints or conclusions are contingent on the will of the Party commissioning the study. This is particularly important as regards the conclusions or the adoption of flanking measures. In many cases, mitigation measures will require direct political decisions within MERCOSUR countries.

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