



THE 'GLOBAL AGREEMENT' THAT PROFITS THE FEW

Free Trade Agreements as Instruments for Corporate Tax
Avoidance and Illicit Financial Flows: the "Modernisation"
of the EU-Mexico FTA

Analysis by Thomas Lines and the Greens/EFA
Group

Commissioned by the Verdelatino Working Group
from the Greens/EFA group in the European
Parliament

Funded and published by the Green/EFA group in
the European Parliament

June 2017



Foreword by Molly Scott Cato

Corporate tax avoidance is one of the biggest injustices of our time, depriving countries of an income that is rightfully theirs, and that should be used for to invest in public services and to provide and maintain the infrastructure that civilised societies depend on. Tax avoidance impacts most heavily on the world's poorer countries who would be able to provide better services and livelihoods for their people if they were not subject to the draining away of resources through immoral and sometimes illegal tax avoidance and evasion. According to recent figures, for every 1 US dollar that is spent on aid in poorer countries, 24 US dollars are lost in net outflows.



From another perspective, money laundering and illicit financial flows fuel criminal networks and can corrupt our institutions. The governments of the majority world are frequently blamed for corruption and yet every corrupt deal has two parties and it is the corporate players in the West who are the hidden players in this deadly tax-avoidance tango. As an African tax expert said recently in testimony to the European Parliament's tax committee, when corrupt money leaves our countries it does not go out as notes in a suitcase but through some of smart, shiny banks based in the world's most powerful economies. When governments collude with corporations and the wealthy it undermines citizens' faith in their representatives and indeed in democracy itself.

This is why Greens are fighting for more effective regulation of financial flows and of the activities of financiers, bankers, tax lawyers and tax accountants. Our objective is to ensure that the global economy works for the common good and that we create the conditions to allow societies to prosper the systems of tax justice and economic justice that such a world requires.

The European Commission is negotiating the so-called 'modernisation' of the 'Global Agreement' which is the existing preferential trade agreement with Mexico, and is negotiating many more new preferential agreements across the globe. At a time when the EU (the largest economy in the world) is seeking to accelerate a free trade agenda, it is important to understand the impact that this may have on the parties involved. The civil struggle against CETA and TTIP was built on a rejection of three key areas: the investor-state dispute settlement model, where private investors could sue countries for 'obstructing or reducing their profits'; the lack of transparency in the negotiation process, and finally the fear that the deal would degrade standards on imports/exports, worker rights and environmental protections. Whilst these will also be concerns within the EU-Mexico deal, the focus of this study is the liberalisation and deregulation of financial services and financial flows, as they can have a grave impact on economies if this allows tax evasion and money laundering to thrive.

The aim of this report is to explore the impact that the so-call 'modernisation' of the EU-Mexico FTA might have on corporate tax avoidance and illicit financial flows with the inclusion and liberalisation of financial services. As the negotiations are still underway and have not been finalised, this report is based on current existing understanding of what is being negotiated. We believe it can be an important point of reference throughout the negotiation process with regard to the chapter on trade in services and as a contribution towards enhancing the power of the citizens of the EU and Mexico in the negotiation process.

CONTENTS	PAGES
1. The ‘modernisation’ of the EU-Mexico free trade agreement	3-6
2. The Commission’s priorities for the negotiations with Mexico	6-8
3. The context: The format of modern international businesses	8-11
4. Mexico, the EU and globalisation since 2000: money laundering and the liberalisation of trade	11-15
5. In more detail: capital flight, tax avoidance and attempts to control them	15-17
6. Double standards: the official fight against tax fraud versus growing illicit financial flows	18-20
7. Concluding remarks and policy suggestions	20-22

1. The 'modernisation' of the EU-Mexico free trade agreement

The first attempt by the European Union to secure a comprehensive trade and investment agreement with a global trading partner from the Americas came in the form of the CETA agreement with Canada, which has recently been ratified by the European Parliament. Next came the proposed TTIP with the USA, which appears by all accounts to now be dead in the water. Now the European Commission has set its sights on the third country in NAFTA, Mexico, to remould their existing Economic Partnership, Political Coordination and Cooperation Agreement. The new negotiations between the EU and Mexico were launched in May 2016, and less than a month later the European Commission and Mexico met in Brussels on June 13th-14th 2016 to prepare for the first round of negotiations.

The Economic Partnership, Political Coordination and Cooperation agreement - otherwise known as the 'Global Agreement' - entered into force seventeen years ago in 2000. It provided the framework for two substantive agreements which were set up under it, one to establish a free-trade area for goods, which was approved in March 2000, the second for the liberalisation of trade in services, approved in February 2001.¹

An assessment or "modernisation" of this deal was due after more than a decade and a half since the old agreement, but this had not previously been high on the agenda of the EU or Mexico. However, only a few days after Donald Trump came into office as President of the USA, Mexico and the European Commission decided (on February 1st 2017) to accelerate the talks on modernisation.² The competent Commission bodies have already engaged in two different tracks: the European External Action Service (EEAS) negotiates chapters on co-operation and political dialogue, including human rights, while the Directorate General for Trade (DG Trade) is busy with the much larger and more substantial trade part of the soon to be "modernised" agreement. As a result of establishing two separate tracks, human rights violations that affect the stability of the country and hamper an orderly development of the economy will not be dealt with inside the trade chapters.

Trade in goods were not the central focus in CETA or TTIP and nor does it seem to be the priority within the trade deal with Mexico. Much more important than the lowering of customs duties is the creation of an ever larger and less regulated "level playing field" for corporate actors and the financial sector. The Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU is the most recent and perhaps one of the most significant of the new generation of FTAs (Free Trade Agreements), which contain an Investor-to-State Dispute Settlement mechanism (ISDS). Following widespread public protests against the inclusion of ISDS in the agreement, the model was reformed to become a so-called Investor Court System (ICS), without being fundamentally different from ISDS. On the long run, the ICS should replace Bilateral Investment Treaties (see box) between EU member states and the third country concerned, but for the time

¹ Available at http://eur-lex.europa.eu/resource.html?uri=cellar:f95ad1a3-795e-4fb0-84e1-28351b99415c.0004.02/DOC_2&format=PDF, http://eur-lex.europa.eu/resource.html?uri=cellar:a024c280-a801-4dcd-bc46-a3afdd86c3ba.0005.02/DOC_1&format=PDF and <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A22001D0153> respectively (July 2016).

² European Commission, 'Joint Press release on the first round of EU-Mexico negotiations of the Global Agreement', June 14th, 2016, http://eeas.europa.eu/statements-eeas/2016/160614_03_en.htm. See also the Organization of American States' website at www.sice.oas.org/TPD/MEX_EU/MEX_EU_e.ASP (both visited in July 2016).

being they will co-exist, which increases the threat for countries to be sued. The proposed deal with Mexico is set to mirror the structure of CETA and to go beyond CETA in substance

In light of the recent failure of the proposed TPP (Trans-Pacific Partnership) agreement and the stalling of the TTIP agreement, the future of this new form of FTA would seem to be in question. However, the European Council and the European Parliament have ratified CETA, as negotiated by the European Commission, though with annexes imposed by Member States at the last minute. The abandonment of TTIP and TPP by the Trump administration has encouraged the EU to take advantage of the situation by putting itself forward, replacing the USA, as a partner for trade deals. The EU does not appear to have given up on the idea of these new-style FTAs.

The main components of this new kind of agreement are:

1. **An 'ambitious liberalisation' of trade**, which means uniform, *race-to-the-bottom* legislation for all the signatories to allow maximum flexibility for businesses. The transition is somewhat similar to that in the EEC/EU from the early days of a Common Market with no import tariffs or quotas between Member States and a common external tariff, to the Single Market, which standardised the rules (or 'regulations') for each part of their economies. While the process is still ongoing, with many actors bringing forward their specific concerns, to be dealt with in order to finalize the common market, democratic structures involving non-business actors and parliaments, are absent from FTAs. Globally, the task of creating a common, low-tariff market has already been achieved to a large extent, but transnational corporations (TNCs) now complain that their international operations are hindered by what economists call 'non-tariff barriers' (NTBs), which usually means government regulations and laws.

Bilateral investment treaties (BITs), also known as international investment agreements (IIAs), have a separate history as the main tool in a system of Investment Protection. They rely on tribunals which use a commercial model to hear corporations' claims for monetary compensation for what they consider to be detrimental actions by governments in countries where they have invested. The dispute process is overseen by the World Bank, with the original aim of encouraging foreign investment in developing countries by protecting corporate operations against nationalisation or laws setting conditions to corporate activities. The tribunals are the mechanism used in a system known as Investor-State Dispute Settlement (ISDS). A recent trend, especially on the part of the European Commission, is to combine both trade and investment features of these treaties within single agreements. The combined agreements are still usually known, somewhat misleadingly, as 'free-trade agreements' (FTAs).

The removal of these barriers is called **regulatory coherence** or **regulatory co-operation**.

2. **Regulatory cooperation** also has a more specific sense, as already agreed between the Commission and Canada under CETA . It is set out in CETA as follows:

'Consulting with each other as appropriate and exchanging information during the regulatory development process. This consultation and exchange may occur throughout the regulatory development process, and should begin as early as possible in that process.' 'A Regulatory

Cooperation Forum ("the RCF") shall be established to facilitate and promote regulatory cooperation between the Parties in accordance with the provisions of this Chapter.³

This forum for formal consultations - with business - when new laws are formulated gives business a privileged position under the law, superior to ordinary citizens and other interested parties, whose opinions are not sought out in this way. This is not mentioned in the EU documents so far available to the public for the new Mexico agreement. However, since it comes into the Commission's plans for both CETA and TTIP and all three agreements are intended to be broadly uniform, it will be important to watch out for its inclusion during the course of the negotiations.

3. **The ICS system of investment protection.** Under public pressure the Commission modified this in its TTIP proposals as a proposed public investment court, instead of the commercial-style tribunals used in other agreements. There is no provision for ISDS in the existing FTA with Mexico but the Commission will build on the new CETA formula in its proposals for Mexico. So in the future, TNCs would not only be allowed to sue governments if their profits are seen to be hindered by the state on the basis of the BITs which link Mexico with European member states, but also on the basis of the new FTA.⁴

In this respect the new FTA will be an extension of the 16 existing BITs (bilateral investment treaties) between European states and Mexico. For instance, Spanish investors (one of the largest European investors in Mexico) launched five ISDS claims against the Mexican government in recent years, one of which is a \$1 billion claim from Telefonica because the Mexican government (under the supervision of the OECD) introduced new regulations in their telecommunications sector⁵. The proposed FTA would enshrine the ICS/ISDS system as a tool for investors within both Parties' jurisdictions.

An issue yet to be addressed is the complicity of TNCs in human rights abuses in Mexico under the current Agreement. In August 2016, over 100 civil society organisations drafted a report detailing around 60 human rights abuses by TNCs recorded in Mexico in previous years⁶. Around 50 foreign-owned TNCs were implicated, some of which are European-owned companies. Abuses from European companies include: the depletion of aquifers and poisoning the water supply with toxic waste; violating indigenous rights; not holding prior consultations; and refusing workers the right to strike⁷. Under Investment Protection, there is a risk that it will be more difficult to introduce measures that protect human rights for fear of an ICS claim.

³ Art. X.4 section 2, p. 398 of the consolidated CETA text, and Art. X.6, pp. 400-01.

⁴ European Commission (2016), 'Commission Staff Working Document: Impact Assessment', doc. no. SWD(2015) 289 final, p. 12, http://trade.ec.europa.eu/doclib/docs/2016/march/tradoc_154396.034027.1.SWD_2015_289_EN%20IAR.pdf (July 2016).

⁵ Manuel Pérez-Rocha and Roeline Knottnerus, *Letter of concern on the proposed 'modernisation' of the EU-Mexico FTA*, Last modified January 2017 <https://www.tni.org/en/article/letter-of-concern-on-the-proposed-modernisation-of-the-eu-mexico-fta>

⁶ Mexico: Over 60 cases of alleged corporate abuse documented in advance of UN Working Group visit | Business & Human Rights Resource Centre, Business-humanrights.org, <https://business-humanrights.org/en/mexico-over-60-cases-of-alleged-corporate-abuse-documented-in-advance-of-un-working-group-visit>

In a similar vein, the inclusion of an investment chapter in the new deal could have equally damaging consequences. Current EU FTAs with third countries include a detailed list of investments and cross-border services in the financial sector. It is clear that deregulating these markets leaves economies more vulnerable to external shocks and capital flight, yet the commitment to deregulation is also - under 'modernised' trade agreements - subject to investor dispute settlement. In other words, if Mexico or the EU want to implement preliminary measures to prevent severe capital flight, or to prevent a financial crisis, they can be penalised by investors for doing so. In the newly ratified CETA agreement, this is central to the agreement and there is no reason to believe that this would be any different in the new EU-Mexico deal.

The Commission has been explicit in its intentions to model the new FTA with Mexico on the recently ratified CETA deal⁸. Even though negotiations are still in the early stages and detailed documents outlining the deal are not yet available, it is therefore to some extent possible to analyse the implications of such a deal between the EU and Mexico. Furthermore, if this deal is conducted in a similar manner to CETA and TTIP, there will be very little transparency throughout, which is why it is important to scrutinize these negotiations as closely as possible and from an early stage.

2. The Commission's priorities for the negotiations with Mexico

In the spring of 2016 the European Commission's Impact Assessment on the planned negotiations with Mexico was placed on an external website, with a 'Restricted' label. It was stated that 'While this document apparently already had been declassified on 13 Jan 2016 it was for unclear reasons only released to the public on 30 May 2016.'⁹ It is rare to gain this sort of insight into trade negotiators' minds before negotiations begin. The case made by the Commission in this document is summarised below.

The underlying rationale for initiating the negotiations (on p. 5) was stated as:

'Fifteen years after its entry into force, the EU-Mexico FTA – which was considered ambitious around the turn of the millennium – does not address some of the important trade and investment issues relevant today in the ambitious way other recent comprehensive agreements concluded by the EU or Mexico or in course of negotiation since then have.'

In this context it mentions CETA, TTIP and the TPP in particular. The Commission was concerned about the EU's possible place in commercial competition with others, and in particular the fear that, 'The TPP could result in the EU further losing ground in the Mexican market, notably to other Pacific countries' (p. 15). It asserted that Mexico too was 'concerned that the TTIP might result in an erosion of the Mexico-US trade and investment relation' and had 'expressed a wish to be associated with the TTIP negotiations' (p. 16). This concern about

⁸ DG TRADE European Commission (2015). Modernisation of the Trade Pillar of the Eu-Mexico Global Agreement. DG TRADE European Commission, p.2. http://ec.europa.eu/smart-regulation/roadmaps/docs/2015_trade_001_modernisation_eu_mexico_agreement_en.pdf

⁹ European Commission (2016), *op. cit.* The external weblink where the document was published, with the explanation given above, is www.scribd.com/doc/314472335/Declassified-EU-Working-Document-on-New-Trade-Agreement-With-Mexico#download.

the 'modernised' FTA's place in relation to other agreements suggests that the Commission will continue to press for it even now that TPP and TTIP have been abandoned by the Trump administration.

The main economic source of concern lies in non-tariff barriers or NTBs. As in TTIP, addressing this is the Commission's most important objective, since 'NTBs nowadays act as a greater impediment to bilateral trade and investment flows than tariffs' (p. 11) and therefore, 'A higher reduction of NTBs facilitates trade and creates more economic growth, and thus leads to more job creation opportunities and a higher increase of welfare gains' (p. 47). And so, among the various options considered, the Commission preferred 'comprehensive modernisation' in its most 'ambitious' form (as it had done before with TTIP). The main reason for this choice was 'the extent to which NTBs on non-agricultural goods and services can be removed', and 'to a lesser extent,' the extension of agricultural market access (p. 23). The latter, however, flies in the face of the devastating impact on much of Mexican agriculture, including maize-tortilla production, of free trade in agriculture under NAFTA.

The Commission defines four other important goals:

1. Opening up more for foreign private investment (p. 12). Postal services, land and air transport, television, ports and financial services are named in particular. The way this is put forward seems rather predatory:

'Postal services are exclusively reserved for the Mexican State, and land transportation of passengers as well as television services (the owning of a TV channel) are entirely reserved for Mexican nationals. Certain port services, some financial services and air transportation also have limitations on foreign ownership.'

What is important to note here, is that the proposed deal only makes very minimal commitments when it comes to trade in financial services, only a 'best endeavors' obligation¹⁰. The lack of concrete regulation proposals may leave Mexico and EU Member States more vulnerable to capital flight.

2. Investment protection. This area 'is not covered by the existing EU-Mexico Agreement', while the BITs concluded between 16 EU member states and Mexico 'differ in their level of ambition and are not in line with the most recent developments of EU investment policy' (p. 12). The aim therefore is to bring it all under a single system covering companies investing from all the EU's member states and add a "state of the art" ICS.

3. Strengthening the defence of Intellectual Property Rights (IPR), since the existing FTA has 'only one limited and general Article' on this, which promises to ensure IPR protection to the 'highest international standards'. This phrase is interpreted as referring to the *minimal* standards established in the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which 'only brings limited added value for EU right holders.' Specific concerns here are the UPOV (International Union for the Protection of New Varieties of Plants) rules on plant varieties, the liability of internet service providers, geographical indications, and counterfeiting and piracy (p. 13).

¹⁰ European Parliamentary Research Service, European Parliament (2016). services in EU free trade and association agreements: Effects on money laundering, tax evasion and avoidance. Brussels: European Parliament, p.55. [http://www.europarl.europa.eu/RegData/etudes/STUD/2016/579326/EPRS_STU\(2016\)579326_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2016/579326/EPRS_STU(2016)579326_EN.pdf)

4. Access to public procurement markets (p. 13) – a major ‘offensive’ demand of the Commission under TTIP too. Mexico, like the US, has not outsourced public services under contracts as much as in some EU member states, and the Commission would like to force these ‘markets’ open for the outsourcing contractors which have prospered in Europe.

5. A possible chapter on trade in services, similar to that of the TiSA (Trade in Services Agreement) arrangement that currently exists between 23 countries aimed at liberalising and catalysing trade in services¹¹. The Commission conducted an online public consultation about the Mexico FTA in the second half of 2015, but participation in it seems to have been as narrow as in the equivalent exercises conducted before the TTIP negotiations began. The online consultation states, ‘According to the stakeholders [sic] own self-classification, around 17.5% are SMEs, 25% are large companies, 35% are trade associations and around 12.5% trade unions and others’ – in other words, at least 75 per cent representing private commercial interests, no doubt through lack of awareness of the consultation in the wider public. Contributions which respondents intended to be available for publication were to be found on DG-Trade’s website. However, no such contributions could be found when this author tried in June 2016 – unlike the submissions to an equivalent TTIP consultation at a similar stage in those negotiations (in 2013). This is a worrying indication of the lack of transparency and the potential controversies of the deal. DG Trade gives the impression that these negotiations are fully transparent. However if the CETA and TTIP negotiations processes are a marker for future deals, this will not be the case.¹²

Finally, the Commission admits, ‘Overall, the effects of the existing EU-Mexico FTA on reducing poverty and inequality are estimated to be very small’, while ‘the impact of the FTA on formal employment has been at best marginal for Mexico and the EU’ (pp. 14 and 7 respectively). What has been forecast for the CETA and other agreements like it, is that there is actually very little GDP growth achieved as a result of this new framework for FTAs. This is combined with the unfortunate lack in regulation for financial services and anti-money-laundering measures. The real question then, is whether the ‘modernisation’ of the agreement will actually benefit the general population in the EU and Mexico, or whether this is simply another deal that will enhance the grip of corporate power and enable multinationals to move their profits elsewhere.

3. The context: The format of modern international businesses

To make sense of the ‘modern, ambitious’ FTAs and IIAs (International Investment Agreements), it is necessary first to understand how TNCs are organised and being reorganised in the contemporary world of free movement of capital and ‘flexible’ labour markets. At the risk of generalisation, modern international businesses are characterised by some or all of these eight features:

¹¹ <https://ustr.gov/TiSA>

¹² Ec.europa.eu. (2017). Mexico - Trade - European Commission. [online] Available at: <http://ec.europa.eu/trade/policy/countries-and-regions/countries/mexico/> [Accessed 13 Jun. 2017].

1. **Physically light:** minimally encumbered by fixed assets or large numbers of staff, and profiting not from surpluses made in production but from economic 'rents' that arise from the ownership of 'intangible' assets such as legally protected brands, patents and other forms of 'intellectual property' (IP). In this world, design, branding, marketing, as well as fiscal or financial manipulation, are more important to strategy than production, let alone such qualities as national or local loyalty, patriotism and good citizenship.
2. **Fragmented global, and often regional, value chains,** often with much or all of actual production as well as ancillary processes such as customer services (in call centres) 'outsourced' (bought in from other firms under contract). The aim is to reduce both fixed costs and wage costs as well as non-wage obligations to those who do the work. The company also avoids direct responsibility if anything goes wrong.

The sourcing of production and components in numerous countries is illustrated in Fig. 1, which shows how many different companies and countries are involved in producing a modern airliner which is designed and sold by the US company Boeing. A large piece of high-technology machinery such as an airliner lends itself readily to a modern, inter-corporate division of labour of this sort; but with modern low costs of transport and low or zero tariffs, the same principle applies in many parts of the economy, including light industries such as clothing, in which part-completed garments are transported from one country or even continent to another one with lower wages, for the addition of zips or other small parts.

In this situation no one country can effectively control the leading company or its production or marketing process. This also makes it difficult for governments to assert their authority: nationalisation is almost impossible, but almost any strong action against a firm can be met by a decision to move the affected link in the chain elsewhere.

3. **International mobility.** Taking advantage of the free movement of capital to book profits wherever taxes are lowest and being willing to switch locations with the greatest ease and speed. 'Flexible labour markets' (understood to be 'efficient' under mainstream economic theory), which reduce employees' rights, and 'tax havens' both serve this purpose.

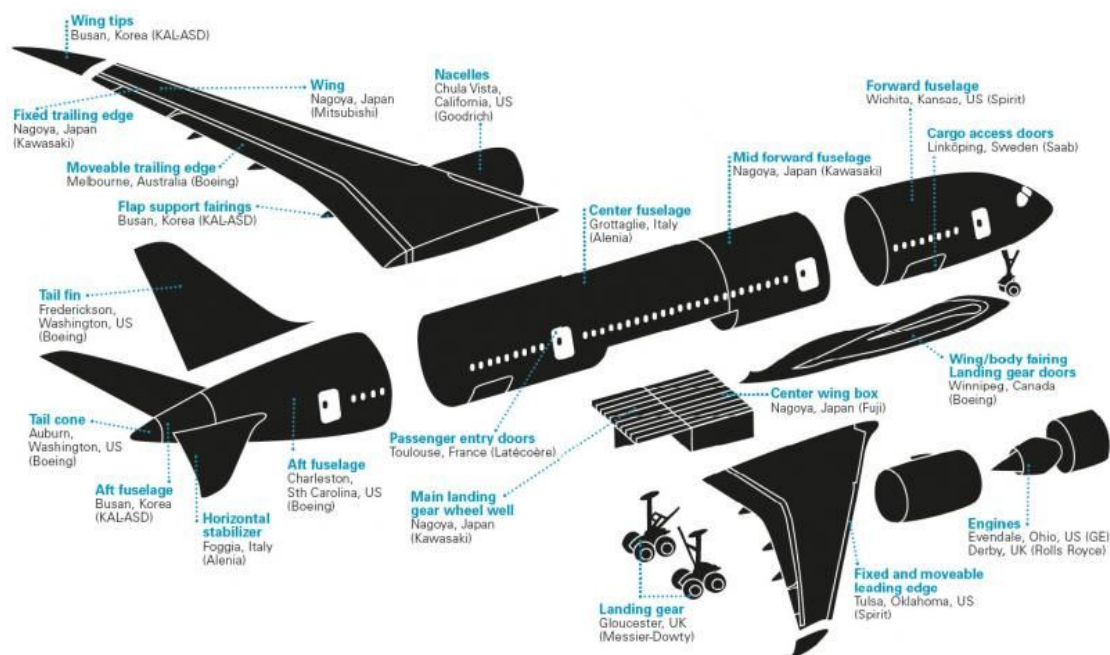


Fig. 1 Production sourcing of the Boeing Dreamliner 787 aircraft via a global value chain¹³

4. **Keenness to avoid obligations** to government or society – not just in paying tax but accepting ‘regulations’. This is a code-word of the modern business world, linked with the notions of an economic *burden* or *barrier*. It can be made to apply to almost any requirements placed on a company by a government.
5. **Playing different states’ regulations and tax regimes off against each other** in order to minimise their impact, exploiting *intergovernmental* rules such as the WTO’s agreements, investment treaties and double taxation agreements to impose their will in this area.
6. **Avoiding scrutiny** by hiding their ownership and creating opaque and complicated structures of ownership, management and group finance. This is closely linked with **tax planning**: ensuring as far as possible that taxes are due in the most compliant countries which have suitably adapted legal, fiscal, and company reporting and registration systems. These are known as ‘secrecy locations’ (or ‘tax havens’).
7. **Part of a vast network of connections** between TNCs, which exhibit highly concentrated ownership among a small core of dominant companies. The researchers who identified this phenomenon wrote:

‘In detail, nearly 4/10 of the control over the economic value of TNCs in the world is held, via a complicated web of ownership relations, by a group of 147 TNCs in the core, which has almost full control over itself. The top holders within the core can thus be thought of as an economic “super-entity” in the global network of corporations. A relevant additional fact at this point is that 3/4 of the core are financial intermediaries.’¹⁴

The research drew its information from a database of 2007 of about 37 million ‘economic actors’ in 194 countries, and identified among them 43,060 TNCs in 116 countries. The most powerful company of all was Barclays PLC in the UK, which controlled directly or indirectly 4.05 per cent of the TNCs.

8. **The main ethical standard**, after the primacy of making profits, is whether or not an action can be defended under the law. In a scandal, the expression ‘He did nothing wrong’ comes to mean no more than ‘He did nothing illegal’.

All of these features work to the advantage of TNCs – and especially the largest of them – rather than small, medium-sized or small/local businesses, because it is TNCs which benefit from economies of scale – what people often really have in mind with the word ‘efficiency’. The Commission’s latest statement of its trade policy offers strong support to TNCs in these critical areas:

‘EU trade policy must strengthen Europe’s place in global supply chains. It must support the full range of economic activities through which Europeans create and sell value.’

¹³ Humphries, N. (2014), ‘Global value chains, border management and Australian trade’, Sydney: Lowy Institute for International Policy at www.lowyinstitute.org/publications/global-value-chains-border-management-and-australian-trade (downloaded June 2016), citing Australian Department of Foreign Affairs and Trade, ‘Trade At A Glance 2013’ (at a weblink that is no longer available)

¹⁴ Vitali, S., et al (2011), ‘The Network of Global Corporate Control’, <https://arxiv.org/pdf/1107.5728>, p. 6. See also New Scientist, ‘Revealed – the capitalist network that runs the world’, October 19th, 2011, www.newscientist.com/article/mg21228354-500-revealed-the-capitalist-network-that-runs-the-world/ (July 2016).

This is nothing new. The pursuit of deregulated trade in goods and services has long been hailed as 'progressive' trade policy, yet as inequality is rising globally, this becomes less and less convincing. It is also worth noting that new trade and investment initiatives such as CETA, are predicted to create very little GDP growth¹⁵, yet the power of investors is greatly enhanced by the investment chapter that is a central part of the CETA agreement, and is set to be central within the new EU-Mexico agreement.

4. Mexico, the EU and globalisation since 2000: money laundering and the liberalisation of trade

Within the new global system, Mexico has become a low-cost ancillary economy to the US, serving in part as a stepping stone to US markets for TNCs from other continents, with 80% of its trade executed with the US. In some industries, Mexico has become deeply integrated in global value chains – something which, although described in different words, was already recognised in the *Harvard Business Review* in 1990:

'The relaxation of licensing regulations and the substantial drop in tariffs [in the 1980s] has already had a profound effect on foreign subsidiaries. Foreign-owned companies ... have been freed from the necessity of producing all essential parts and end-products internally [in Mexico] and can now rationalize their manufacturing organizations and focus their efforts on the things they can produce most efficiently in Mexico.'¹⁶

Economic relations between the EU and Mexico have greatly expanded under the Global Agreement, which eliminated all tariffs for industrial goods.¹⁷ Since the Global Agreement entered into force in 2000, EU-Mexico trade in both directions has nearly tripled to reach \$65 billion in 2014, which is 8 per cent of Mexico's total foreign trade, although the US accounts for 64 per cent of this.¹⁸ On the other hand, the EU, unlike the US, has retained a large trade surplus with Mexico. The considerations applying to trade between Mexico and Europe are quite different from those between Mexico and the US: for European TNCs, factories in lower-wage countries within the EU, as well as neighbouring areas such as Turkey and North Africa, serve the same purpose as Mexican ones for US corporations.

The new Trump approach has marked an era of uncertainty in US free trade agreements, which has in turn destabilised Mexico's trade strategy since the NAFTA agreement in the 1990s. European companies have tended to use Mexico not as a market in itself, but as a gateway to the US market and to an extent also Canadian markets. If the US closes its markets and pursues a protectionist agenda for trade, European companies will have to rethink their investment strategies.

¹⁵ Kohler, P. and Storm, S. (2016). CETA Without Borders: How Cutting 'Trade Costs and More' Will Cause Unemployment, Inequality and Welfare Losses. Tufts University. [online] Available at: <http://www.ase.tufts.edu/gdae/Pubs/wp/16-03CETA.pdf> [Accessed 13 Mar. 2017].

¹⁶ Sanderson, S.W., and R.H. Hayes, 'Mexico — Opening Ahead of Eastern Europe', *Harvard Business Review*, September–October 1990, p. 6 of 8. <https://hbr.org/1990/09/mexico-opening-ahead-of-eastern-europe> (September 2015).

¹⁷ European Commission (2015), doc. no. SWD(2015) 289 final (*op. cit.*), p. 10.

¹⁸ European Council, 'Factsheet: EU-Mexico Relations and VII EU- Mexico Summit: Brussels, 12 June 2015', www.consilium.europa.eu/en/meetings/international-summit/2015/06/Fact-sheet-EU-MX--Summit2015-v5-CL-clean_pdf.

Overall, Mexico has become the world's eighth largest car, truck, part and component producer and the sixth largest producer of heavy vehicles; in 2014 it also became the number seven producer of light vehicles, ahead of France and Spain. The industry accounts for 6 per cent of Mexico's GDP and 18 per cent of its manufacturing production.¹⁹ In this sector, Mexico benefits from a 'clustering' effect, as described in a consultancy report: 'Because Mexico is a major auto manufacturer, 89 of the world's top 100 auto parts makers have production in the country. The companies are concentrated in five Mexican states, reducing transportation costs.'²⁰ All told, the motor industry accounted for 21 per cent of Mexico's incoming FDI in 2012. European car companies have turned Mexico into an important final-assembly point in their global value chains. The German carmakers Volkswagen, BMW and Daimler-Benz were attracted by low production costs, proximity to the US market and Mexico's broad network of FTAs with other countries.²¹ One Mexican economist went so far as to call Mexico 'the hub behind the automobile renaissance of North America.' However, he admitted that 'in many cases, industries that had been emblematic for the country and had previously created many jobs, such as the textile, clothing and footwear industries, among others, began to decline.'²²

In some respects the EU has become engaged with the Mexican economy to a comparable or even greater extent than the US. Thus, European companies have invested three-quarters as much as US ones in Mexico since the EU's FTA came into force. Between 2000 and 2014 the US and Canada provided 52 per cent of the FDI coming into Mexico, and the EU 39 per cent.²³ Up to 2011, the total value of the EU's FDI was \$101 billion, of which 38 per cent was in manufacturing and 28 per cent in financial services. It came in at a rate of \$8.4 billion per year, compared with \$2.3 billion before the FTA started.²⁴

The geographical sources of Europe's FDI are quite concentrated. The countries that invested the most between 2000 and 2014 were Spain, with \$51 billion, the Netherlands with \$49 billion and the United Kingdom with \$16 billion. Even including automotive investments, German FDI over this period came to \$9 billion. Up to 2010, these four countries supplied 92 per cent of the EU's investments, with 30 per cent of it from just three Spanish companies: the BBVA and Santander banks and Telefónica Española.²⁵ However, Germany emerged as Mexico's most important *trading* partner within the EU, and its firms employ over 120,000 people in the country. The Netherlands' high place in the list of investors is explained by its role as a corporate 'hub' country, through which TNCs can advantageously channel foreign investments. According to a company which specialises in this area, 'The Netherlands offer an excellent business climate and is used by many multinationals

¹⁹ 'Automotive Industry in Mexico: A Key sector', www.automotivemeetings.com/mexico/index.php/en/automotive-industry-in-mexico (September 2015).

²⁰ Coy, P., 'Four Reasons Mexico Is Becoming a Global Manufacturing Power', Bloomberg, June 27th, 2013, www.bloomberg.com/bw/articles/2013-06-27/four-reasons-mexico-is-becoming-a-global-manufacturing-power (September 2015).

²¹ Konrad, A., 'EU Trade & Investment in Mexico: Facts and figures', Wilson Center Mexico Institute, July 15th, 2015, www.wilsoncenter.org/sites/default/files/pdf/Infographic_EU-Mexico_Trade.pdf (August 2015).

²² Ruíz (2015), p. 7-7.

²³ Konrad, *op. cit.*

²⁴ 'Mexico-EU Trade Links', Year 12, No. 3, Mexican Mission to the EU, Brussels, March 2012, www.economia-nci.gob.mx/sic_php/pages/bruselas/trade_links/ing/maring2012.pdf (August 2015).

²⁵ Arroyo Picard, A., 'Inversión extranjera europea ¿beneficios para México?', Table 3, p. 82, and p. 79, in M. Orozco Contreras, 2011, *op. cit.*

as a gateway. Through the beneficial holding company regime multinationals are still able to make use of the beneficial tax features of the Dutch tax system.²⁶

Outside the motor industry, few of the EU's investors have followed the high-tech GVC (global value chain) route. More have bought into existing Mexican firms, creating few new factories or jobs. An important sector has been brewing, in which in 2013 Anheuser-Busch InBev, the world's largest beer company, based in Belgium, bought Grupo Modelo for \$20 billion. In 2010 the Dutch company Heineken bought Femsa Cerveza, Mexico's second-largest brewer, for around \$7 billion. The company had 20,000 employees, and Mexico is reported to have become Heineken's largest profit producer.²⁷ This follows a typical global pattern of ownership concentration. AB InBev has recently taken over SABMiller, the world's second largest brewing company, creating a new firm which controls nearly 30 per cent of all the world's beer sales.²⁸ The global beer market is an exercise in branding, not in outsourced and fragmented GVCs. AB InBev is typical of the leading companies in placing its beers in three categories: 'global brands' (of which there are six, including Corona from Mexico), 'international brands' and 'local champions' (Victoria and Modelo Especial in Mexico). What matters is the international brand name, not the *place* of manufacture: Heineken's 'global and international brand' from Mexico is Sol, and according to its label, Sol beer sold in the UK is brewed and bottled in the Netherlands 'under supervision' of Heineken's subsidiary in Mexico.²⁹ Not only has this resulted in few new jobs, but it has also in some ways contributed to capital flight. In January 2016 Anheuser-Busch InBev was caught up in illegal tax evasion under the 'Only in Belgium' scheme, which allowed TNCs to record profit as 'excess'. Yet the EU remains an important investor in the Mexican economy, and this importance may well increase under the 'modernised' deal.

Within the world of finance, the Mexican peso has come to be used by international currency dealers as another chip to play with, alongside the euro, the pound, the yen, the Australian dollar and others from the rich world. Dealers recently marked the peso down in response to the UK's referendum on EU membership 'even though you would be hard pressed to discern an economic impact on Mexico from Britain opting out of a European free trade area,' the *Financial Times* reported. 'The Mexican peso is by far the most liquid of the emerging markets currencies, trading about \$135bn a day, 24 hours a day. That makes it an ideal vehicle for hedging all kinds of

²⁶ Vidend Consultancy, www.taxhub.nl/ (July 2016).- broken link

²⁷ Konrad, *op. cit.*; AP, 'Grupo Modelo Deal Finalized, Completing Anheuser-Busch's Purchase of Mexican Brewer', in *Huffington Post*, April 5th, 2013, www.huffingtonpost.com/2013/06/04/grupo-modelo-deal-anheuser-busch_n_3385566.html; Sellers, P., 'Heineken's Charlene de Carvalho: A Self-made heiress', *Fortune*, December 3rd, 2014, <http://fortune.com/2014/12/03/heineken-charlene-de-carvalho-self-made-heiress/> (both in September 2015).

²⁸ European Commission, 'Mergers: Commission approves AB InBev's acquisition of SABMiller, subject to conditions', May 24th, 2016, http://europa.eu/rapid/press-release_IP-16-1900_en.htm; *Wall Street Journal*, 'AB InBev Takeover of SABMiller Would Realign Global Beer Industry', October 14th, 2015, www.wsj.com/articles/ab-inbev-takeover-of-sabmiller-would-reshuffle-global-beer-industry-1444743235# (both in July 2016).

²⁹ See www.ab-inbev.com/brands/brand-portfolio.html (As things stand before AB-Inbev's takeover of SABMiller); and for Heineken, www.theheinekencompany.com/brands (both in July 2016).

risks in the financial system,' it explained.³⁰ More acerbically, Mexico's open capital account was elsewhere described as providing 'an amusement park for foreign exchange traders'.³¹

Europe now controls much of the banking sector, after taking over the leading Mexican banks rather than setting up their own. In a troubled period for West European banks, their Mexican subsidiaries have in some cases come to the rescue; but in others, incompetence or neglect has compounded their other problems. Only two of the eight biggest banks in Mexico at the end of 2012 were Mexican-owned, holding between them just 23 per cent of those banks' \$430 billion in assets. The leading banks under EU ownership were worth nearly twice as much as those owned from the US and Canada.³² Mexico's largest and fourth largest banks were subsidiaries of Spanish banks (BBVA and Santander respectively), the second was US-owned (Citigroup), the fifth was British (HSBC), the seventh Canadian (Scotia Bank) and the eighth German (Deutsche Bank). All of these foreign purchases were facilitated by NAFTA and the EU's FTA.

The owners of these banks are in Bilbao, New York, Madrid, London, Toronto and Frankfurt, and several have exercised insufficient oversight, showing few scruples over who the subsidiaries lent to. Under foreign ownership the banks' lending practices deteriorated, with especially damaging effects on small businesses, including farms. The Carnegie Endowment reported:

'With the consolidation of Mexico's banking sector during the 1990s, credit policy and risk management procedures have become more homogeneous, and have explicitly turned away from the financing of smaller-scale businesses of all kinds. Banks in Mexico have complained to the World Bank about the lack of "creditworthy" clients, and credit is increasingly directed to larger corporations and government agencies.'³³

BBVA Bancomer, the largest bank in Mexico, is consistently the biggest contributor to BBVA's global profits, returning €2.1 billion of the group's €3.75 billion net profit in 2015.³⁴ HSBC, Britain's largest bank, purchased Banco Internacional S.A., known as Bitel, in November 2002, but it would be hard to say that HSBC's investment was a blessing for the country: in December 2012 HSBC reached a legal settlement in the US that included a \$1.9 billion fine for a series of money-laundering offences, the biggest of them being in Mexico, from which as much as \$7 billion was removed. A Cayman Islands subsidiary was set up, handling 50,000 client accounts from Mexico and \$2.1 billion in holdings, but with no staff or offices.³⁵ Mexicans had a right to expect that a takeover by one of the world's largest and most internationally experienced banks would introduce management of the highest professional and ethical standards, rather than this.

³⁰ *Financial Times*, 'No end of reasons to whack Mexican peso', June 22nd, 2016, <https://next.ft.com/content/eee411f6-3863-11e6-a780-b48ed7b6126f>

³¹ Karthik Sankaran, Director of Global Strategy, Eurasia Group, in answer to a question at a session of the FT Festival of Finance, London, July 1st, 2016.

³² Author's calculation, from figures in a list of the 20 largest banks in Mexico ranked by total assets (in 2012) at www.banksdaily.com/topbanks/Mexico/ (August 2015).

³³ Audley, J.J., et al (2004), 'NAFTA's Promise and Reality: Lessons from Mexico for the hemisphere', Washington: Carnegie Endowment for International Peace, p. 79, <http://carnegieendowment.org/files/nafta1.pdf> (July 2016).

³⁴ See <https://info.bbva.com/en/news/economy/results-bbva-2015-4t/> (July 2016).

³⁵ Rushe, D., 'HSBC "sorry" for aiding Mexican drugs lords, rogue states and terrorists', London, *The Guardian*, July 17th, 2012.

There was also a \$400 million fraud at Citigroup's Banamex subsidiary, the country's second largest bank. *New York Times* reporters considered that this bank had experienced 'widespread problems with controls and oversight across its Mexican unit.'³⁶ The latest of these scandals has come in the form of a complaint filed against Rabobank - the Netherlands' second largest bank - which claims that Rabobank has been implicit in laundering the proceeds of drug cartels in Mexico.³⁷ Allegations against the Rabobank branch in Calexico, Mexico have been ongoing for several years, with the Mexican authorities looking into the case several times.³⁸ Currently the inquiry is still incomplete and Rabobank are yet to face any ramifications.

Major investment, particularly into the financial sector, by European banks have not appeared to increase standards in Mexico's financial sector, but have in some known cases been complicit in money-laundering activities, as in the case of Rabobank and HSBC. In 2016, Mexico was a country of primary concern for money-laundering crimes according to the US State Department³⁹, despite its increasing compliance with Financial Action Taskforce recommendations. Mexico is number 3 worldwide in terms of illicit financial flows, after China and Russia.⁴⁰

The banking and finance system has been corrupted in new ways under foreign - and especially European, - ownership. There has also been a loss of much unskilled, semi-skilled and rural employment and an increase in geographical stratification, especially between the north and the south. This has been accompanied by a huge increase in violent crime, some but not all of it connected with the illegal drug trade.

5. In more detail: capital flight, tax avoidance and attempts to control them

After the takeover of many of Mexico's largest banks by European banks, one of the biggest of the world's recent banking scandals took place at the Mexican subsidiary of HSBC, which is the UK's biggest bank. In December 2012 the bank reached a legal settlement in the US that included a \$1.92 billion fine for a series of money-laundering offences, the biggest of them in Mexico. 'Had the US authorities decided to press criminal charges, HSBC would almost certainly have lost its banking licence in the US,' in the opinion of Lanny Breuer,

³⁶ *New York Times*, 'Citi Fires 11 More in Mexico over Fraud', New York, May 14th, 2014, http://dealbook.nytimes.com/2014/05/14/citigroup-says-it-has-fired-12-in-mexico-over-fraud/?_r=0 (August 2015).

³⁷ Moneylaunderingkills.nl. (2017). Campaign information – Money Laundering IS NOT a Victimless Crime. [online] Available at: <https://moneylaunderingkills.nl/index.php/campaign-informationen/#1487870880890-4d529bf9-f7bc> [Accessed 13 Feb. 2017].

³⁸ DutchNews.nl. (2017). Rabobank faces money laundering probe in California: Bloomberg - DutchNews.nl. [online] Available at: <http://www.dutchnews.nl/news/archives/2015/10/rabobank-faces-money-laundering-probe-in-california-bloomberg/> [Accessed 13 Jan. 2017].

³⁹ US Department of State (2016). Countries and Juristictions Table. U Department of State, [pp.https://www.state.gov/j/inl/rls/nrcrpt/2016/vol2/253369.htm](https://www.state.gov/j/inl/rls/nrcrpt/2016/vol2/253369.htm).

⁴⁰ P.9 [http://www.europarl.europa.eu/RegData/etudes/STUD/2016/579326/EPRS_STU\(2016\)579326_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2016/579326/EPRS_STU(2016)579326_EN.pdf)

Assistant Attorney-General of the US.⁴¹ The main accusation was that, with lax oversight, the bank allowed itself to be used as a conduit for international payments by Mexican drug traffickers, especially in the north-western coastal state of Sinaloa. As much as \$7 billion was moved from Mexico. Moreover, a Cayman Islands subsidiary was set up, handling 50,000 client accounts from Mexico and \$2.1 billion in holdings, *but with no staff or offices*, the *Guardian* reported.⁴² That scandal involved money laundering and the concealment of financial transactions in a tax haven or offshore financial centre (OFC).

Another, related practice that was scarcely mentioned for many years has recently reappeared. This is the series of techniques used by companies to reduce their taxation around the world, whether by legal or illegal, legitimate or illegitimate methods. The main area for such behaviour is in the pricing of transfers of goods, services, profits and interest payments between a company's subsidiaries in different countries. As the World Bank put it as long ago as 1985: 'By underinvoicing exports and overinvoicing imports, residents export capital illegally.'⁴³ It is a form of capital flight, and was an important source of concern for developing countries by the 1970s.

Relations between developing countries and TNCs operating on their territories have long been a major issue in development. A U.N. agency, the Centre on Transnational Corporations (UNCTC), was established in 1974 to advise on relations with TNCs. In 1988 it published an important report on 'International Income Taxation and Developing Countries'.⁴⁴ However, it was closed in 1993. Since then the WTO has been created, with several new agreements which reduce each member government's freedom of action vis-à-vis TNCs, while the number of trade and investment treaties which further secure TNCs' position has grown apace. Corporate 'tax planning', which revolves around the manipulation of transfer prices and other tax- and payment-related issues, is a vital part of every modern TNC's strategy. According to the U.N., 'Transfer pricing is generally considered to be the major international taxation issue faced by MNEs [multinational enterprises] today.'⁴⁵ Their directors are surrounded by specialist lawyers, accountants and other highly paid professionals to advise them about it. This issue has reappeared in politics as a result of tax scandals in some of the richest countries, and recently the OECD launched an Action Plan on ways to prevent TNCs from hiding, mis-describing or diverting their earnings to avoid taxation. The OECD uses the curiously mystifying term 'base erosion and profit-shifting' (BEPS) to describe this phenomenon. UNCTAD relates TNCs' tax planning to their investment structures:

⁴¹ As reported in the London *Guardian*, 'HSBC's record \$1.9bn fine preferable to prosecution, US authorities insist', December 11th, 2012, www.theguardian.com/business/2012/dec/11/hsb-fine-prosecution-money-laundering (July 2016).

⁴² Rushe, D., 'HSBC "sorry" for aiding Mexican drugs lords, rogue states and terrorists', London, *The Guardian*, July 17th, 2012.

⁴³ World Bank (1985), *World Development Report 1985*, Washington: World Bank, p. 64.

⁴⁴ In 2013 the report was said to be available online at unctc.unctad.org/data/e88jia6b.pdf. However, that address no longer appears to be valid. See U.N. Department of Economic and Social Affairs (2013), 'Practical Manual on Transfer Pricing for Developing Countries', New York: United Nations, p. 10, footnote 11, www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf (July 2016).

⁴⁵ U.N. Department of Economic and Social Affairs (2013), p. 36. This 500-page manual provides a clearly written and very thorough discussion of the issues involved in transfer pricing and other tax issues involving TNCs, from both companies' and governments' points of view.

‘From an investment perspective, two archetypal categories [of tax planning] stand out: (i) intangibles-based transfer pricing schemes and (ii) financing schemes. Both schemes ... make use of investment structures involving entities in offshore investment hubs.’⁴⁶

‘Intangibles’ refers to assets that fall into the category of ‘intellectual property’ (IP), such as trade marks, copyrights and patents, which generate royalties and licensing fees. It is not possible to understand modern international business without knowing of the large – some would say central – role which these intangibles now play. Due to the difficulty of assigning precise market values to them, payments for such rights are convenient vehicles for transferring money from a TNC’s subsidiary in one country to another.

UNCTAD identified ‘the main tax avoidance levers’ in a list which is copied in the box below. There is not room here to go into every detail, and in this section we will limit ourselves to the exploitation of differences in tax rates, mainly via manipulation of transfer prices.

Tax rate differentials	<input type="checkbox"/> Transfer pricing manipulation (trade mispricing, use of intangible/IP, commissionaire structures) <input type="checkbox"/> Excessive debt financing <input type="checkbox"/> Others (e.g. location planning, loss utilization)
Legislative mismatches and/or gaps	<input type="checkbox"/> Hybrid mismatches <input type="checkbox"/> Derivative transactions <input type="checkbox"/> Disguised domestic investments <input type="checkbox"/> Deferred repatriation
Double taxation treaties	<input type="checkbox"/> Treaty shopping <input type="checkbox"/> Triangular structures <input type="checkbox"/> Circumvention of treaty thresholds ⁴⁷

A corollary of international tax avoidance of this sort lies in the tax incentives that governments offer to foreign companies that might invest in a country. They compete to attract investments with special tax deals, but once operating, the same companies tend to do what they can to avoid paying even the residual taxes that are due. Either way, the people of the country and its own businesses are treated unequally and the privileges of multinational business grow further.

⁴⁶ U.N. Conference on Trade and Development (UNCTAD) (2015), ‘FDI, Tax and Development: The fiscal role of multinational enterprises: Towards guidelines for Coherent International Tax and Investment Policies’, Geneva, p. 22.

⁴⁷ UNCTAD (2015), Table I, p. 25.

6. Double standards: the official fight against tax fraud versus growing illicit financial flows

Officially, these issues have nothing to do with FTAs or IIAs – or the EU. FTAs govern transfers of goods and services between states, and IIAs (International Investment Agreements) and BITs (Bilateral Investment Treaties) protect foreign capital that was transferred in investments, and the earnings arising. Tax relations between states are regulated bilaterally, with no role for the EU, in which taxation (except VAT) remains the responsibility of member states. Treaties dealing with tax issues are therefore a matter for each member state. FTAs and IIAs do not cover this ground either. Nor is there any global regulation of corporate profit or income taxation, in sharp contrast to the rules on so many other aspects of economic administration imposed by the WTO and other bodies, including, in the fiscal area, duties on imports and exports. Where there are bilateral tax treaties between countries, their purpose is usually to avoid double taxation. Mexico recently had double taxation agreements with 40 countries, according to a study of ‘illicit financial flows, macroeconomic imbalances, and the underground economy’ in that country.⁴⁸ The complementary issue, largely neglected until very recently, is double *non-taxation*: when tax that should be due is not paid in either jurisdiction, for various reasons. However, over the course of the last generation the IMF and WTO between them have forced a big reduction in the tax base of many developing countries, which traditionally relied heavily on ‘border’ taxes (duties) on international trade, since they are easily identified and hard to evade. Both IMF stabilisation programmes and WTO trade rules have reduced these in the interests of ‘efficient global markets’ (and, by implication, the TNCs’ value chains).

Are the FTAs, IIAs and BITs – including the one between Mexico and the EU, as well as its projected successor – at all responsible for the problem of BEPS and tax avoidance? Is it in any way related to the liberalisation of trade and investment? Is there any danger that a new CETA-style agreement with the EU will make the problem for Mexico worse? Or is corporate tax planning and its regulation an entirely separate process, which has few links with the trade regime?

As an active member of the OECD, Mexico provides that organisation’s current Secretary-General and is keen on the OECD’s programme to fight tax avoidance, the 15-point ‘Action Plan on Base Erosion and Profit Shifting’.⁴⁹ Under it, Mexico has already introduced a substantial tax reform. A ‘complete overhaul’ of its tax system for 2014 ‘included the revocation of the business flat tax and the imposition of new limitations on the *maquiladora* regime. The tax reform measures were included in the Mexican government’s 2014 budget.’⁵⁰ The reforms involve international payments for interest, royalties and technical assistance. Besides over- and underinvoicing, these are some of the main areas of manipulation used by TNCs for the purposes of tax planning. Mexico’s new rules require companies to identify the effective beneficiary of a payment, in order to fight the secrecy that surrounds operations with tax havens. Where there are double-taxation agreements, the

⁴⁸ Kar, D., (2012), ‘Mexico: Illicit Financial Flows, Macroeconomic Imbalances, and the Underground Economy’, Washington: Global Financial Integrity, p. 47.

⁴⁹ Organisation for Economic Cooperation and Development (OECD) (2013), ‘Action Plan on Base Erosion and Profit Shifting’, Paris: OECD Publishing, <http://dx.doi.org/10.1787/9789264202719-en>.

⁵⁰ Johnston, S.S., (2014), ‘Practitioners Highlight BEPS-Driven Tax Changes in North America and EU’, Falls Church, VA, USA: Tax Analysts, p. 1. Available at www.sandw.com/assets/html/documents/Tax%20Analysts_6.9.14_Worldwide%20Tax%20Update.pdf (July 2016).

tax authorities would require legal assurances that any such payment to a related foreign company will actually be taxed in the recipient country.⁵¹ The government has tried to force the issue with three big TNCs in consumer goods markets, Procter & Gamble and Colgate of the US and the Anglo-Dutch firm Unilever. According to Reuters, 'Mexico's tax authority SAT held back more than \$384 million in value-added tax (VAT) from the three companies while it was probing them and nearly 270 others for possible tax avoidance after President Enrique Peña Nieto took office in late 2012.'

In February 2015 Mexico had reached three settlements under the investigation. Unilever reached a deal in 2014 to pay more corporation tax, and it later received about \$131 million in VAT it was owed. However, at that time Procter & Gamble and Colgate had not reached deals.⁵² But Mexico has been criticised for being too keen to implement the OECD reforms. One commentator deplored its 'rather aggressive approach in the BEPS context' as it appeared 'to be getting ahead of itself by immediately imposing measures to address BEPS in its domestic legislation.' He argued that 'this was intended to be a set of harmonized rules that will be adopted by all the countries at the same time.'⁵³ The international accountancy and consultancy group, KPMG – itself a major TNC which, among other things, advises other firms on the exploitation of international tax differences and loopholes – commented on Mexico's 'hasty and uncoordinated implementation' of the reforms. However, the same commentary reported a 'tax certainty agreement' which 'commits the federal [Mexican] government to a moratorium on tax law changes until the current presidential period ends in November 2018.'⁵⁴ So maybe they were not so hasty after all. If Mexico is taking the clampdown more seriously than most countries in the OECD, it has good reason to. Reuters reported that according to the SAT, Mexico has the lowest tax take in the OECD: the top 132 foreign firms in fact paid almost nothing – 'less than 1.5 per cent' of gross profits – in corporate tax.⁵⁵ Meanwhile, the government reported to the U.N. these obstacles in assessing profit taxes and ensuring that they were paid:

1. Lack of information about the global business of a TNC's group;
2. Lack of public information on local comparable companies [for the purpose of assessing what normal, 'arm's length' transfer prices would be];
3. The volume and complexity of international trade within the group.⁵⁶

This is a longstanding problem. In 1985, a World Bank analysis concluded: 'In absolute terms, no country has suffered more capital flight than Mexico.' It estimated that a total of \$26.5 billion had fled the country between

⁵¹ Johnston (2014), pp. 1–2.

⁵² Alper, A., 'Mexico withheld millions in tax refunds from P&G, Unilever, Colgate', Reuters, September 1st, 2015, www.reuters.com/article/2015/09/01/us-mexico-tax-idUSKCN0R147Y20150901 (September 2015).

⁵³ Johnston (2014), p. 1.

⁵⁴ KPMG International (2014), 'OECD BEPS Action Plan: Taking the pulse in the Americas region', pp. 5 and 17 respectively, unnamed location: KPMG International Cooperative, <https://home.kpmg.com/xx/en/home/insights/2015/10/oecd-beps-action-plan-taking-the-pulse-series.html> (July 2016).

⁵⁵ Alper, 2015, *op. cit.*

⁵⁶ U.N. Financing for Development Office (2014), 'Questionnaire: Mexico's experiences regarding base erosion and profit shifting issues', New York: United Nations, www.un.org/esa/ffd/wp-content/uploads/2014/10/ta-BEPS-CommentsMexico.pdf (July 2016).

1979 and 1982, equal to 47.8 per cent of the \$55.4 billion of gross capital inflows in those years. ‘Effectively, much of the money being borrowed from abroad was funneled straight out again, thereby not earning returns that could be used to service the debt. In such cases, foreign borrowing was a recipe for disaster,’ the Bank commented.⁵⁷ And yet under the liberal reforms which followed the Debt Crisis, the government reduced its controls in this area. It ‘substantially relaxed’ its restrictions on FDI, for example by eliminating in 1989 the 55 per cent withholding tax which Mexico had previously levied on the repatriation of dividends, according to the *Harvard Business Review* article already cited.⁵⁸ The GFI (Global Financial Integrity) study on illicit financial flows between 1970 and 2010 asserted that there had been ‘no recent studies on capital flight from Mexico’ for the years after 1982.⁵⁹ Its analysis concluded that the illicit capital flight was not necessarily or even mostly of drug money, but came from Mexico’s large ‘underground’ economy. The goods traded were not necessarily illegal, but the ‘under-the-table’ way they were traded was. The report estimated that over the 41 years between 1970 and 2010, the outflows of illicit capital averaged about 5.2 per cent of Mexico’s GDP per year. It found that over the whole period almost three-quarters of the illicit flows leaving Mexico did so via trade mispricing, although in the 1970s and 1980s trade mispricing and discrepancies (or ‘leakages’) in the import and export data had accounted for roughly equal shares; but in the 1990s and 2000s trade mispricing accounted for approximately 80 per cent of it. The report attributed the growing share of trade mispricing to the ‘increasing trade openness since 1994 when NAFTA was implemented’.⁶⁰

7. Concluding remarks and policy suggestions

As the EU and Mexico plan to accelerate trade talks, there is a small margin for the thorough scrutiny that these so-called ‘modern’ trade deals require and deserve. In May 2016, Sorin Moisă MEP (Rapporteur for the renewed EU-Mexico trade agreement) tabled a Written Question to the Commission ‘...*despite recent efforts to fight money laundering Mexico remains one of the main sources of illicit financial outflows worldwide. Does the Commission intend to address this issue and its link to trade as part of the future negotiations with Mexico?*’⁶¹ The Commission’s response was that it is not the role of the FTA to provide measures for tackling money laundering. Yet it is evident that trade deal cannot be separated from tax issues, human rights and money laundering. This report has largely focused on the potential for this FTA to increase the risks of tax avoidance, capital flight and money laundering on both sides of the Atlantic. However, this is just one facet of the deal, and as with TTIP and CETA, it is evident that there are many causes for concern within such deals. Though FTAs with the EU do not deal with tax regulation explicitly, they do play an important role in minimising or increasing

⁵⁷ World Bank, *World Development Report 1985*, p. 64, including Table 4.4.

⁵⁸ Sanderson and Hayes (1990), p. 5 of 8.

⁵⁹ Kar (2012), p. 18.

⁶⁰ Kar (2012), pp. 5 and 47.

⁶¹ European Parliament (2016). Anti-corruption and the modernisation of the trade pillar of the EU-Mexico Global Agreement. [pp.http://www.europarl.europa.eu/sides/getDoc.do?type=WQ&reference=E-2016-004377&language=EN](http://www.europarl.europa.eu/sides/getDoc.do?type=WQ&reference=E-2016-004377&language=EN).

the chances of tax fraud through provisions and regulation or lack thereof. Therefore, FTAs like the EU-Mexico deal risk facilitating tax fraud and illicit financial activity

These concerns about the proposed EU-Mexico deal are not isolated. In September 2016 the Dutch trade minister produced a paper calling for more progressive and inclusive trade policies⁶² Succinctly put, the paper has the title '*Reforming EU trade policy: protection, not protectionism*' Reflecting this view, our policy suggestions are:

1. Check chapters on financial services, on the right of establishment and related chapters, in order to exclude the use of the FTA for money laundering and tax fraud purposes. Movement of capital has to be controlled, in particular:
2. Submit current account transfers in value and number to supervision via automatic data exchange on financial flows and bank accounts. Liquidation and repatriation of investments and any profit stemming from it, as well as the currency in which transfers are made, have to be controlled and authorised.
3. Enshrine mechanisms to disclose ownership (ultimate beneficial owner) by nationals and non-nationals ,concerning company assets and land, as well as taxes paid, without distinguishing between residents and those whose principal residence or capital is abroad.
4. Make the submission of an annual report by Financial Action Task Force to the EU and GAFILAT (Financial Action Task Force of Latin America) for Mexico mandatory.
5. Delete any wording such as “best endeavours” or “take note of” and replace these expressions by mandatory provisions.
6. Clearly define “investment” and distinguish in the text between foreign direct investment (FDI) - as a long term investment - and speculative operations. The latter must be excluded from any protection measure concerning FDI. Options, futures and other products of financial engineering should not fall into the scope of the agreement.
7. The text needs to be thoroughly protected from abuse so that international corporations can gain better conditions than national enterprises.
8. Delete the limitation of prudential carve-outs to balance-of-payments reasons, limited in time, to preserve the “stability of the financial markets”. The “stability of financial markets” is never really defined. To invoke this principle is an obstacle for reform and improvement of financial markets. Also delete the provision that they are not allowed to be “more burdensome than necessary” to achieve their aim.
9. Introduce the precautionary principle for prudential carve-outs.
10. Enshrine mandatory performance requirements for European companies operating in Mexico, and for Mexican companies operating in the EU
11. Define “service supplier” as a natural or juridical person with real and verifiable economic activities in the host country.
12. Carefully shape the establishment of cross-border supply tax advisory services, in order to stop the “Panama Papers disease”.

⁶² Minister for Foreign Trade and Development Cooperation, Netherlands (2016). Non-Paper: Reforming EU Trade Policy: protection, not protectionism. Netherlands, pp.<http://www.politico.eu/wp-content/uploads/2016/10/NL-non-paper-Reforming-EU-trade-policy-Protection-not-protectionism.pdf>.

13. Enshrine provisions concerning the investigation and prosecution of illicit financial flows, including trade-based money laundering schemes and transfer mispricing.
14. Carefully shape provisions in transparency, so that the agreement does not create a de facto right for lobbyists and the financial industry to comment on and influence any proposed financial regulation for their private purposes.
15. Delete any standstill clause for national regulation.
16. Exclude ICS (Investor Court System) and similar forms of investor-to-state-dispute settlement.
17. Exclude TISA (Trade in Services Agreement) provisions, and refrain from introducing a TISA + as part of the agreement.