Submission No 10

Australia's trade with Mexico and the Region

Organisation: Department of Foreign Affairs and Trade

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Address:

Joint Standing Committee on Foreign Affairs, Defence and Trade
Trade Sub-Committee

Australian Government

Department of Foreign Affairs and Trade

8 December 2006

The Secretary
Trade Sub-Committee
Joint Standing Committee on Foreign Affairs, Defence and Trade
Parliament House
CANBERRA ACT 2600

Dear Secretary

I refer to the letter dated 13 October 2006 from the Hon Warren Snowden, MP, Deputy Chairman of the Trade sub-Committee inviting submissions to the Sub-Committee's Inquiry into Australia's Trade with Mexico and the Region. I am pleased to enclose copies of the Department's Submission to the Inquiry.

I should also confirm that the Department of Foreign Affairs and Trade and the Australian Embassy in Mexico would be pleased to facilitate any visit members of the Sub-Committee might wish to make to Mexico and the region in the course of the Inquiry.

Yours sincerely

Les Luck
First Assistant Secretary
Americas Division

Parliament of Australia
Joint Standing Committee on Foreign Affairs, Defence and Trade

Trade Sub-Committee
Inquiry into
Australia's Trade with Mexico and the Region

Submission
by
The Department of Foreign Affairs and Trade

December 2006

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Submission by the Department of Foreign Affairs and Trade

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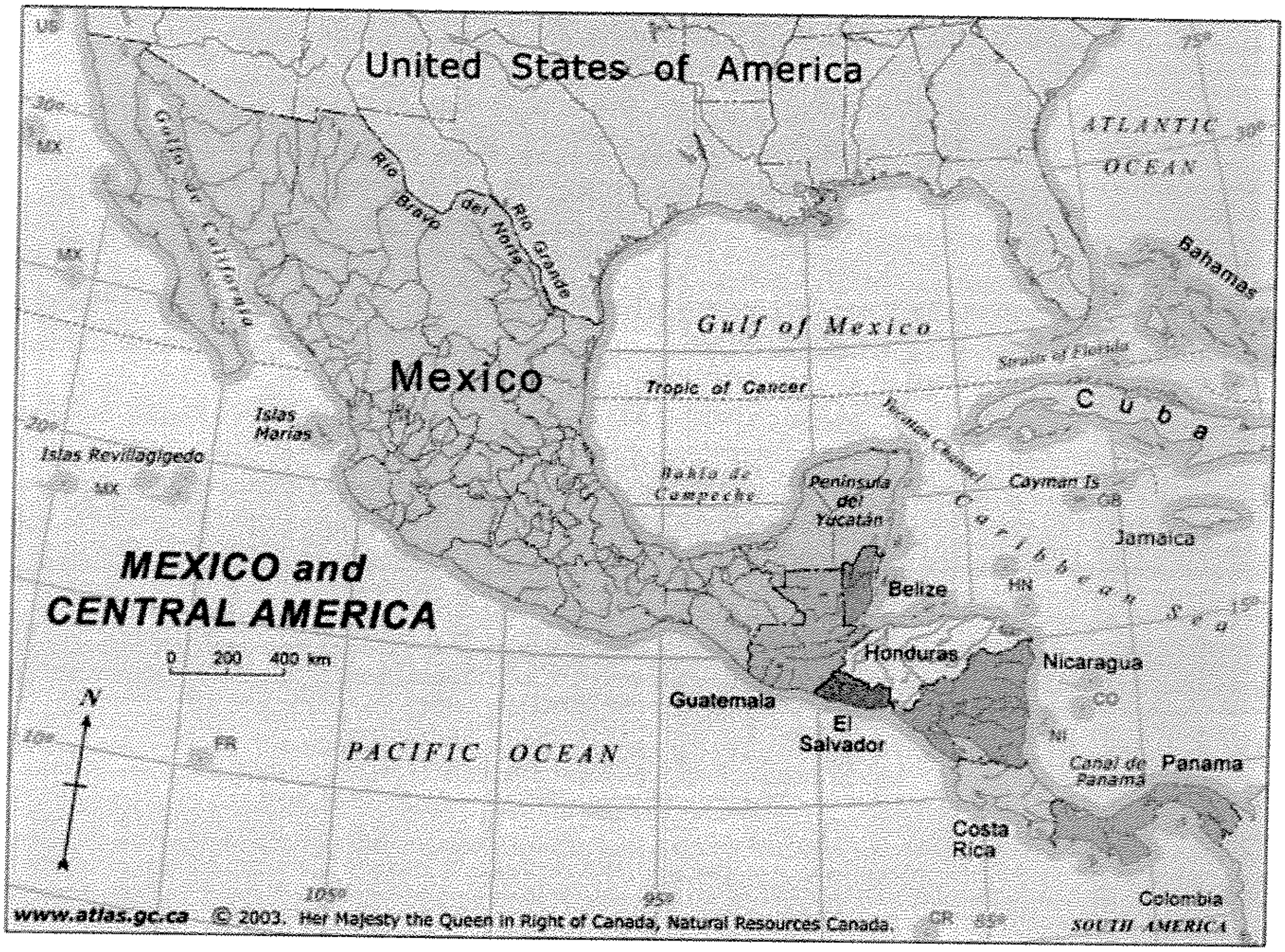
Mexico, Central America & Cuba



It is timely that the Trade Sub-Committee of the Joint Standing Committee on Foreign Affairs, Defence and Trade has decided to conduct an inquiry into Australia's trade with Mexico and its region.

2006 marks the fortieth anniversary of the establishment of diplomatic relations between Australia and Mexico. Australia established its Embassy in Mexico City in May 1966 and in the same month Mexico opened its Embassy in Canberra. Australia now has an Honorary Consul in Monterrey. Mexico has Honorary Consulates in Brisbane, Darwin and Melbourne (although the Melbourne Consulate is temporarily closed).

Austrade is represented in Mexico City and that office is responsible for Mexico, Central America and the Caribbean, although the focus of the office is on Mexico's burgeoning economy.

The partnership between **Australia and Mexico** is strong and growing. **Section 2** of this submission outlines in detail the current state of the economic and trade relationship between the two countries. Mexico was Australia's largest merchandise trading partner in Latin America in 2005-06 and our twenty ninth largest merchandise trading partner overall, with two-way trade worth AUD1.8 billion. Australian exports of goods and services to Mexico were approximately AUD874 million in 2005-06, consisting of coal, meat, livestock, dairy, leather and an increasing range of services. The trend growth in Australia's exports to Mexico in the last five years has been 15 per cent.

A high point in bilateral relations with Mexico was the visit by Australian Prime Minister Howard in 2002 for the APEC Leaders' Summit. During that visit Mr Howard expressed interest in Australia's negotiating a Free Trade Agreement (FTA) with Mexico.

The visit set in train or assisted several negotiations, the results of which have contributed significantly to supporting our bilateral trade and economic interests. These include the conclusion of a bilateral Double Taxation Agreement (2004), a Memorandum of Understanding (MOU) on Mining (2002), an MOU on Education and Training (2003) an MOU on Energy (2005) and, most recently in August 2005, an Investment Protection and Promotion Agreement.

In March 2006, Australia and Mexico agreed to establish a Joint Experts Group, to investigate ways of strengthening economic relations, including the possible negotiation of a Free Trade Agreement sometime in the future. Terms of Reference for the Group have now been agreed, and it is expected to hold its first meeting early in 2007.

Negotiations on a bilateral Air Services Agreement were also finalized in March 2005, and Qantas and Mexicana Airlines signed a new code-share service agreement in July 2006.

Australia's relationship with Mexico has been enhanced in recent years by high level political engagement. Visits to Mexico in 2006 by the Minister for Foreign Affairs and Trade, Mr Downer, and the Minister for Industry, Tourism and Resources, Mr Macfarlane, along with visits by Mexican Ministers and vice-ministers to Australia, underscore our mutual interest in strengthening bilateral trade, investment, political and people-to-people links.

Australia's ability to help meet Mexico's energy needs by supplying high quality coal and possibly LNG may well define the future of the bilateral trade relationship. Mexico has a clear preference for Australian coal and it dominates our bilateral export profile. There is also the possibility of uranium exports as Mexico looks to boost nuclear energy generation. The High Level Group under the Energy MOU will be important in managing this potential sensitivity. Mexico is very interested in putting the MOU into action and establishing a cooperative work program on energy issues.

The 2001 Australian Census revealed that there were around 1,200 Mexican-born persons resident in Australia at that time. In 2005, around 7300 Australians traveled to Mexico for short stays of less than twelve months while 5,340 Mexicans visited Australia in 2005, of whom some 1,045 arrived on student visas. Mexican arrivals peaked in 2000 (the year of the Sydney Olympics) at 6,300 and have remained at around the 5,000 level in subsequent years. In the period since 2000, however, student numbers have increased markedly – there were only 158 Mexican students enrolled in Australian education institutions in 2000 and there were 1 123 in 2005. The increase in student numbers from Mexico reflects increased promotional activity over the last five years. Similar increases in tourism might also be expected with a greater level of tourism promotion in Mexico.

Section 3 of this submission will provide more detail on Australia's limited trade and investment ties with **Central America**. Australia has no diplomatic representation in Central America. Australia's Embassy in Mexico City covers our relations with countries in Central America on a non-resident basis. No Central American country has representation in Australia.

Trade and investment ties are nevertheless growing consistently from a very small base. There are opportunities to expand trade exist in agribusiness, food commodities and the provision of professional services. Whilst still modest, two-way merchandise trade with Central America has increased significantly over recent years. Between 2004-05 and 2005-06, two-way merchandise trade grew by more than 25 percent, to around AUD126 million.[1] Australia's main exports to Central America are dairy products, in particular milk, cream, butter and cheese. Other major exports are recreational boats, medicaments and paper and paperboard. Our major imports include integrated circuits, coffee, and clothing, computer parts and medical instruments. There is also scope to promote the Australian education system as an attractive option for Central American tertiary students and students wanting to study English language.

Despite the modest nature of two-way trade, Australian companies are taking advantage of niche opportunities to provide professional services throughout the region. The Australian Government, through our post in Mexico City and our Austrade representation there, helps raise the profile of Australian companies and ensures that Australian businesses and exporters are well positioned to make the most of emerging opportunities. The most significant Central American project that Australia has been directly involved in recently was the design and construction of the second bridge over the Panama Canal. The bridge was opened in 2004. Expansion of the Panama Canal could create further opportunities for Australian businesses.

Australia cooperates with Costa Rica and Guatemala in the Cairns Group, to promote our common commitment to agricultural trade reform. Central American communities within Australia, such as the large El Salvadorean community, help promote links between our two regions. As fellow members of the Commonwealth, we share positive and friendly ties with Belize and cooperate in various Commonwealth organisations and events. We also cooperate with Central American countries, to

[1] Trade statistics for Central America exclude Mexico and Cuba, and ~~include~~ Guatemala, Belize, El Salvador, Honduras, Nicaragua, Costa Rica and Panama.

varying degrees, in a range of international fora on important international issues such as the environment, whaling, fisheries management, human rights and security.

Australia and Cuba have maintained diplomatic relations since January 1989, but there is relatively little bilateral trade. Australia has non-resident accreditation to Cuba from its Embassy in Mexico City, while Cuba has a Consulate-General in Sydney. The Cuban Ministry of Foreign Affairs has raised with our Embassy in Mexico City the possibility of establishing an Embassy in Canberra, but plans have not advanced due to financial constraints.

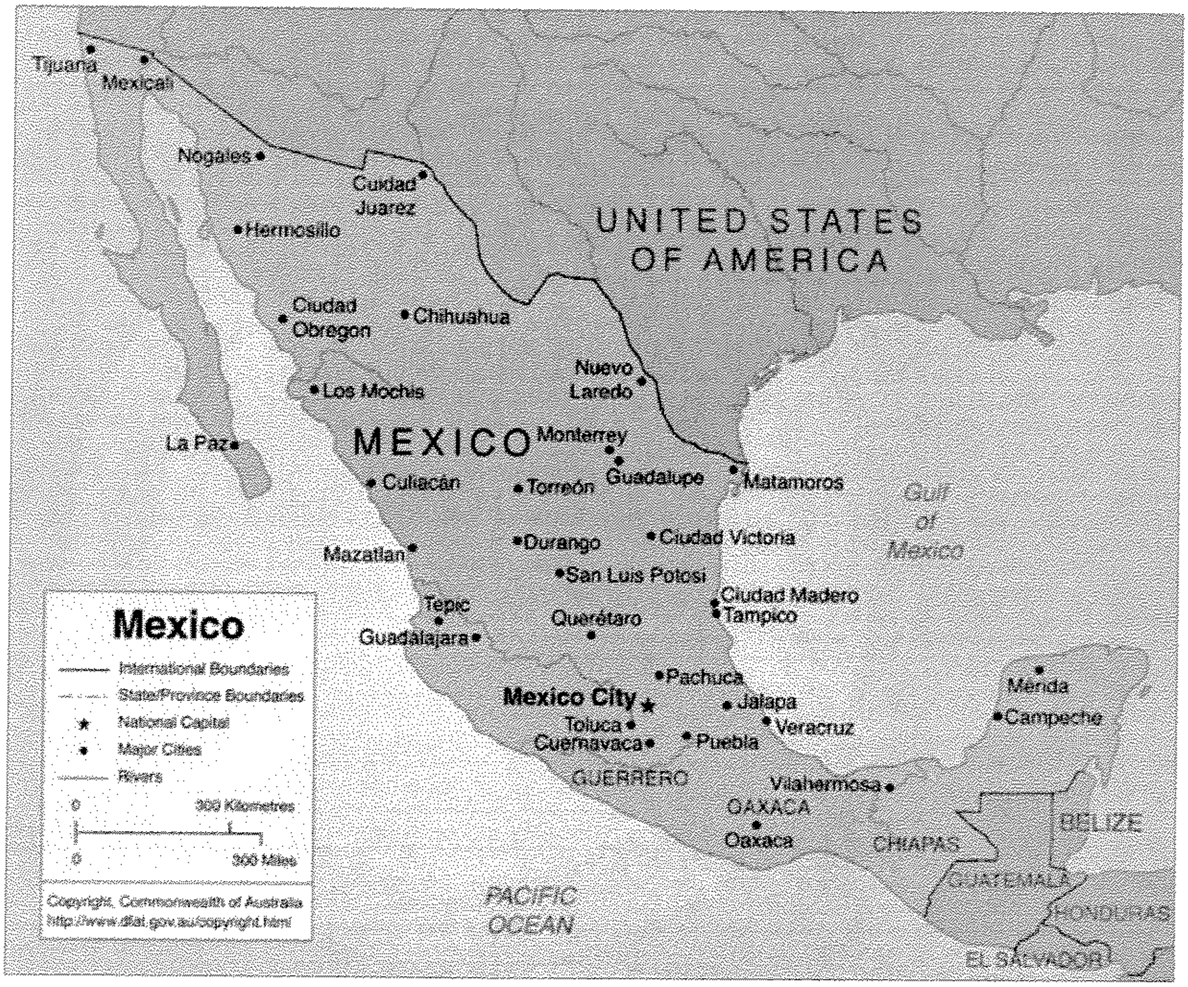
Australia's merchandise exports to Cuba in 2005-06 totalled approximately AUD 8.2 million, while Australian imports from Cuba were AUD 5.8 million. Australia's main imports from Cuba are crustaceans ,tobacco and fruit juices.

The potential for expanding Australian trade with Cuba is limited because of the existence of the U.S. Helms-Burton legislation, which offers a disincentive to overseas businesses considering trade with Cuba. While Australia in recent years has voted in favour of Cuba's resolution in the United Nations General Assembly calling for an end to the US economic embargo, Australia continues to have concerns about the human rights record of the Castro regime. **Section 4** of this submission deals in more detail with our links with Cuba.

An important development in Australia's relations with Latin America, including Mexico and its region, was the Australian Government's decision in 2001 to establish the **Council on Australia-Latin America Relations (COALAR)**, in response to the September 2000 report of the Trade Sub-Committee on Building Australia's Trade and Investment Relationship with South America. This Council, which has a budget for 2006-07 of AUD500,000, aims to enhance commercial, political and social relations between Australia and Latin America. Since its inception, the Council has been active in promoting Latin America as a market for Australian exporters. Its current priorities are to influence corporate Australia and assist in developing government policies so as to enhance Australia's economic, political and social relations with Latin America, particularly in the areas of tourism, investment, and agribusiness; to support Australia's broader diplomatic and economic objectives in the Latin American region through cultural promotion and education; and to foster a greater awareness of Australia in Latin America, and of Latin America in Australia. The Council has developed as a significant additional asset for Australia in pursuing trade and investment objectives in this region.

The Forum for East Asia – Latin America Cooperation (FEALAC), is another body through which Australia can expand and strengthen relationships with Mexico and Central America. It aims to increase and improve mutual understanding, trust, political dialogue and friendly cooperation among member states. The Forum has 30 member nations including Australia, Costa Rica, El Salvador, Panama, Guatemala and Nicaragua and Mexico. FEALAC has some way to go, however, to fulfill its potential.

2. Mexico



Historical and Political Overview

Mexico is a federal democracy with a directly elected President. The President serves a six-year term and cannot be re-elected. The bicameral Congress comprises 128 Senators, each serving a six-year term, and 500 members in the Chamber of Deputies, serving a three-year term. Senators and Deputies cannot stand for re-election. Mexico's political evolution has been marked by colonization and at times considerable political instability and violence.

The Aztecs ruled Mexico prior to 1519-1521 when Hernando Cortes defeated the Aztec empire and claimed Mexico for Spain. The Aztecs were the successors to other great civilisations that had ruled in Mexico - the Mayas, the Olmecs, and later the Toltecs. Spain ruled Mexico until 1810 - the start of the Mexican revolution. The Mexicans won independence from Spain in 1821.

The first fifty years of Mexico's independence was a time of difficulty for the country. Mexico experienced a wide variety of short-lived governments, lost Texas to the United States in 1836 and after defeat in the war with the U.S. (1846–1848), lost the area that is now California, Nevada, and Utah, most of Arizona and New Mexico, and parts of Wyoming and Colorado under the Treaty of Guadalupe Hidalgo. In

1855, the Indian leader Benito Juárez began a series of reforms, including the disestablishment of the Catholic Church, which owned vast property. The subsequent civil war was interrupted by the French invasion of Mexico (1861) and the crowning of Maximilian of Austria as emperor (1864). He was overthrown and executed by forces under Juárez, who again became president in 1867.

The Mexican revolution (1910-1917) overthrew the twenty-seven year military dictatorship of Porfirio Diaz in 1911. Difficulties developed in Mexico's relations with the United States, which resulted in a punitive US expedition being sent to northern Mexico in 1916-17. A brief civil war in 1920 was followed by a sustained period of agricultural, political and social reform in Mexico. The dominant political party during this period was the National Revolutionary Party (PNR), which was renamed the Institutional Revolutionary Party (PRI) in 1946. PRI controlled Mexico from the Party's formation in 1929 to the end of the twentieth century.

Following World War II, the Mexican government emphasized economic growth. During the mid-1970s, under the leadership of President José López Portillo, Mexico became a major petroleum producer. By the end of Portillo's term, however, Mexico had accumulated a huge external debt because of the government's unrestrained borrowing on the strength of its petroleum revenues. The collapse of oil prices in 1986 cut Mexico's export earnings. In January 1994, Mexico joined Canada and the United States in the North American Free Trade Agreement (NAFTA). Mexico suffered a severe banking crisis in 1995, with only strong support from the United States averting a collapse of Mexico's private banking system.

Electoral reforms introduced by President Zedillo in 1996 saw the major opposition parties, the National Action Party (PAN) and the Party of the Democratic Revolution (PRD), strengthen their positions. Mid-term elections held in July 1997 resulted in the PRI losing its absolute majority in Congress for the first time in its 70 year history. In addition Cuauhtémoc Cárdenas was elected as Mayor of Mexico City, the first time this position had been directly elected and the first time the Mayor of Mexico City had not come from the PRI.

These reforms set in train a significant change in Mexico's political landscape. In 2000 the political hegemony of the Institutional Revolutionary Party (PRI), which had endured in Mexico for 71 years, was broken by the election of President Vicente Fox of the National Action Party (PAN). Fox, a former Chief Executive of Coca-Cola in Mexico and Governor of Guanajuato state, defeated the PRI candidate, Labastida, on a platform of democratic change, an end to corruption and wider community prosperity. During six years in office, Fox's government pursued macroeconomic goals focused on increasing investment and employment. Sound fiscal management promoted economic growth and moved Mexico out of recession. However, the introduction of widespread structural and economic reforms was hindered by opposition within the Mexican Congress.

In the lead up to the Presidential elections of 2 July 2006, Mexico divided along ideological and socio-geographic lines. The PAN candidate, conservative technocrat and former Energy Minister, Felipe Calderon, campaigned on a platform of continuing Fox's economic liberalization and stable macroeconomic policies, improving employment rates and strengthening investment. Calderon had the support of the business sector and wealthier northern states, while the poorer central and southern regions, containing many of Mexico's rural and urban poor, backed leading opposition contender and former Mayor of Mexico City, Andres Manuel Lopez Obrador, from the Democratic Revolution Party (PRD).

Calderon won the Presidency by only 0.57 percent, the slimmest majority in Mexican history. Lopez Obrador and his supporters claimed the elections were unfair and alleged irregularities in the voting process. These allegations were rejected by Mexico's Electoral Court, which then declared Calderon as President-elect. Calderon took office on 1 December, 2006. His slim mandate will present significant challenges for the new administration, particularly in forming effective congressional coalitions to progress economic reform, even though the PAN currently holds the largest number of seats in both the Senate (52 out of 128) and the Chamber of Deputies (206 out of 500). Both the PAN and the PRD made significant gains in the last election at the expense of the PRI.

Economic Overview

Over the past two decades, Mexico has moved from a highly protected to a more open, regionalised, and market-based economy. The economy is a mixture of modern and outmoded industry and agriculture, and is dominated increasingly by the private sector. Cautious fiscal and monetary policies over the past six years have reinforced expectations of sustainable macroeconomic stability, but so far these policies have failed to produce rapid growth on a scale needed to boost employment and reduce poverty substantially: nearly half of Mexico's 104 million population lives below the poverty line. Mexico's economy needs to grow by at least 6 per cent per year to create the one million jobs required annually just to keep pace with additions to the workforce from population growth. In 2005, the economy grew by only 3 per cent.

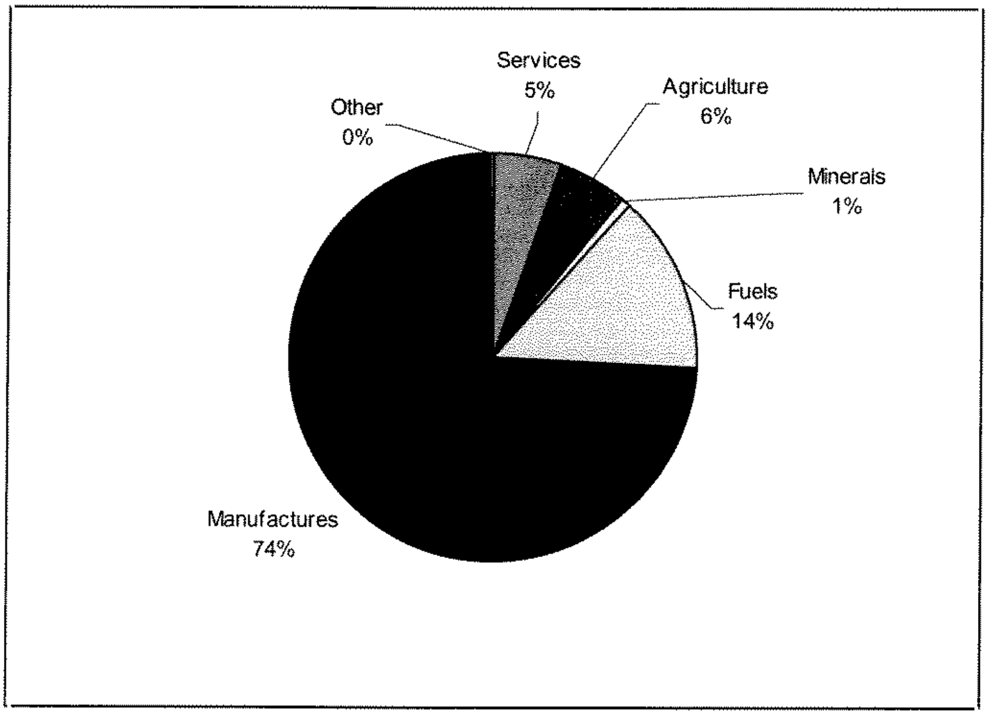
Mexico's reliance on oil revenues is unsustainable, and long-term economic and social reform is required to lift the rate and quality of economic growth. Mustering broad political support for microeconomic reform in areas like taxation, labour markets, energy, and regulatory systems will be difficult. The incoming Calderon Administration, like the Fox Administration, faces a country that is divided politically, economically and socially. To be politically credible, the new administration must make real inroads into poverty reduction. To be economically credible, it must advance an ambitious economic and social reform agenda by crafting a workable national consensus, in partnership with pro-market elements in an opposition-dominated Congress, on what needs fixing and how to fix it.

Mexico's economic profile

Mexico's per person gross domestic product (GDP) is approximately one-quarter of Australia's, but its GDP is larger - the second largest in Latin America after Brazil, twelfth in the world measured by purchasing power parity and thirteenth measured on an official exchange rate basis (Table 2.1). Mexico is the only Latin American member of the Organisation for Economic Cooperation and Development (OECD), testimony to rapid progress since the early 1990s in reducing government influence in the economy and opening up to foreign trade and investment.

Manufacturing accounts for nearly one-fifth of Mexico's GDP and for about three-quarters of its exports; unlike Australia, manufacturing is now the mainstay of the Mexican economy (Chart 2.1). Foreign trade as a percentage of Mexico's GDP is substantially higher than Australia's, accounting for 35 per cent of GDP in 1993 and 63 per cent in 2005 (Chart 2.3). The US is Mexico's dominant trading partner and major source of foreign direct investment (FDI), but capital inflows from Europe (particularly Spain) and Japan are rising sharply, albeit from a low base, and seem set to grow quickly in areas like autos and services.

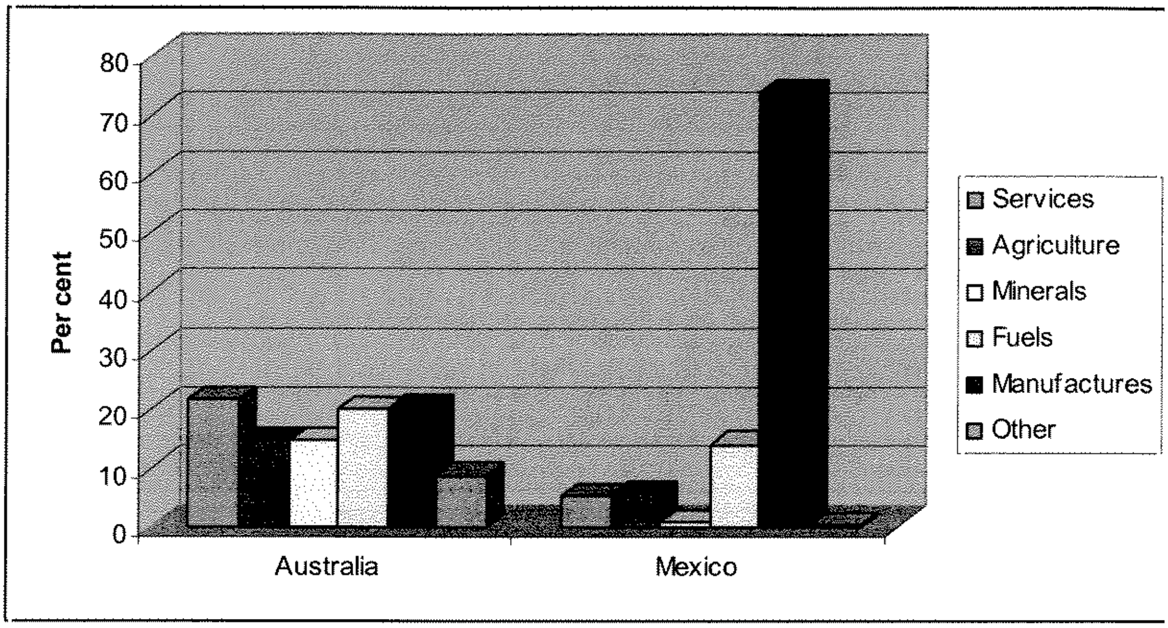
Chart 2.1: Mexico – Share of Exports by Sector - 2005



Source: UN trade data on DFAT STARS database and WTO database

The following chart shows how this dominance of manufacturing in Mexican exports compares with Australia's composition of exports.

Chart 2.2: Share of Exports by Sector: Mexico (2005) and Australia (2005-06)



Source: DFAT STARS database (2005-06 Australian data and 2005 Mexican data)

Approximately 35 per cent of Mexico's population lives in rural and regional areas, and agriculture provides employment for about 16 per cent of the workforce and generates 4 per cent of GDP. In Australia, agriculture employs 3 per cent of the workforce and contributes 4 per cent of GDP.

Like Australia, Mexico has a strong resource base. It is the world's largest producer of silver, the ninth largest exporter of oil, and the third largest supplier of oil to the US. Oil and gas generate about one-third of the Mexican Government's revenue.

Table 2.1: The Australian and Mexican Economies

Select Indicators	**Australia**	**Mexico**
Population in 2005 (million)	20.5	105.3
Surface Area ('000 square Km)	7,692	1,958
GDP (US billion, current prices – market exchange rate) - 2005	711.7	768.4
GDP (US billion – PPP) 2005	630.1	1,072.6
Real GDP Growth (% change YOY - 2005)	2.9	3.0
Per capita GDP 2005 (USD/person) Current prices – market exchange rate 2005	34,757	7,298
Exports goods and services (% of GDP) 2005	19.1	30.0
Consumer Price Inflation, average 2005 (%)	2.8	4.0
Unemployment rate, average 2005 (%)	5.2	-
Secondary school enrolment ratio (% of relevant age group, 2002/2003)	88	60
Public expenditure on health (%GDP)	6.2	2
Infant mortality rate (per 1000 live births, 2004)	4.6	22.6

Source: World Bank, IMF, ABS, Department of Foreign Affairs and Trade

Economic performance

Since the 'Tequila crisis' of the mid-1990s, economic reform and improved economic management in Mexico have underpinned lower inflation, stronger external accounts, lower government debt, more robust export growth, and a sounder banking sector. Private consumption linked to increased employment and rising wages has become the leading driver of growth, and the implementation of the North American Free Trade Agreement (NAFTA) in 1994 has facilitated a doubling of Mexico's trade with the US and Canada. NAFTA also has contributed to Mexico's integration into the world economy through rapidly evolving manufacturing links to the US. Mexico's economic performance is now tied very closely to the US economic cycle.

Following a brief period of stagnation in 2001, Mexico's economy has since expanded steadily. It grew by 4.2 per cent in 2004 as private consumption and investment rebounded, but slowed to 3 per cent in 2005, influenced by sluggish domestic demand, falling agricultural yields and weak growth in US industrial production.

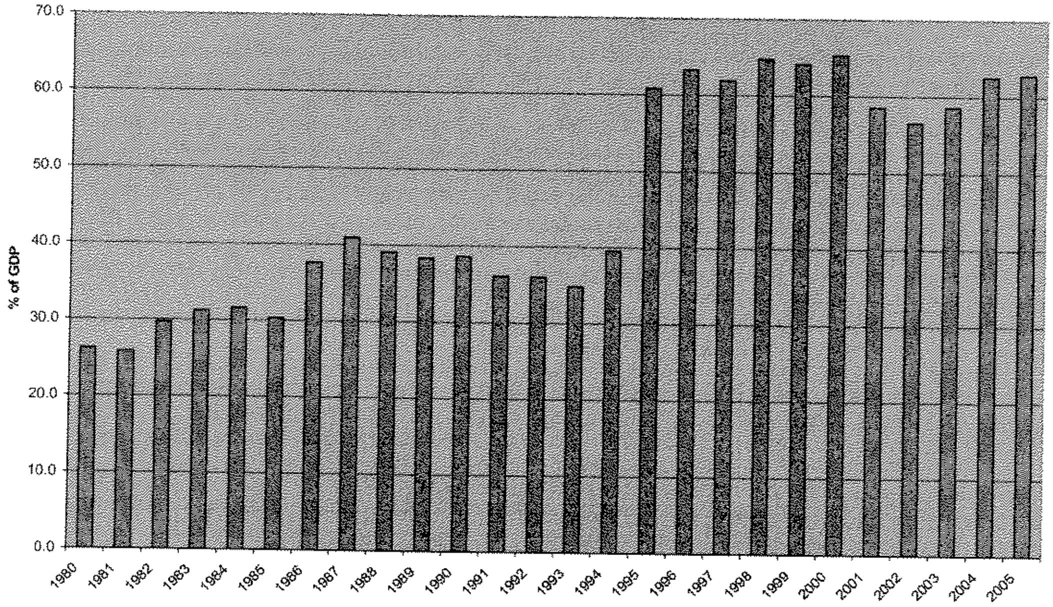
The economy accelerated in the first quarter of 2006 in response to solid US growth: real GDP grew by 5.5 per cent year-on-year in the March 2006 quarter, the fastest rate of growth since the September quarter of 2000. Consensus Economics forecasts growth of 3.8 per cent for calendar year 2006 on the basis of increased manufacturing activity, strong domestic demand and buoyant US demand. Capital spending is expected to trend upwards, supported by declining borrowing costs. Falling inflationary expectations, modest wage inflation and a strong peso should continue to keep inflation within the Bank of Mexico's long-term target of 3 per cent plus or minus 1 percentage point. The current account deficit is expected to widen as export volumes slow and oil prices begin to decline, but should remain well under 2 per cent of GDP. The main risks in the near-term outlook include any slowing in US economic growth, falling business confidence (possibly linked to political developments following the presidential elections) and changes in global liquidity conditions.

Over the medium-to-long term, the outlook for the Mexican economy is mixed. On the one hand, growth is expected to be driven by favourable demographic developments, steady increases in investment linked to gradual deregulation of some infrastructure sectors, accumulation of human capital (though it will lag behind other OECD countries), the gradual shift towards more elaborately transformed manufacturing exports, increased emphasis on knowledge-intensive services, and continued growth in migrants' remittances. Remittance income is estimated at around USD20 billion in 2005 and has a disproportionate impact on domestic demand, and therefore on growth, as it is spent overwhelmingly on consumption. On the other hand, there are major imponderables about the Mexican Government's capacity to pursue microeconomic reform, Mexico's competitiveness in key markets and the robustness of the energy sector.

Openness of the Mexican Economy

Mexico has signed 12 free trade agreements (FTAs), including with the US and Canada, the European Union (EU), Japan, Israel, Chile, and Nicaragua. It has the important advantage of close geographical proximity to the world's largest economy (the US), which purchases 84 per cent of its merchandise exports. Its other NAFTA partner (Canada) is Mexico's second ranked export market, and purchases a further 5 per cent of its exports.

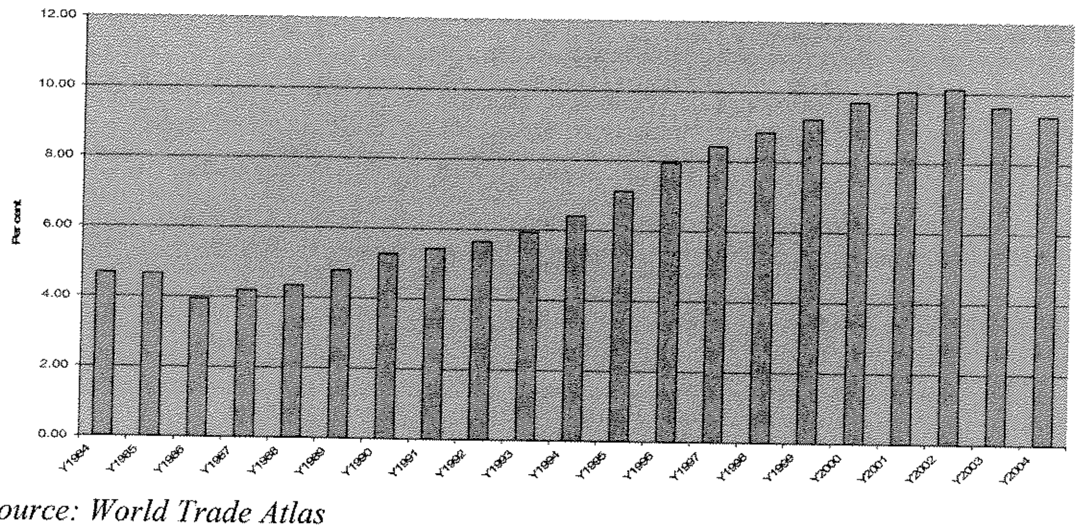
Chart 2.3: Mexico's Total Trade as a Percentage of GDP



Source: World Trade Atlas

Mexico's trade with the US and Canada has increased substantially since NAFTA entered into force: merchandise exports to these countries rose from 11 per cent of GDP in 1993 to 25 per cent in 2004, and its share of their total merchandise imports rose from 5.9 per cent of GDP to 9.4 per cent over the same period (Chart 2.4).

Chart 2.4: Mexico's Share of its NAFTA Partners' Total Imports



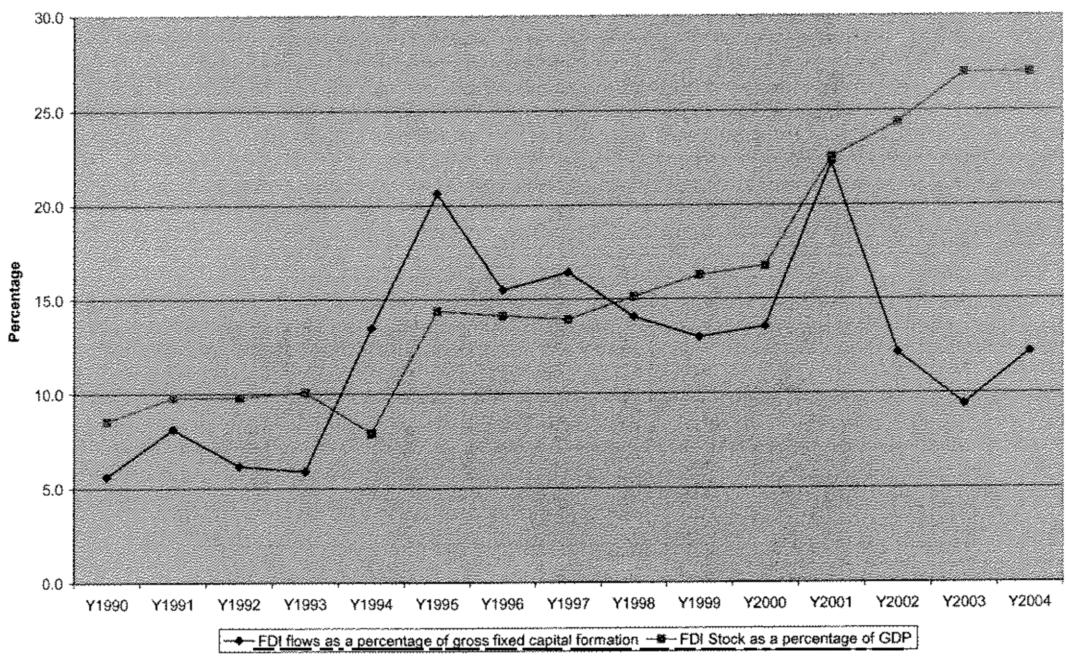
Source: World Trade Atlas

Mexico's trade with non-NAFTA countries also has risen strongly since the early 1990s, in part because of its FTA strategy. Exports to non-NAFTA countries more than doubled between 1993 and 2004 - from USD8.4 billion to USD19.9 billion. Mexico's merchandise trade with the EU has grown strongly since entry into force of the EU-Mexico FTA in 2000: exports rose from USD4.9 billion in 1999 to USD8.2 billion in 2004, and imports from USD10.4 billion to USD19.9 billion.

Mexico's share of total world exports increased from 1.27 per cent in 1993 to 1.78 per cent in 2004 (and reached 2.27 per cent in 2000). Its export growth was among the fastest in the emerging market economy group of countries in the post-NAFTA period, and its import growth was the fastest in the group.

Mexico is an attractive destination for foreign investment and has the largest stock of FDI in Latin America. Inward FDI made up 12 per cent of Mexico's gross fixed capital formation in 2004, and inward FDI stock was equivalent to 27 per cent of GDP. NAFTA boosted Mexico's strength as a foreign investment destination. The share of FDI in Mexico's domestic gross fixed capital formation doubled between 1993 and 2004, mainly due to US investment (Chart 2.5).

Chart 2.5: Foreign Direct Investment in Mexico



Source: UNCTAD World Investment Report 2005

Challenges to Mexico's economic growth

Widespread poverty

Mexico's living standards continue to lag far behind the OECD average and GDP growth to date has been too slow to narrow the income gap appreciably. Mexico's income distribution is among the most unequal in the OECD, reflecting widespread poverty and the narrowness of the middle class (around one-fifth of the population). Inequality is compounded by the dominance of the informal sector. Well over twothirds of Mexico's working age population are employed there – approximately 30 million out of the country's 43 million working age population and therefore do not qualify for wage and job protection. Low living standards and under-developed formal market institutions and arrangements are critical constraints on growth.

Oil

The Mexican government is dependent on oil for about one-third of its revenue: non-oil taxes account only for 12-14 per cent of GDP. Recent high world oil prices will continue to bolster government revenue and finance spending, but this is unsustainable.

The energy sector is in urgent need of reform: proven hydrocarbon reserves are falling sharply and production may already have peaked. Substantial road blocks obstruct modernization of the sector, including constitutional restrictions on private investment in the industry, the strong political influence of the energy unions and entrenched business attitudes.

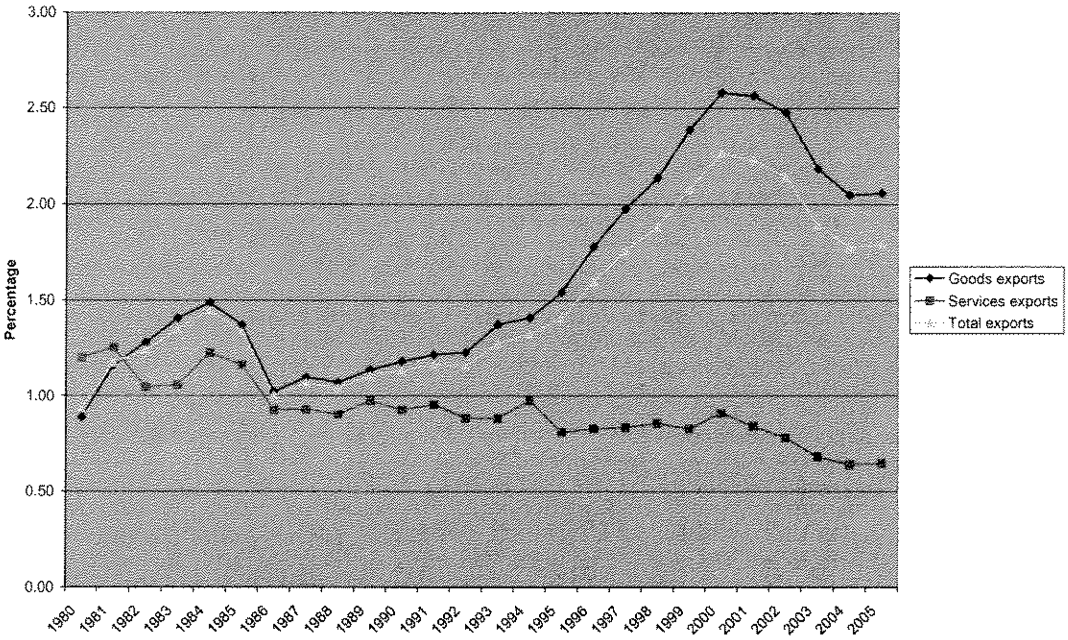
Declining competitiveness

Mexico's economic competitiveness continues to decline, slipping from 48th to 54th in the 2005 World Economic Forum Competitiveness Index Rankings behind China (ranked 49$^{th)}$. In the 2006 IMD World Competitiveness ranking, Mexico was ranked 53rd, well behind China (19th), India (29th) and Malaysia (23rd). More worrying, this lack of competitiveness was detected in Mexico's critically important manufacturing sector. There is an urgent need to strengthen competitiveness through comprehensive micro economic reform.

Growing competition from Asia

Mexico's dependence on the US exposes it to growing competition from Asia, particularly China. Mexican and Chinese products now compete directly in about one-half of their product range, equivalent to three-quarters of the total value of their exports to the US. The Mexican manufacturing sector (*maquiladora*) has thrived on exporting manufactures to the US, but has been hit hard by losing US market share to China in textiles and clothing, televisions and video equipment, computers and computer parts, and auto supplies. Mexico also faces strong competition in the US market from the Republic of Korea (in automobiles) and India (in textiles and clothing). These developments largely explain Mexico's falling share of world exports over the last four or five years (Chart 2.6).

Chart 2.6: Mexico's Share of Total World Exports



Chinese competition also has contributed to declining FDI flows into Mexico's manufacturing sector (Chart 2.5). China's lower costs of production, massive domestic market and increasingly attractive business environment (particularly in the main metropolitan centres on the east coast) have made it more difficult for Mexico (and others) to attract direct investment and, in some cases, have encouraged a few manufacturing operations to re-locate from Mexico to China.

The need for further structural reform

Human capital shortage

To compete with East Asia, Mexico needs to increase expenditure on human capital development to reap the full benefits of its young and growing labour force. Its working age population has the lowest average years of formal schooling in the OECD. Spending on research and development also is much less than in comparable countries - 0.4 per cent of GDP compared with 1.2 per cent in China and 2.6 per cent in ROK. Predictably, growth in labour productivity is much slower than in other emerging markets such as Korea.

Obstacles to business and investment

Mexico also needs to address weaknesses in the business environment to lift long-term growth prospects. Its investment ratio (20 per cent) is low compared with fast growing emerging markets. Physical infrastructure is under-developed and of poor quality (for example, only one-third of roads are paved). Public expenditure is constrained by the narrow revenue base, and private expenditure is prohibited in crucial sectors like electricity, oil and ports. Efficiency in freight transportation continues to be impaired by labour disputes, and ports remain inefficient. Electricity prices are well above the OECD average, and supply is unreliable. Telephone charges for business users are the second highest in the OECD.

Private investment is constrained by cumbersome administrative processes, labour market inflexibility, deficient rule of law, widespread corruption, and restrictions on competition in key areas like telecommunications, rail transport and cement production. Mexico ranks 43rd out of 155 countries in the World Bank's Ease of Doing Business Index. Although this is a major improvement over recent years and puts Mexico ahead of China (91) and Brazil (119) it is far behind competitors such as Malaysia (21) and Chile (25). Limited availability of credit also restricts private activity and investment in the Mexican economy: Mexico ranks 80th out of 117 countries in the Ease of Access to Loans sub-index of the Growth Competitiveness Index.

Reform prospects

Comprehensive structural reform across energy, telecommunications, labour markets, governance, and regulatory systems is needed if Mexico is to move to a higher growth path. Significant forces stand in the way. The politics of reform have been complicated by Calderon's very narrow electoral victory.

Australia's Trade and Investment Relationship with Mexico

Distance, inadequate transport links, differences in language and culture, trade barriers, and unfamiliar business environments have all worked to limit Australian business awareness of, and interest in, Mexico. These factors also apply to Mexican business perceptions of engagement with Australia.

Nevertheless the Australia-Mexico economic relationship is in good shape and is now underpinned by a range of recently signed agreements, including a double tax agreement (2006), an Investment Protection and Promotion Agreement (2005), an Air Services Agreement (2005), and memoranda of understanding on mining (2002), energy (2005), and education and training (2003). Senior officials meet regularly in the Australia-Mexico Joint Trade and Investment Commission (JTIC). On 6 November 2006 a memorandum of understanding was also signed setting out the terms of reference of for a Joint Experts Group to examine ways of strengthening bilateral trade and economic relations between the two countries.

While bilateral trade and investment flows are small there is goodwill and momentum on both sides to strengthen the relationship. Mexico was Australia's largest merchandise trading partner in Latin America in 2005-06 and our twenty-ninth largest trading partner overall with two-way trade worth AUD1.8 billion. Mexico is Australia's second largest export market in Latin America, just behind Brazil: Australian exports of goods and services to Mexico were approximately AUD874 million in 2005-06, consisting of coal, meat, livestock, dairy, leather and an increasing range of services. Australia is Mexico's twenty-sixth largest trading partner. Mexico's exports of goods and services to Australia have increased significantly over the past decade, to total AUD961 million in 2005-06. Australia's major imports from Mexico include internal combustion engines, motor vehicle parts, telecommunications equipment and computers.

Table 2.2: Australia's Exports to Mexico (AUD million)

2 Digit HS - ranked on latest year	FY1996	FY2003	FY2004	FY2005	FY2006
	AUDm	AUDm	AUDm	AUDm	AUDm
Total merchandise exports	99	430	341	687	835
27 Mineral fuels and mineral oils	0	176	116	416	505
02 Meat and edible meat offal	9	80	65	50	49
01 Live animals	1	14	6	7	37
04 Dairy produce; eggs & honey	26	44	32	21	36
41 Raw hides and skins and leather	1	1	1	36	36
99 Confidential items	23	25	37	30	35
84 Nuclear reactors	6	11	24	28	25
30 Pharmaceutical products	0	3	5	4	19
35 Albuminoidal substances, starches & glues	2	9	12	8	18
26 Ores, slag and ash	0			30	16
76 Aluminium and articles thereof	0	0	0	8	13
85 Electrical machinery and equipment	2	9	6	8	10
39 Plastics and articles thereof	0	2	1	8	9
11 Malt; Starches; Inulin; Wheat gluten		3	4	4	6
90 Optical, photographic, & medical equipment	1	6	2	5	5
87 Vehicles	0	13	14	11	3
51 Wool, and woven fabric	18	18	5	4	3
73 Articles of iron or steel	0	1	1	1	2
22 Beverages, spirits and vinegar	0	2	0	1	2
95 Toys, games and sporting goods	0	0	0	1	1
28 Inorganic chemicals		0	1	1	1
12 Oil seeds and oleaginous fruits	0	0	0	0	1
29 Organic chemicals	0	0	0	1	1
38 Miscellaneous chemical products	0	1	1	1	1

Source: DFAT, STARS database

Table 2.3: Australia's imports from Mexico (AUD million)

2 Digit HS - ranked on latest year	FY1996 AUDm	FY2003 AUDm	FY2004 AUDm	FY2005 AUDm	FY2006 AUDm
Total merchandise imports	**169**	**572**	**603**	**776**	**938**
84 Nuclear reactors	17	141	132	181	254
87 Vehicles	1	69	97	119	150
85 Electrical machinery and equipment	44	151	145	135	147
90 Optical, photographic, & medical equipment	4	48	70	88	93
76 Aluminium and articles thereof	0	0	0	59	65
22 Beverages, spirits and vinegar	7	24	29	33	51
30 Pharmaceutical products	0	27	44	56	48
39 Plastics and articles thereof	2	9	9	12	11
82 Tools & cutlery of base metal	4	6	3	7	10
38 Miscellaneous chemical products	2	14	10	11	9
96 Miscellaneous manufactured articles	1	2	1	5	8
63 Worn clothing and Rags	0	5	3	4	6
94 Furniture; Bedding, lamps and fittings	1	1	1	1	6
48 Paper and paperboard	0	4	2	4	5
08 Edible fruit and nuts	5	5	4	4	5
40 Rubber and articles thereof	0	3	3	3	4
83 Base metal articles other than tools & cutlery	0	3	3	4	4
73 Articles of iron or steel	12	6	4	2	4
57 Carpets and other textile floor coverings	1	2	2	3	4
37 Photographic or cinematographic goods	12	6	1	3	4
62 Clothing	0	3	2	3	4
95 Toys, games and sporting goods	6	7	6	5	3
20 Prepared vegetables & fruit	1	3	3	3	3
99 Confidential items	2	6	5	4	3
89 Ships, boats and floating structures	0	0	0	1	3
19 Prepared cereals, flour, & starch products	0	0	0	1	3
55 Man-made staple fibres	0	0	0	0	2
28 Inorganic chemicals	5	0	0	1	2
61 knitted or crocheted clothing	0	1	2	1	2
33 Essential oils, perfumery & cosmetics	0	0	1	1	2
12 Oil seeds and oleaginous fruits	3	2	3	3	2
88 Aircraft, spacecraft, and parts thereof	0	0	0	0	1
09 Coffee, tea, mate and spices	1	1	0	1	1
71 Gold, pearls, precious and semi-precious stones	1	1	1	1	1
92 Musical instruments	2	1	1	1	1
32 Tanning or dyeing extracts	2	1	2	1	1
70 Glass and glassware	1	2	1	1	1
69 Ceramic products	1	1	1	1	1
29 Organic chemicals	14	6	1	1	1
07 Edible vegetables and certain roots and tubers	1	0	0	0	1

Mexico attracts significant foreign direct investment (over USD15 billion per year for the last 10 years) due to NAFTA membership and its generally liberal investment laws. The investment environment has improved markedly over the last several decades as a result of domestic reform and the introduction of more simplified procedures, higher ceilings on foreign equity and greater intellectual property protections. Despite these developments, Australian direct investment in Mexico remains modest. It was valued at AUD285 million in 2004 and comprised mainly investment in consolidated services (49.5 percent) linked to finance and leasing arrangements, followed by manufacturing (28.6 percent).

Orica is Australia's largest investor in Mexico. Other companies with investments in Mexico include Kings Minerals and Bolnisi Gold. The Australian firm Securency is expected to enter into a joint venture with the Central Bank of Mexico to produce polymer banknotes, having launched a new 50 peso polymer note (using Australian technology) in November 2006. The Australian Treasurer launched a new 20 peso polymer note in Mexico in 2002.

Futuris Corporation, Mayne Group, Blue Scope Steel, Babcock & Brown, Ansell Limited, CEA Technologies, Howe Leather, Mincom, Australian Elite Genetics, Elders, Baja Aqua Farms and TNA Packaging Systems all have commercial links with Mexico, as does GM Holden Ltd. BHP Billiton, Rio Tinto Australia, Xstrata Coal and Shell Australia are involved in the energy and resources sectors with Mexico. QANTAS also now has a code share arrangement with Mexicana Airlines.

While in 2004 Mexican investment in Australia was only AUD10 million (0.001 percent of all foreign direct investment in Australia) and concentrated in real estate and manufacturing, one of Mexico's largest companies, Grupo Gruma (makers of tortillas, machinery and owners of the country's fourth largest bank) bought two Australian companies, Rosita's and Oz-Mex Foods, in 2006. Further plant investments in Victoria are planned.

On 28 October 2006, Mexican cement group, Cemex, the world's third largest cement maker, announced a hostile take-over bid for Australian construction materials company, Rinker Group, worth over AUD16 billion. The initial bid has been rejected; it might presage increased Mexican interest in investing in Australia.

The Australia Festival in Mexico

The Australia Embassy's annual Australia Festival has become Australia's largest promotional event in Mexico. In May 2006, the fourth edition of the Australia Festival, the Embassy organised over 30 seminars, wine tastings and a two-day exhibition associated with the Australia Festival, which was also used to commemorate 40 years of diplomatic relations between Australia and Mexico.

The Australia Festival reaches over 10 million Mexicans and in 2006 generated almost AUD6 million in positive media mentions of Australia.

The key theme of the 2006 Australia Festival was that Australia offered all the options of a continent to Mexicans. The theme was widely accepted with an excellent turnout for events. In total, some 39 exhibitors and over 3,000 Mexicans participated in the two-day exhibition and associated seminars. An estimated additional 50,000 Mexicans were introduced to Australia via an Australian Wine Festival which took place at 19 Mexican restaurants between May and July 2006.

The Australia Festival themes of education, tourism, business and food and wine struck a core with Mexicans and the results the promotions have had on Mexicans are impressive. Student numbers continue to grow, with over 1,000 Mexicans studying in Australia and Mexico being in 2006 the third largest student recruitment market for Australia in Latin America. Equally, Australian food and wine brands are increasingly on sale in Mexico. A few years ago, only three brands were on offer in Mexico and now (December 2006), 42 Australian wine brands can be purchased in supermarkets, restaurants and stores throughout Mexico. Equally, tourist numbers are very positive and expected to grow as a result of a new tourist visa program and the new Qantas-Mexicana code-share arrangement.

Leveraging off of the goodwill and general interest in Australia that the Festivals engender, the Embassy utilises the Festival to promote and conduct Australian cultural activities, education (via the second Australia-Mexico Education Symposium), business migration and of course increase and improve business linkages.

The Australia Festival has become the largest Australian promotional event in Mexico. In 2007, it will incorporate traditional and popular themes and industries and will also be the launch pad for the inaugural Australia-Mexico Business Awards. New business elements will be introduced and new industry/trade only programs will be incorporated to help increase business linkages. The 2007 Australia Festival will take place in May 2007.

Opportunities to Increase Trade and Investment

Given their complementary economic and trade profiles, there are good prospects for expanding Australia-Mexico trade and investment. Mexico is potentially an attractive market for Australian services exports, particularly energy- and mining-related services and education services. Continuing, and possibly intensified, micro-economic reform in Mexico could boost demand for overseas education services, including from Australia. Mexico also has a growing need for infrastructure development, including in the services sectors. This, coupled with its close proximity to the US and Central and South America, could make it a highly attractive destination for Australian businesses across a range of industries.

Australia also is a promising market for Mexican business. Australia's strong domestic economy and high disposable incomes make it a potentially important market for Mexican manufactures and high value added agricultural products. Similarly, Australia's rich resource endowments, skilled workforce, intensive use of information technology, and close proximity to fast-growing Asian-Pacific markets make it an attractive destination for foreign investment, including potentially from Mexico.

Even if both countries' key commercial priorities lie elsewhere (for Mexico, the US, Canada, and the impact of China, for Australia, East and Southeast Asia and the US), this should not prevent the trade and economic relationship from growing significantly. A sound policy framework is in place that should underpin closer economic relations.

The Australian Government is working actively to promote and facilitate bilateral trade. The Australian Embassy and Austrade work closely with Australian companies in a range of sectors to help enhance new market opportunities in Mexico. Promotional events are conducted regularly to boost sales of Australian food and wine, education, tourism and mining technology and services. In most sectors, Australian exporters face competition from other sources that benefit from significantly lower tariffs, due to Mexico's existing free trade agreements. However, Mexican companies are continually looking at diversifying their trade relationships and doing business with Australia is now a viable option for most. In addition, the Australian Government devotes considerable effort to improving the regulatory environment for Australian exporters and investors and in assisting Australian exporters to resolve market access issues as they arise.

Prospects in key sectors are summarised below.

Energy

Australia is well placed to benefit from Mexico's fast rising energy requirements: real potential exists to increase Australian energy exports in response to Mexico's tightening energy supply/demand balance. The potential supply of LNG to Mexico presents a promising opportunity for Australia, given the shift towards natural gas usage in Mexico's overall energy mix. As the export figures listed above show, Australia has also emerged as a major supplier of thermal coal to Mexico.

Food and Agriculture

Opportunity exists for Australian investment in Mexico's food processing sector and for wider engagement on agriculture. Australia currently exports live animals, meat (beef and sheep meat), dairy, wool, leather and wine to Mexico. There is considerable potential to increase export volumes out of Australia and to boost Australian investment in Mexico's food processing industry. Australian wine is also well positioned to increase sales among Mexico's growing middle class (20-25 million people) and the number of Australian wine brands available in Mexico has grown from 3 to over 40 in the last three years alone.

Infrastructure

Construction and engineering account for some 4 per cent of Mexican GDP. New investment in highways (USD5.5 billion), utilities (USD9.1 billion), resorts (USD1.2 billion) as well as the need to build over 5.1 million new homes by 2010 make Mexico a very attractive market for the Australian building, construction and engineering industries. Australian companies are already enjoying success in supplying high-end building products, water treatment technology and a range of services (source: BMI Mexico Infrastructure Report 2005).

Mining

Mexico is the world's largest producer of silver and bismuth. It is the world's fifth largest lead, sixth largest zinc and tenth largest copper producer. Mexico has a long history of mining and has an attractive regulatory regime and business environment for foreign investment and participation in the sector. Australian mining 'juniors' are active in the industry. They have been joined by a number of Australian technology and services exporters. The most attractive part of the industry is that the major players have already worked with Australian capability. In fact, two of the major Mexican players (Grupo Mexico and Luismin) have mining investments in Australia.

Education and Training

There are excellent prospects for expanding Australia's education and training relationship with Mexico. Mexico is now Australia's third largest education and training market in Latin America, after Brazil and Colombia. Currently, around 800 Mexicans are on student visas and enrolled in Australian educational institutions. Increased training needs to improve productivity and skills are also expected to provide new opportunities for Australia's Vocational and Training Education sector (VTE). Australian education services are well regarded in Mexico and the Department of Foreign Affairs and Trade, Austrade and Australian Education International work to continue to promote Australia as a quality provider of education services.

Other Services

Market opportunities exist for Australian businesses providing services linked to productivity gains, efficiency gains across the major industry sectors (energy, mining, construction, agriculture and food processing). The growth of Mexico's middle-class also presents the chance for expansion in tourism, financial, professional services and franchising. Australia now has some eight active franchises in the Mexican market.

The Possibility of a Free Trade Agreement (FTA) between Australia and Mexico

When the Australia-Mexico Joint Experts Group (JEG) meets, one of the first items it will consider will be studies by both countries on ways to strengthen the economic relationship. The main conclusion of the Australian study, written by the Department of Foreign Affairs and Trade in September 2006, was that both countries stand to benefit from an ambitious, comprehensive FTA that would complement programs in both countries to promote increased economic efficiency and greater competitiveness on world markets. Key findings of the Study on a possible FTA with Mexico are summarised below.

Benefits to Australia: Australia would benefit from closer economic relations with one of the world's most important developing countries whose middle class population – estimated at around 20 million – enjoys large and increasing disposable incomes. An FTA between Australia and Mexico would boost trade in Australian products like agricultural commodities, processed foods, wine, and mining technology that are restricted by tariffs and non-tariff measures; energy-related services that are restricted by rules on government procurement; education and training services that are hindered by recognition of academic qualifications and professional experience; activities ranging from franchising to property management to business services to agri-business that are limited essentially by lack of awareness; and investment flows that are limited by sectoral regulations and caps on foreign investment.

Benefits to Mexico: Mexico would benefit from closer economic relations with one of the Asia-Pacific's most important countries whose economy is the third largest in the region, whose economic success over the past two decades is based on sustained structural change, advanced services and a complex network of political and economic linkages with East Asia and beyond. An FTA could advance Mexico's interests in manufacturing (for example, in auto parts, food and beverages, and textiles, clothing and footwear) and horticulture. It might lead to more foreign investment – a key Mexican objective in all its FTAs. It also might lead to up-grading the priority attached to commercially-based and possible government-to-government cooperation in agri-business (farm management, abattoir management, farm logistics, dry land farming, water management, tropical agriculture), quarantine (diseases in poultry and pigs, fruit fly problems), processed food (food standards, food safety), mining services (mine construction, minerals processing, mine safety, transport and logistics), and education and training (English language, technical and vocational training, and post-graduate training in agriculture, engineering and information technology).

Benefits to both countries: Both countries could benefit strategically from an FTA that complemented and reinforced existing trade agreements with the US and various East Asian countries, and Mexico's FTAs and people-to-people links with Central and South America. For Australia, Mexico's close proximity to the US and its dense cross border supply networks could amplify access advantages conferred through the Australia-US FTA. For Mexico, an FTA with Australia could form part of its long term strategy to diversify trade and investment networks, and expand commercial and economic relations with the Asia-Pacific region. There also could be strategic benefits from accessing Australian skills and knowledge on a fully commercial basis to increase Mexico's competitiveness in the key US market.

Sensitive issues in possible FTA negotiations

As a global manufacturing giant, Mexico could be expected to press for increased access to the Australian market for manufactures across-the-board. Australia is a largely open market for most categories of manufactures, but tariffs above 5 per cent will continue to apply over the medium term particularly in autos and textiles, clothing and footwear (TCF). It is likely that Mexico would seek preferential concessions in these sensitive areas (for example, auto parts) that are at least equivalent to concessions made in Australia's existing bilateral FTAs. It also is likely that Australian industry would be critical of market liberalisation that went beyond existing industry plans for the auto and TCF sectors.

Mexico is competitive as an exporter of horticultural products, and may want to use an FTA with Australia to increase access for these products, as it did most recently in FTA negotiations with Japan. Access for avocados, citrus and table grapes could be key objectives.

On the Mexican side, access for Australian meat, dairy and wine could be contentious. Agriculture has consistently been the most sensitive issue in Mexico's FTAs. Under the North America Free Trade Agreement (NAFTA), Mexico took on comprehensive access commitments, but insisted on long phase-ins – 10 years or more – for eliminating tariffs on commodities like cereals, dairy, sugar, oil crops, and intensive meats.

Table 2.4 shows the tariff regime currently facing Australian agricultural exporters to Mexico, without the benefit of an FTA.

Table 2.4: Key Tariff Barriers to Australia's agricultural exports to Mexico

Item	Applied Tariff %	WTO Bound tariff %	NAFTA %
Meat and Livestock			
Live bovine	0 – 15	9 - 37.5	0
Live sheep	0 – 10	9 - 18	0
Live goats	0 – 10	9 - 37.5	0
Meat of bovine	20 – 25	45	0
Meat of sheep, goat	10	22.5	0
Edible offal	10 – 20	20 - 45	0
Dairy			
Milk and cream	10 – 125		0
Cheese and curd	20 – 125		0
Other			
Avocados			0
Wheat		67	4.5
Processed foods			
Wine		20	0
Spirits		10-20	0

Source: Mexico Harmonised Tariff Schedule 2006

Approach to a possible FTA

Mexico's approach: The vast majority of Mexico's trade is covered by bilateral agreements, with NAFTA overshadowing everything. More recently, Mexico has concluded FTAs with the European Union (2000) and Japan (2005), among others. Negotiations are underway for a Strategic Economic Cooperation Agreement (SECA) with the Republic of Korea, and New Zealand is currently participating in a Joint Experts' Group that may lead to FTA negotiations. Mexico's recent FTAs are not as comprehensive as NAFTA and involve carve-outs of some sensitive industries.

The factors that have shaped Mexico's approach to international trade negotiations over the last decade are likely to continue to exert a powerful influence on possible future negotiations. The incoming Calderon Administration will probably want to press for an ambitious international trade agenda as part of an overall strategy to increase Mexico's competitiveness, particularly in the key US market, create jobs and make inroads into poverty. The Administration also is likely to continue the PAN (National Action Party) policy of expanding trade and investment in the Asia-Pacific region as part of a long term strategy to reduce over reliance on the US market.

How actively the new Calderon Government can advance this international agenda will depend on two key factors: its effectiveness in developing domestic political coalitions to advance micro economic reform, and its capacity to re-kindle interest in comprehensive FTAs that are capable of delivering tangible benefits to Mexico.

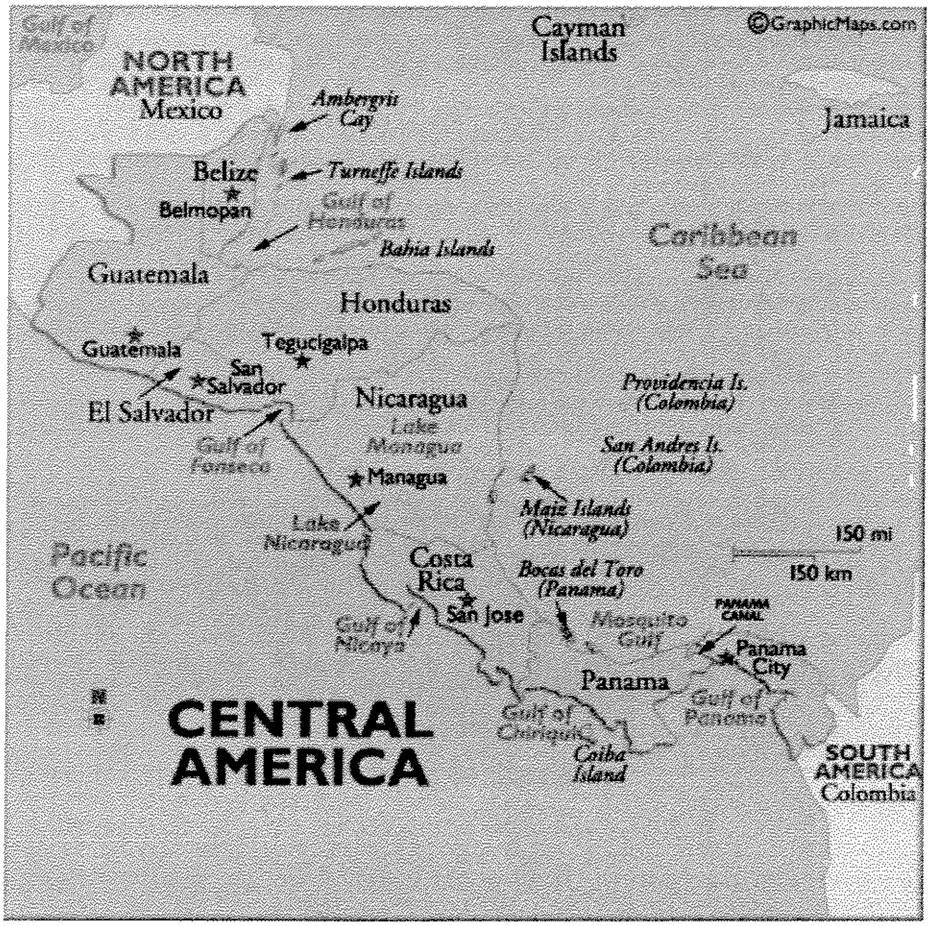
Australia's approach: Australia's basic approach to the selection of potential FTA partners was agreed nearly a decade ago. At a minimum, an FTA must satisfy four requirements: have the potential to deliver substantial commercial and economic benefits to Australia; be fully consistent with WTO principles and rules, achieve trade liberalisation faster than through multilateral reform and, where desirable and to the extent possible, deliver WTO-plus outcomes; provide for comprehensive and substantial liberalisation across all sectors; and enhance Australia's broader economic, foreign policy and strategic interests.

The benchmark for an FTA with Mexico should be our FTA with the US and Mexico's FTA with its NAFTA partners. Australia seeks a high quality, comprehensive FTA that is consistent with our key criteria for selecting potential FTA partners and with Mexico's demonstrated capacity in NAFTA to commit to negotiating and implementing a genuinely comprehensive FTA. We judge that a lesser agreement would not deliver significant benefits to either country.

Mexico is not Australia's highest negotiating priority (and Australia is not Mexico's). Mexico does not rank along side our current FTA negotiations or prospective negotiations with Japan – our largest trading partner but is attractive as an FTA partner, and could in time become a primary market for Australia given its size and importance, its close links to the US economy and very good links to markets in Central and South America where Australia has limited access.

Australian officials will be advancing these arguments in more detail through the Joint Experts Group with Mexico. Officials will explore the depth of Mexico's commitment to go down the path of negotiating a comprehensive FTA with Australia as the next stage in building Australia's trade and economic relations with Mexico. A comprehensive FTA would also add further impetus to capitalizing on the trade opportunities outlined above.

3. Central America



This Section sets out some basic information about the countries comprising Central America and Australia's trade relations with them.

Central American Free Trade Zone

One of the key structural elements linking the countries of Central America in trade terms with the United States is the Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR). This was ratified by the US Congress in July 2005. The Agreement includes seven signatories: the United States, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua. It creates an export zone that is the United States' second largest free trade zone in Latin America after Mexico, and the tenth largest US export market in the world. CAFTA-DR is being implemented on a rolling basis and, as of November 2006, only the Parliaments of the Dominican Republic and Costa Rica are yet to approve the Agreement.

CAFTA-DR is set to increase Central America's already deeply entrenched economic ties with the USA whilst enhancing economic security throughout the region.

Washington hopes that CAFTA-DR will advance US economic integration with the Americas and promote better regional governance and greater regional security and prosperity. The agreement has been widely supported by Central American political and business elites support CAFTA. But farmers are concerned about unfair competition from subsidised US grains and legumes under CAFTA, as occurred in Mexico under the North American Free Trade Agreement (NAFTA). On the other hand, Central American sugar producers gained greater access to the United States market under CAFTA-DR, than was the case for Australian sugar producers when AUSFTA was negotiated.

Costa Rica

Head of State and Head of Government: H. E. President Mr Oscar Arias Sanchez
Capital: San José
Population: 4.3 million (2005)
Surface Area: 51 thousand sq km

Recent Economic Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006(a)**
GDP USD bn (current prices)	16.4	16.9	17.5	18.5	20.0	21.5
GDP PPP USD bn (b)	35.1	36.7	39.9	42.7	45.1	47.3
GDP per capita USD	4 093	4 127	4 195	4 362	4 620	4 874
Real GDP growth	1.1	2.9	6.4	4.1	5.9	6.5
Current Account balance USDm	-729	-945	-958	-806	-946	-1 054
Goods & Services exports (% GDP)	41.7	42.3	46.8	46.5	48.6	n.a.
Inflation (% change YOY)	11.3	9.2	9.4	11.7	13.6	13.0

Source: IMF/WEO database, Sept 2006; EIU Viewswire
(a) IMF & EIU forecast (b) PPP is purchasing power parity
n.a. Data not available.

Costa Rica, one of the most peaceful and stable democracies in Latin America, declared its independence from Spain in 1821, and held its first democratic elections in 1899. Unlike most of its neighbours, Costa Rica has no armed forces. More recently, Costa Rica has been rocked by a number of incidents including the assassination of an anti-corruption campaigner in 2001, the deaths of three Chilean diplomats taken hostage by a security guard in 2004, and corruption allegations against three former presidents. Oscar Arias, a political centrist who is regarded as being untainted by the recent corruption scandals, won the presidential election in February 2006. President Arias, who previously served as President between 1986 and 1990, won the Nobel Peace Prize in 1987 for his efforts in negotiating the end of civil wars in Nicaragua and El Salvador.

Traditionally dependent on coffee, banana and beef exports, Costa Rica has successfully diversified its economy, and economic growth is now driven by electronics exports (American-owned Intel established a computer-chip factory in Costa Rica in 1998) and the tourism and agriculture sectors. During the 1990s, Costa Rica's development strategy embraced global markets and encouraged foreign investment, particularly from high technology businesses, which resulted in an average annual growth rate of almost five per cent. Although almost twenty per cent of the population still live below the poverty line, a strong safety net is in place, and standard human development indicators are high relative to neighbouring countries. High levels of education, along with political stability, have also encouraged foreign investment.

Despite steady, long term economic growth, Costa Rica faces the challenges of maintaining macroeconomic stability and strengthening trade and competitiveness. A fiscal deficit, funded by substantial public borrowing, has limited the resources available for investment in Costa Rica's deteriorating public infrastructure. Continued economic growth may hinge on the government's ability to implement much needed economic reform, which has been impeded by a hostile Congress. A key element of the reform agenda has been the ratification of the Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA). Costa Rica and the Dominican Republic are the only countries yet to ratify fully the DR-CAFTA.

Costa Rica is Australia's major trading partner in Central America (excluding Mexico). In the 2005-06 financial year, two-way merchandise trade between Australia and Costa Rica was AUD49 million (exports AUD10 million, imports AUD39 million), an increase of 41 per cent when compared with 2004-05. Australia's principal exports to Costa Rica included ships, boats and floating structures, medicaments (including veterinary), starches, inulin and wheat gluten, paper and paperboard. Principal imports from Costa Rica included integrated circuits, computer parts, medical instruments and coffee and coffee substitutes.

Through membership of the Cairns Group, Australia and Costa Rica share a common commitment to market-oriented reform of the agricultural trading system. Costa Rica hosted the 26th Cairns Group Ministerial Meeting in February 2004.

Guatemala

Head of State and Head of Government: H. E. President Lic Óscar José Rafael Berger Perdomo

Capital: Guatemala City
Population: 13.7 million (2005)
Surface Area: 109 thousand sq km

Recent Economic Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006(a)**
GDP USD bn (current prices)	21.0	23.3	24.7	26.0	27.4	29.7
GDP PPP USD bn (b)	47.1	49.0	51.1	53.9	57.0	60.0
GDP per capita USD	1 700	1 835	1 897	1 941	1 995	2 108
Real GDP growth	2.3	2.2	2.1	2.7	3.2	4.1
Current Account balance USDm	-1 253	-1 235	-1 050	-1 142	-1 231	-1 231
Goods & Services exports (% GDP)	18.6	17.0	16.6	17.7	n.a.	n.a.
Inflation (% change YOY)	7.3	8.1	5.6	7.6	9.1	6.9

Source: IMF/WEO database, Sept 2006; EIU Viewswire
(a) IMF & EIU forecast (b) PPP is purchasing power parity
n.a. Data not available.

Guatemala, which gained independence from Spain in 1821, is the largest and most populous country in Central America (excluding Mexico), with a population of 14.3 million people. From the mid-19th century until the mid-1980s, Guatemala endured a series of dictatorships, insurgencies, coups and stretches of military rule, with only occasional periods of representative government. Peace accords signed in 1996 ended 40 years of civil war, but stark inequalities have posed ongoing challenges to political and economic stability.

The economy is dominated by the private sector, which contributes approximately 85 per cent of GDP. Agricultural products, especially coffee, sugar and bananas, account for approximately 25 per cent of GDP and 75 per cent of exports. Guatemala has introduced important economic reforms that have improved fiscal discipline, strengthened the banking sector and increased international reserves. Despite some progress in macroeconomic stabilisation, economic growth has been sluggish and poverty remains widespread, with around 75 per cent of the population still living below the poverty line. Further reforms are needed to promote competitiveness, boost economic growth and improve transparency and governance.

Australia's trade with Guatemala is modest but increasing gradually. In the 2005-2006 financial year, two-way merchandise trade was AUD23 million (exports AUD19 million, imports AUD5 million), an increase of 31.7 per cent up from the 2004-05 financial year. Dairy products (milk, cream, butter and cheese) dominated Australia's exports to Guatemala, followed by paper and paperboard. Australian Dairy Goods has spoken in positive terms about growing potential in Guatemala. Major imports from Guatemala were coffee and coffee substitutes, followed by oil seeds and ethylene polymers. An opportunity to expand the commercial relationship may exist in enhancing cooperation to develop import protocols for agricultural products, particularly genetics and seeds. There is also potential for exports of agricultural technology.

Australia and Guatemala cooperate in the Cairns Group to promote agricultural trade reform, and agriculture forms the basis of the bilateral trade relationship.

Panama

Head of State and Head of Government: H. E. Mr Martín Torrijos Espino
Capital: Panama City
Population: 3.2 million (2005)
Surface Area: 75 thousand sq km

Recent Economic Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006(a)**
GDP USD bn (current prices)	11.8	12.3	12.9	14.2	15.5	16.9
GDP PPP USD bn (b)	18.4	19.1	20.4	22.1	23.5	24.9
GDP per capita	3 931	4 013	4 155	4 482	4 794	5 139
Real GDP growth	0.6	2.2	4.2	7.6	6.4	6.5
Current Account balance USDm	-174	-860	-501	-1 132	-814	-677
Goods Exports (% GDP)	50.8	43.2	39.3	43.2	46.4	n.a.
Inflation (% change YOY)	0.3	1.0	0.6	0.5	2.9	2.8

Source: IMF/WEO database, Sept 2006; EIU Viewswire
(a) IMF & EIU forecast (b) PPP is purchasing power parity
n.a. Data not available.

Panama gained independence from Colombia in 1903. Due to its importance in trade and geo-political terms, the United States has intervened in Panama on several occasions, including ending the military dictatorship of General Manuel Antonio Noriega in 1989. In November 2006, following the failure of either Venezuela or Guatemala to secure the required number of votes, Panama was chosen as the Group of Latin America and Caribbean countries' (GRULAC's) consensus candidate to fill a non-permanent seat on the United Nations Security Council (UNSC) in 2007.

Panama is an open economy with a large and diversified services sector. Situated at the crossroads of the North and South American continents and the Atlantic and Pacific oceans, Panama benefits from its strategic location, and the offshore finance, insurance, shipping registry and tourism industries generate jobs and revenue. The services sector accounts for nearly 80 per cent of GDP, and includes the Colon Free Zone, a large banking system integrated with international financial markets, tourism and the operation of the government-owned (since 2000) Panama Canal. In October 2006, more than 75 per cent of Panamanians voted in favour of expanding the Panama Canal. The project would significantly expand that waterway to accommodate large, modern container ships which cannot currently traverse the Canal.

A strong economic recovery has been underway in Panama since late 2003, led by a boom in construction and export-oriented services. But the economy remains vulnerable due to high public debt which exceeds 60 per cent of GDP. The Panama government sees free trade agreements (FTAs) as central to its strategy to boost investment and growth, with a focus on further developing the country as a hub for transportation, communication and related services. Panama has FTAs with Taiwan, El Salvador and Singapore, and negotiations with the United States are ongoing. Panama's international competitiveness is hampered by weak public institutions and labour market rigidities.

In the 2005-06 financial year, two way merchandise trade between Australia and Panama was AUD11.5 million (exports AUD8.1 million, imports AUD3.4 million), a 43 per cent decrease when compared with the previous financial year. Australia's principal exports to Panama included confidential items, pharmaceutical products, paper and paperboard, and toys, games and sporting goods. In January 2002, Baulderstone Hornibrook, in a joint venture with parent company Bilfinger Berger, was commissioned with an AUD180 million contract to build a second bridge over the Panama Canal. The Centennial Bridge was launched and opened to traffic in 2004. Orica Mining Services is a regular supplier of explosives to the Panama Canal Authority. Principal imports from Panama included medicaments, civil engineering equipment, coffee and coffee substitutes and paper manufactures.

At the present time, Panama represents the market with most potential in Central America (excluding Mexico), and receives regular visits from Austrade representatives. The Panama Canal Expansion project presents significant opportunities for Australian businesses and Australian firms would be well placed and highly regarded if bidding for contracts. Austrade is preparing a report on the Panama Canal Expansion to be distributed to industry in early 2007.

Belize

Head of State: H. M. Queen Elizabeth II, represented by the Governor-General H. E. Sir Colville Young

Head of Government: H. E. RT Hon Prime Minister Said Musa

Capital: Belmopan

Population: 0.3 million (2005)

Surface Area: 23 thousand sq km

Recent Economic Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006(a)**
GDP USDm (current prices)	871	932	988	1 055	1 111	1 217
GDP PPP USDm (b)	1 571	1 674	1 865	2 002	2 098	2 199
GDP per capita USD	3 510	3 682	3 828	4 014	4 146	4 457
Real GDP growth	4.9	5.1	9.3	4.6	3.5	5.3
Current Account balance USDm	-195	-187	-219	-152	-159	-129
Goods & Services exports (% GDP)	49.0	50.1	50.0	48.0	n.a.	n.a.
Inflation (% change YOY)	1.2	2.2	2.6	3.1	3.7	4.3

Source: IMF/WEO database, Sept 2006; EIU Viewswire
(a) IMF & EIU forecast (b) PPP is purchasing power parity
n.a. Data not available.

Belize, a small, export-dependent country with a population of approximately 300,000, was a British colony until it gained independence in 1981, and English remains the official language. Goods and services exports account for approximately 50 per cent of GDP, led by agricultural (sugar, bananas and citrus) and marine products (shrimp and lobster). The tourism industry, which has grown strongly in recent years, is Belize's number one foreign exchange earner and attracts significant foreign investment. Tax concessions and other incentives have encouraged the development and diversification of manufacturing industries, including clothing and textiles for export, plywood and veneer manufacturing, matches, beer, rum, soft drinks, furniture, boat building and battery assembly.

Belize is highly vulnerable to external trade and weather-related shocks, including high oil prices and hurricanes. Other weaknesses include the ongoing risk of an external payment crisis, an inability to protect the country's currency peg and high unemployment. Continuing strong performances in key several export sectors, such as citrus fruits and shrimp, and an increase in cruise ship tourism, will be critical to sustaining economic growth.

The trading relationship between Australia and Belize is growing, but from a very low base. In the 2005-06 financial year, two way merchandise trade between Australia and Belize was AUD1.6 million, an increase of 117 per cent when compared with 2004-05. Australia's principal exports to Belize included toys, games and sporting goods, alcoholic beverages, transmission shafts and parts, and measuring and controlling instruments. Principal imports from Belize included rubber tyres, hand or machine tools, coffee and coffee substitutes and wire products. Despite a shared language, the potential for expansion of trade with Belize is limited by its small size and poor transportation links. However, as a fellow Commonwealth member, Australia has positive and friendly political ties with Belize.

El Salvador

Head of State and Head of Government: H. E. President Mr Elias Antonio Saca Gonzalez

Capital: San Salvador
Population: 6.9 million (2005)
Surface Area: 21 thousand sq km

Recent Economic Indicators	2001	2002	2003	2004	2005	2006(a)
GDP USD bn (current prices)	13.8	14.3	15.0	15.8	17.0	18.2
GDP PPP USD bn (b)	26.4	27.5	28.5	29.7	31.1	32.4
GDP per capita USD	2 161	2 198	2 266	2 342	2 468	2 602
Real GDP growth	1.7	2.3	2.3	1.8	2.8	3.5
Current Account balance USDm	-150	-405	-702	-632	-786	-827
Goods & Services exports (% GDP)	26.0	26.6	26.6	27.2	27.9	28.6
Inflation (% change YOY)	3.8	1.9	2.1	4.5	3.7	4.1

Source: IMF/WEO database, Sept 2006; EIU Viewswire
(a) IMF & EIU forecast (b) PPP is purchasing power parity
n.a. Data not available.

El Salvador, the smallest country in Central America, achieved independence from Spain in 1821. During the 1980s El Salvador was ravaged by a bitter civil war driven by inequality between the elite minority that dominated the government and the economy and the overwhelming majority of the population. A United Nations-brokered peace agreement in 1992 ended the civil war, and El Salvador has since made significant progress in political stability and improved social conditions. Although the Government faces major problems including a large trade deficit, very unequal income distribution and rising inflation, El Salvador is currently one of the stronger and better managed economies in Central America. The government has pursued open trade policies and privatisation, together with reforms to tax policy, the public service and the pension system. El Salvador ratified the CAFTA (now DR-CAFTA) in December 2004, the first nation in Central America to do so.

El Salvador has one of the most industrialised economies in the region. The industrial sector accounts for approximately 30 per cent of GDP, and includes textiles and clothing, food processing and chemical and petroleum products. The agricultural sector, the major exports are coffee, sugar and shrimp, accounts for approximately 10 per cent of GDP. The services sectors contribute approximately 60 per cent to GDP, including tourism, transport, communications and financial services. The most important source of foreign income is the USD2 billion of annual remittances from El Salvadoreans living abroad.

In the 2005-06 financial year, two way merchandise trade between Australia and El Salvador was AUD19.2 million (exports AUD17.4 million, imports AUD1.8 million), a healthy increase of 102 per cent from a modest base when compared with 2004-05. Australia's principal exports to El Salvador included milk and cream, cheese and curd, electrical equipment for circuits and butter. Australian Dairy Goods has substantial investments in El Salvador and the Australian company TNA Solutions has just been awarded a major contract to provide 26 twin packaging systems consisting of 26 scale and 52 ROBAGS. Principal imports from El Salvador included alcoholic beverages, clothing of textile fabrics, coffee and coffee substitutes and electrical capacitors.

Around 15 000 of the many El Salvadorians who fled the civil war as humanitarian and political refugees in the 1980s settled in Australia. Since the signing of the peace treaty, approximately 5000 Australian citizens have returned to El Salvador providing a strong link between our two countries. The Australian diaspora in El Salvador may provide potential for increased business linkages. Areas of export potential include textiles, paper and paperboard, processed foods, electricity generation and distribution equipment, automotive parts and service equipment and environmental technologies.

Honduras

Head of State and Head of Government: Manuel Zelaya Rosales
Capital: Tegucigalpa
Population: 7.2 million (2005)
Surface Area: 112 thousand sq km

Recent Economic Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006(a)**
GDP USD bn (current prices)	6.3	6.5	6.9	7.5	8.3	9.0
GDP PPP USD bn (b)	17.2	17.9	19.0	20.3	21.7	23.2
GDP per capita USD	960	965	995	1 058	1 148	1 218
Real GDP growth	2.6	2.7	3.5	4.6	4.2	4.5
Current Account balance USDm	-259	-202	-254	-403	-033	-054
Goods exports (% GDP)	21.7	20.7	20.0	21.4	21.0	21.4
Inflation (% change YOY)	9.7	7.7	7.7	8.1	8.1	5.8

Source: IMF/WEO database, Sept 2006; EIU Viewswire
(a) IMF & EIU forecast (b) PPP is purchasing power parity
n.a. Data not available.

With a per capita GDP of USD 1 148 in 2005, and despite recent structural reforms including public sector modernisation and financial liberalisation, Honduras remains one of the poorest countries in Latin America. Honduras is vulnerable to volatile international market price fluctuations for its banana and coffee exports, high oil prices and hurricanes. These factors are exacerbated by a highly uneven distribution of wealth, massive unemployment, corruption, money-laundering, endemic crime, gang violence, prison riots and a significant HIV/AIDS problem. Honduras received assistance through an IMF-approved poverty reduction and growth facility (PRGF) that has supported the country's 2004-06 economic program. Honduras has also received expanded trade privileges under the Enhanced Caribbean Basin Initiative and debt relief under the Heavily Indebted Poor Countries (HIPC) initiative.

In late May 2003, and in the face of strong internal opposition, Honduras became the first Central American country to agree to deploy troops to assist the post-war reconstruction of Iraq. The deployment was described by the Honduras government as a demonstration of "friendship and solidarity" with the United States, however, in May 2004, Honduras decided to withdraw its troops. In March 2006, the Honduras Congress approved the DR-CAFTA which should improve growth prospects and increase competitiveness.

The trade relationship between Australia and Honduras is growing but from a very modest base. In the 2005-06 financial year, two way merchandise trade between Australia and Honduras was AUD17.4 million (exports AUD7.3 million, imports AUD10.1 million), an increase of 36 per cent when compared with 2004-05. Australia's principal exports to Honduras included confidential items, coated flat steel, butter, milk and cream. Principal imports from Honduras included coffee and clothing.

Nicaragua

Head of State and Head of Government: H. E. Enrique Bolaños Geyer
Capital: Managua
Population: 5.8 million (2005)
Surface Area: 132 thousand sq km

Recent Economic Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006(a)**
GDP USD bn (current prices)	4.1	4.0	4.1	4.5	4.9	5.4
GDP PPP USD bn (b)	17.1	17.6	18.3	19.8	21.0	22.3
GDP per capita USD	788	753	748	799	850	908
Real GDP growth	3.0	0.8	2.3	5.1	4.0	3.7
Current Account balance USDm	-1 280	-1 230	-1 270	-1 370	-1 290	-1 350
Goods exports (% GDP)	7.6	22.9	25.6	30.3	31.7	33.0
Inflation (% change YOY)	4.7	4.0	6.6	9.3	9.6	8.6

Source: IMF/WEO database, Sept 2006; EIU Viewswire
(a) IMF & EIU forecast (b) PPP is purchasing power parity
n.a. Data not available.

Nicaragua is another of the poorest countries in Latin America with a per capita GDP of USD 850 in 2005. Since 2002, Nicaragua has made good progress toward macroeconomic stability and has cemented a range of reforms since 2002, including tax reform, the streamlining of expenditures and strengthening the enforcement of prudential rules for banks. Its external competitiveness has also improved in recent years, and Nicaragua has been the only country in the region able to compete successfully with Chinese exports, such as textile products, and to broadly maintain market share in the United States. However, significant economic vulnerabilities remain, including hurricanes, corruption, poor infrastructure, limited access to credit, regulatory uncertainty, high levels of public debt and a large current account deficit.

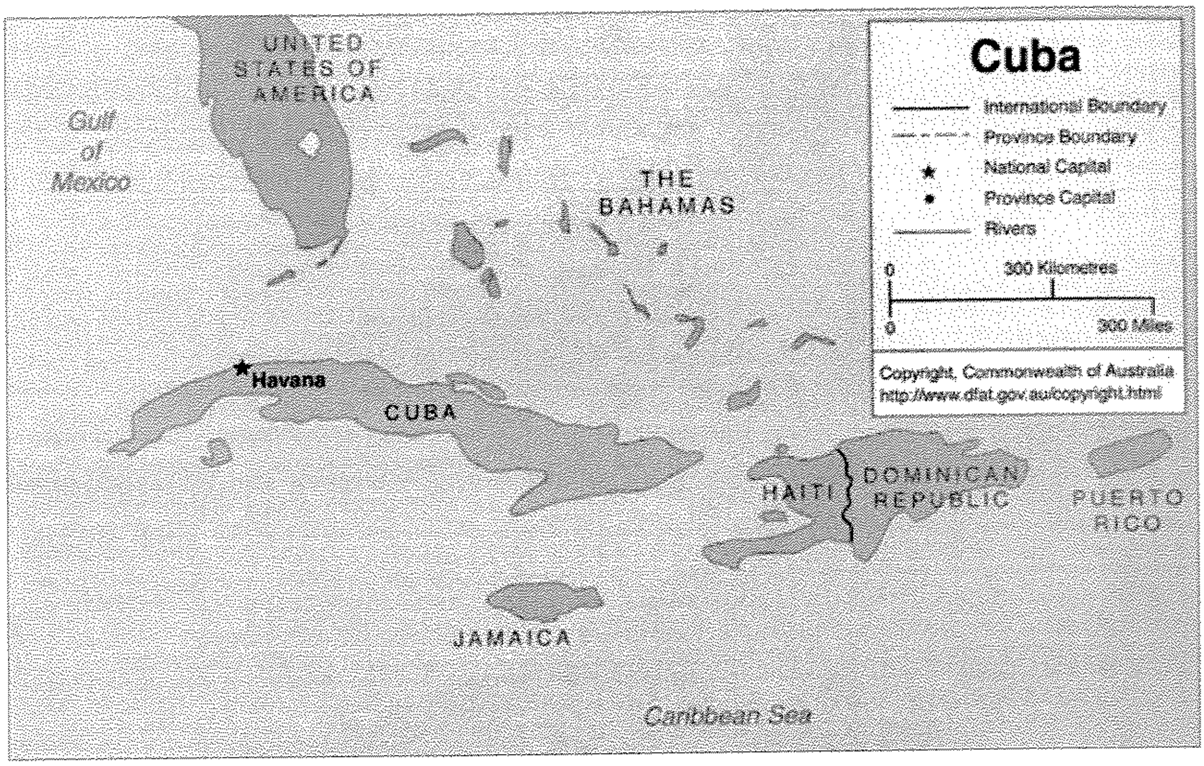
Nicaragua continues to be dependent on international aid and debt relief under the Heavily Indebted Poor Countries (HIPC) initiative and the IMF-sponsored poverty reduction and growth facility (PRGF) program. In view of the broadly positive economic developments in 2005, the IMF granted Nicaragua debt reduction under the Multinational Debt Relief Initiative; the government is committed to using the resources for poverty reduction.

Daniel Ortega, former President and leader of the leftist Sandinista party (FSLN), won the Nicaraguan Presidential Election on 5 November by a clear margin. Ortega first seized power when his Sandinista movement, backed by the Soviet Union, overthrew the Somoza dynasty in 1979. A decade of civil war and economic mismanagement followed, and Ortega was subsequently voted out of office in 1990. Ortega's success was a major win for Venezuelan President Hugo Chavez, who had been a vocal supporter of the Sandinista leader, and a significant blow to the United States, which had supported the conservative challenger, Montealeagre.

Although Nicaragua ratified the DR-CAFTA in October 2005, which should assist Nicaragua to attract foreign investment, create jobs and achieve higher economic growth, any progress on the trade agreement under an Ortega administration is uncertain.

Nicaragua is one of Australia's smallest trading partners with sporadic trade and fluctuating exports. In the 2005-06 financial year, two way merchandise trade between Australia and Nicaragua was AUD4.3 million (exports AUD1.1 million, imports AUD3.2 million) a decrease of 16 per cent when compared with 2004-05. Australia's principal exports to Nicaragua included vehicle parts and pumps for liquids. Principal imports from Nicaragua included coffee and substitutes, clothing and mechanical handling equipment.

4. Cuba



Head of State and Head of Government: HE Dr Fidel Castro Ruz

Capital: Havana
Population (2005): 11.2 million
Surface Area: 111 thousand sq. km

Recent Economic Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006(a)**
GDP USD bn (current prices)	27.9	28.4	29.9	32.0	36.2	40.1
GDP PPP USD bn (b)	n.a.	78.2	82.2	88.2	99.5	110.2
GDP per capita USD	2 491	2 540	2 660	2 850	3 210	3 560
Real GDP growth %	3.0	1.5	2.9	4.3	9.5	7.5
Current Account balance USDm	-653	-674	-347	-340	-296	-0.530
Goods & Services exports (% GDP)	n.a.	12.6	14.4	18.0	23.8	30.9
Inflation (% change YOY)	-4.1	8.8	0.6	1.3	7.0	5.1

Source: EIU Viewswire

(a) IMF & EIU forecast (b) PPP is purchasing power parity
n.a. Data not available.

Cuba is located 217 km south of the tip of Florida, in the Caribbean Sea, and comprises two main islands (Cuba 114,524 square km and Isla de la Juventud 1180 square km) and over 1500 islets and keys, covering a total area of 115,704 square km. It has a total population of around 11.4 million (July 2006 estimate).

Cuba was the last major Spanish colony to gain independence, following a 50-year struggle which began in 1850. On May 20, 1902, the United States granted Cuba its independence, but retained the right to intervene to preserve Cuban independence and stability under the Platt Amendment. Until 1959, Cuba was often ruled by military figures who obtained or remained in power by force. At that time, however, the influence of Marxist revolutionary thought swept across Latin America.

On January 1, 1959, following a three-year guerrilla campaign a young lawyer, Fidel Castro, flanked by military leaders 'Che' Guevara and Camilo Cienfuegos, overthrew the Cuban Batista's dictatorship.

President Castro declared Cuba a socialist state on April 16, 1961. This move caused relations between Cuba and the West, especially the United States, to deteriorate. For the next 30 years, President Castro pursued close relations with the Soviet Union. During that time Cuba received substantial economic and military assistance from the U.S.S.R, estimated at USD5.6 billion annually, which kept Cuba's economy afloat and enabled it to maintain an enormous military establishment.

The 80 year-old President Castro remains at the centre of Cuban politics and the head of the one-party system of "Cuban Socialism". In contrast to other nominally communist regimes – such as in China and Vietnam – President Castro has resisted making large scale economic reforms, and in some cases has reversed earlier reforms where possible. Cuba remains a heavily authoritarian state, with severe limits on political freedoms, including freedom of expression and the media.

Despite President Castro's dominance of the political scene, his recent illness saw him nominally transfer power to his brother (and designated successor), Raul, on a "temporary" basis in August 2006. President Castro underwent surgery for intestinal bleeding in August, and television footage of him recovering in hospital was released shortly thereafter.

Cuba's antagonistic relations with the US continue to dominate its foreign policy. US policy towards Cuba has focused on the lack of political and economic freedom and on the outstanding claims for compensation for property expropriated from US citizens and Cuban Americans in the 1960's. The US maintains an economic embargo on Cuba, which, under the *Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996* (also known as the "Helms-Burton Act"), also includes provisions for sanctions to be applied to third-parties trading with Cuba, although these sanctions have been sparingly applied. Since the end of the Cold War, Cuban foreign policy has largely been directed at gaining international support for the lifting of the US economic embargo, which it blames for Cuba's economic difficulties.

The collapse of the Soviet Union in 1991 removed Cuba's main economic and political benefactor, with the country undergoing a 35% decline in GDP in the period 1989-93 as a result of the loss of Soviet subsidies. Limited reforms since then, as well as increasing levels of tourism and investment from the EU and Canada (in spite of the US economic embargo), have seen the economy make some recovery. In addition, Cuba's stronger economic ties with leftist states may be behind the increased growth as China serves as a market for Cuban commodities and Venezuela provides oil in exchange for Cuba's world class health services. Cuba's GDP for 2005 was USD36.3 billion. Cuba saw a growth rate of 5% per cent in 2005, and economists predict this growth will continue in 2006. This is mainly the result of a recovery in tourism and increased activity in the mining, energy, telecommunications and manufacturing sectors. Growth in tourism, energy, and nickel exports, combined with better terms of trade, will ease the constraints on external financing brought about by US efforts to tighten economic sanctions.

The global tourism market recovery will create slightly more favourable conditions for Cuba's economy. However, given Cuba's heavy reliance on hard currency tourism, the continuing recovery of its economy remains highly vulnerable to external shocks, and Cuba's tourism income would suffer if world economic growth were to slow.

Australia's trade and investment relationship

Australia and Cuba have maintained diplomatic relations since January 1989. Australia has non-resident accreditation to Cuba from its Embassy in Mexico City. Cuba has a Consulate-General in Sydney. The Cuban Ministry of Foreign Affairs has raised with our Embassy in Mexico City the possibility of establishing an Embassy in Canberra, but plans have not advanced due to financial constraints.

Although Australia remains concerned about the human rights situation in Cuba, Australia believes that confrontation and isolation are not productive policies in relation to Cuba. Since 1993, Australia has voted in favour of Cuba's resolution in the United Nations General Assembly calling for an end to the US economic embargo.

Commercially, Australia has relatively little trade with Cuba, although our merchandise exports to Cuba reached a high of AUD28.9 million in 2001-02, primarily due to milk and cream exports. Australia's exports to Cuba in 2005-06 totalled approximately AUD8.2 million, while Australian merchandise imports from Cuba were AUD5.8 million. Australia's main imports from Cuba are tobacco, fruit juices and crustaceans.

The potential for expanding Australian trade with Cuba is limited because of the U.S. Helms-Burton legislation, which offers a disincentive to overseas businesses considering trade with Cuba.

A running issue of some concern for our relations with Cuba has been the non-payment of loans. During the mid-1980s, Australia's export credit agency, the Export Finance and Insurance Corporation (EFIC), made a number of loans to the Cuban Central Bank, on behalf of the Australian Government, for the purchase of sugar cultivation and harvesting equipment from Australia by Cuba. In May 1986, Cuba defaulted on loan repayments, leaving debts of approximately AUD14.5 million. Under a bilateral agreement signed in 1995, between 1996 and 1998, Cuba repaid approximately AUD4.9 million of its debt, but has since made no payments. Late interest now far exceeds the outstanding value of the loans of approximately AUD9.7 million. Australia has supported negotiations through the Paris Club to reschedule Cuba's debt to Paris Club creditors (excluding the United States of America), but a package has not been reached. As a result, since 2001, the Group of Cuba Creditors (Paris Club creditors to Cuba, including Australia and excluding the United States of America) agreed not to negotiate bilateral agreements on medium to long term debt with Cuba but agreements on short term debt could be concluded bilaterally. Since 2001, Cuba has raised with Australian officials on several occasions (the last in May 2006) the possibility of renegotiating the debt and having further credit made available. Nothing has come of these overtures. Recent reports from Paris Club creditors are that many countries have negotiated packages for Cuba's short term debt, but Cuba's performance of these packages has been generally poor and is deteriorating. Cuba has since approached several Paris Club creditors.

Likely future trends

With President Castro's illness, Cuba may be entering a period of some uncertainty. It is not yet clear whether the President will resume the full load of his responsibilities – even if he makes a good recovery, he may seek to change his role to something like an "elder statesman", while the day to day running of the country falls to others in a more collective leadership group. While he is on the scene – even in a different role – wide-ranging economic or political reform will remain unlikely.

Should the President not make a good recovery – or if he were to die in the short term – it is difficult to envisage anyone (even his brother) being able fully to replace him. No other political figure in Cuba has the personal standing and charisma of Fidel Castro. His departure from the political scene in Cuba is likely to see a more collective leadership group emerge, if not a period of instability or jockeying for power.

In the longer term, it is possible that a successor to President Castro would see value in some economic reforms, perhaps along the lines that China has made. Fidel Castro's passing – coupled with at least some reforms – may see a softening of the US position. Less probable would be a move to full democracy, especially while President Chavez in Venezuela provides an ideological partner to Cuban's socialist leanings.

Absent wide-ranging changes in Cuba, with an attendant softening of the US embargo, Australia's political and trade relationship with Cuba is unlikely to improve greatly. In the short term, Cuba's minor economic weight – and its distance from Australia, especially relative to our major markets in Asia – means that the economic benefits to be achieved would not outweigh the disincentives posed by the US embargo legislation. But even were this situation to change significantly, geography and numbers would imply that Cuba will remain of minor economic significance to Australia.

5. Conclusion

As this submission demonstrates, Australia's trade and investment prospects in Mexico and its region have improved in the last five years with some significant commercial gains during that period.

The number of Australian companies directly supported by Austrade Mexico to achieve export success has increased over 30 per cent each year for the past five years, with the vast majority of these exports being to Mexico.

While the economic hub of Mexico City provides an increasing number of opportunities, other large Mexican cities are also prospective for Australian companies. For example, Monterrey, in Mexico's northeast, is a major industrial city and its proximity to the US border contributes to making it generally open to international business. Australian businesses have already had success in Monterrey, and its state of Nuevo Leon, in areas as diverse as wine, manufacturing, software, mining services and construction equipment. Greater business outcomes could be supported by locating an Austrade business development resource in Monterrey.

Several important factors will also determine whether what has been a reasonable trend growth rate in trade (at least with Mexico) can be exceeded significantly in coming years.

Setting to one side global macroeconomic factors, such as global growth rates and more importantly the health and growth rate of the United States economy, and assuming that Mexico continues or improves the growth rates it has experienced in recent years, Australia could lift significantly its commercial profile with Mexico if it could negotiate a comprehensive, high quality FTA with Mexico. The work of the recently established Joint Experts Group will determine whether the governments of both countries will decide to move in this direction. This too might be affected by other multilateral trade developments such as progress in the Doha Round of multilateral trade negotiations in the WTO and whether a decision might be taken to attempt the negotiation of an APEC wide Free Trade Agreement.

With or without an FTA, and particularly if Mexico continues with structural reform in its economy, Australian enterprises could benefit if they exploit opportunities in key sectors, particularly energy. Australian government officials can assist as necessary, although as with other major resource deals, much of the market development is undertaken by the companies themselves. Most of these now operate on a global basis.

Measures to address the challenges identified in Section 2 to Mexico's continued economic growth will also provide opportunities to strengthen commercial and other linkages with Mexico. There appears in this context to be great scope to build on and develop the promising growth in educational linkages between Australia and Mexico. An ongoing challenge will be to increase the number of Mexicans studying in Australian institutions and to facilitate great student, academic and research exchanges. Combined with effective alumni programs, this can also develop a much stronger basis for closer bilateral interaction whether in trade and commerce or in other fields.

There may also be scope for Australian enterprises to work more extensively with Mexican counterparts to address issues such as declining Mexican industrial competitiveness, particularly in comparison with the East Asian economies. As Mexico looks to expand its commercial and other involvement in the Asia Pacific region Australia could serve as a regional base for Mexican interests. This would involve however much greater and wider appreciation in Mexico of Australia's strengths as a regional base – a challenge in turn both for the Australian government and our private sector.

In recent years Australia has developed a much stronger "Team Australia" approach to image projection and profile raising in the key markets in Latin America. DFAT, Austrade, DEST(AEI), our diplomatic missions, COALAR, University representatives, commercial participants and sponsors (e.g. MLA) have combined together to project Australia and what it has to offer in "Australia Weeks" in major cities. The evidence so far suggests that such events are well worth the resource commitments needed to make them successful. They offer a model which might be developed further and expanded with greater participation on the Australian side from other industries (such as the tourism industry).

Opportunities for significant expansion in commercial links with Central America and Cuba are much more limited. Priority in using limited Australian government resources has to be given to Mexico. Nevertheless existing links (e.g. Costa Rica and Guatemala's membership of the Cairns Group) should be built on as resources and opportunities permit. Given that there is now some awareness in Panama of Australian engineering infrastructure capabilities consideration might be given to a specific integrated strategy to advance Australia's commercial interests in being part of the expansion of the Panama Canal.

Mexico, Cuba and the nations of Central America all need further human capital development. Australia could give more attention to building stronger educational links with all these countries, possibly through an expanded, targeted scholarship program (some Universities already operate their own scholarship and exchange programs and DEST has a limited scholarship program which accepts applications from Latin American scholars). Further investment in this field would almost certainly pay sustained long term dividends in building Australia's links with Mexico and its region.