How does the EU- Mercosur Free Trade Agreement affect EU Member States economically?

Jonas Borgmeier

Student Number: 213179

Course: The Economics of European Integration
School of International Studies, University of Trento

2019/2020

Introduction

In the summer of 2019, the EU and Mercosur reached an agreement on a Free Trade Area. MERCOSUR describes a group of countries in Latin America, including Argentina, Brazil, Paraguay and Uruguay. Venezuela remains as a suspended member (MERCOSUR, 2019). The EU-MERCOSUR agreement (EUMA) is the result of long negotiations that started 20 years earlier at the EU-Latin America summit in Rio de Janeiro in 1999 and included over 40 negotiation rounds (Gonzáles, 2019; Reid, 2019). Both parties were eventually ready to take the final step. On the one hand, former EC President Juncker called the agreement a win-win-deal signed in a historic moment and former Trade Commissioner Malmström emphasized the opportunities of cooperation and openness between the two trading blocs (European Commission, 2019b). The EU sees the EUMA also as an insurance against further deterioration of the rules-based international trading system (Baltensperger and Dadush, 2019; Gonzáles, 2019). The EUMA is in line with a new wave of EU trade agreements acknowledging that fifteen states such as Japan and Canada have become closer economic partners since 2014 (European Commission, 2019b).

On the other hand, the past socialist governments in the Southern Cone made progress very complicated during the 2000s. The negotiations started to become more productive when new offers on market access were exchanged in 2016 and consensus was reached. Debates about the remaining controversial aspects including agriculture, sustainability, geographical indicators and rules of origin were finally concluded in 2019 (O'Keefe, 2019; Rocha Gabriel, 2019).

Acknowledging the controversial debates about the social and ecological impacts and the politics of the EUMA, this work, however, will focus on understanding the economic rationale behind this agreement and tries to answer the research question of how the EUMA may affect different EU Member States (MS). In order to address this topic, a comparative case study analysis will be employed as a research method to investigate how the agreement affects France, Germany, Italy and Poland in purely economic terms. Critical social and ecological aspects will not be focused upon in this work. This paper consists of two main parts. First, the theoretical background will be presented by exploring the principles of the EUMA and by reviewing the main academic references. The second part focuses on the comparison of the cases and offers data analysis.

Literature Review

Recognizing that the focus of the paper is set on the comparative case analysis, first essential theoretical concepts, a basic economic background, the principles of the agreement and a review on the specific academic discourse need to be presented. The EU-Mercosur Agreement is a free trade agreement (FTA) whose nature will only be explained to the extent to which it is vital to comprehend the content of this work. According to Balassa (1994), FTAs can be seen as the first step of economic integration which aims at the elimination of trade barriers such as tariffs and quotas. Next, an FTA may be further developed to become a Customs Union, followed by a Common Market, an Economic Union and finally a Political Union. However, this does not necessarily have to take place. A FTA may as well remain a FTA (Balassa, 1994; Sapir, 2011). The World Trade Organization (WTO) defines a FTA as a regional trade agreement which allow reciprocal preferential trade between two or more partners, which is a general exception to the most-favored nation principle but accepted by the WTO (World Trade Organization, 2018). The EU currently partners with more than thirty countries within the framework of a FTA (European Commission, 2019e).

In order to understand the economic context of the EUMA, figure 1 illustrates the trade relations between the two regions. It is noticeable, that the trade surplus of the EU nowadays and twenty years ago was actually turned into a trade deficit during the two decades. Especially the increased Mercosur exports of manufacturing goods appeared to be decisive for the intermediate export surplus in times of the global economic crisis. The data also shows that the value of EU imports of agricultural products and minerals has exceeded the amount of the exports.

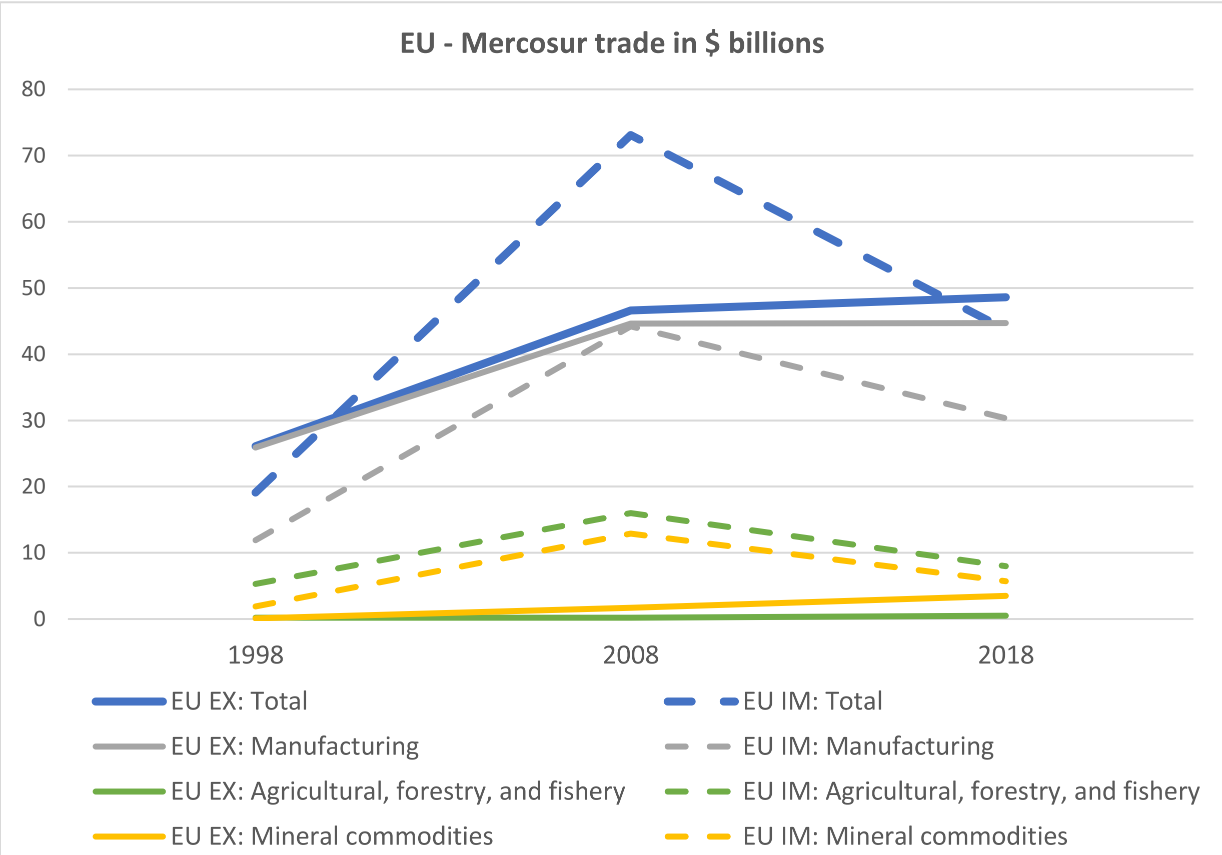

Figure 1 EU exports to Mercosur in $ billions
Note: Mercosur is Argentina, Brazil, Paraguay and Uruguay. EU is EU15 in 1998, EU27 in 2008 and EU28 in 2018. Source: Baltensperger and Dadush, 2019; Own Representation

The EU-Mercosur Agreement (EUMA) was signed in June 2019 and the main aspects were published in a summary that is structured according to seventeen principles which will be briefly presented according to the relevance for this work (European Commission, 2019f). It is important to point out that there is still a political ratification process ahead in order for the EUMA to be applicable.

A lot of emphasis is put on the trade in goods and the liberalization of market access. The EUMA binds MERSOSUR to open up its market to 91% of imports from the EU within the transition period that generally last for ten year. The EU, on the other hand, conducts the liberalization in a similar manner for a total of 92% of goods. The industrial and agricultural sector are key markets for economic relations between the two trading partners. Whereas the elimination of all the duties on industrial goods including machinery and pharmaceuticals do not seem to raise a lot of concern, the liberalizations in the agricultural sector are more controversial. 93% of tariff on EU agri-food exports to Mercosur will be eliminated which equates to 95% of the value of these products. In contrast, the EU only cuts the tariffs on 82% of imports completely and reduces certain duties on some of the remaining ones. A small number of products are entirely protected encompassing beef, poultry, sugar or honey. Another instrument, the reciprocal tariff-rate quotas, will be applied to cheese, milk powder and infant formulas which sets a limit of tons that can be imported duty free (European Commission, 2019f).

Moreover, the EUMA also contains the principle of national treatment which can also be found in Article 3 of GATT (The General Agreement on Tariffs and Trade, 1947) and the prohibition of subsidies and measures having equivalent effect to ensure a level playing field. Further aspects regard the Rules of Origin and Customs and Trade facilitation which aim at reducing trade barriers by providing a modern set of rules of origin as well as good governance and transparent processes for customs. Aside from this, the chapter on intellectual property encompasses the crucial aspect of geographical indications (GI). The EUMA protects 355 names of food, wine, and spirit products the originate in the EU which practically means that the use of expressions such as ‘kind’, ‘type’ or ‘imitation’ of the defined products is illegal. Another chapter defines trade remedies which are based on the WTO trade defense instruments including measures against dumping and subsidies. The EUMA also allows for bilateral safeguard measures. In order to ensure the working of the agreement, the need for dialogues is addressed as well. These shall ensure communication and cooperation in key areas of animal welfare, biotechnology and food safety (European Commission, 2019f).

Further chapters may be summarized under the heading of competition which includes the decrease of technical barriers to trade, fair competition rules and an open market for public procurement, the latter was actually vetoed by Brazil for a long time (Rocha Gabriel, 2019). Moreover, transparency and sustainable development shall be respected. In addition, the free circulation of services and the right of establishment are described as new business opportunities for trans-Atlantic economic interactions (European Commission, 2019f).

Focusing on the academic discourse on the EUMU, it may be assessed that there is only a limited number of studies that cover the economic impacts of the EU-Mercosur agreement. Most of them like the *Sustainability Impact Assessment in Support Association Agreement Negotiations between the European Union and Mercosur* focus on diverse interregional effects and apply varying models to project possible future consequences of the agreement including economic but also social and environmental factors *(LSE Consulting, 2019; The University of Manchester, 2008)*. To ensure a more comprehensive approach, the scope of review will encompass contemporary papers, newspaper articles and the public debate as well.

The Economist described the EUMA as a landmark free trade deal that creates a market made up of 780m people and saves EU exporters over €4bn in tariff payments (The Economist Intelligence Unit, 2019). The Financial Times pointed out that for Mercosur the increased access for agricultural goods such as beef, poultry, sugar and ethanol was the biggest achievement. With respect to the EU, they emphasize that the overall export environment would improve significantly (Brunsden et al., 2019).

However, the ratification of the agreement is seen quite complicated because European farmers in countries such as France or Poland have raised concerns about losing market share to cheaper Mercosur products. On the other hand, the industrial and manufacturing sector in the Southern Cone worries about the market entrance of more competitive EU companies despite their timeframe to improve its productivity in the next years prior to the full liberalization (The Economist Intelligence Unit, 2019). Therefore, Mercosur companies need the support of their governments to capitalize on their substantial development potential (Baltensperger and Dadush, 2019). With respect to the long-term effects, scholars argue that the EUMA would eventually increase trade interactions and facilitate market access. Consequently, the exporting Mercosur agri-businesses and European export-oriented industries of industrialized products would benefit the most (Rocha Gabriel, 2019). Having a closer look at the rationale behind this FTA, it may be assumed that exporters would end up reducing the prices due to the tariff cuts which would lead to a reallocation of resources. For example, in the case of Brazil the loss in net tariff payments could be compensated by the increase in agriculture exports and the subsequent creation of more jobs (Baltensperger and Dadush, 2019).

Acknowledging the major benefits for the agri-food sector in Latin America and the industrial sector in the EU, the EUMA may actually deepen trade asymmetries between the two trading regions. This has already happened in the case of EU trade agreements with other Latin and Central American countries, which further specialized in export of raw materials and the exploitation of natural resources. Recognizing its higher degree of added value, the industrial imports from the EU have deepened the economic inequality. Regarding Mercosur, the EUMA threatens regional value chains, which have been slowly set up among the countries in the Southern Cone. For instance, Brazilian import of Argentinian industrial and consumer products would most likely be substituted by EU-exports which could have enormous negative impact on Argentine economy whose exports to Brazil made up 16% of total exports in 2018. With respect to Public Procurement the outcome could be similar because EU-companies are more competitive and benefit from liberalized market access (Angelis et al., 2019; Ghiotto and Echaide, 2019).

This review has shown diverging effects of the EUMA on different sectors and regions mainly within Mercosur. A similar approach to the possible impacts on different EU Member States has not been conducted. In order to address this identified gap, the following comparative case study analysis aims to offer more insights.

Comparative Case Analysis

Having introduced the main principles and key aspects of the EUMA, the perspective of individual MS will be subject to analysis in the following. This paper investigates the cases of Germany, France, Italy and Poland. Germany is of special interest because it is the largest economy of the EU. France and Italy serve as cases that have similar size of the economy and of population. Poland represents a central European state with a significant agriculture sector which arguably will be affected by the Treaty. The choice of countries is also influenced by the availability of data because there are currently only seven country-specific factsheets available that serve as main data source for the comparison (European Commission, 2019d).[1]

[1] The data collection and calculations of the author are added as an annex to this work.

First, it is important to familiarize with the overall trade context which varies among the states.

Figure 2 Total Turnover in € billions (2018)
Sources: European Commission, 2019a/c/g/h; Own Representation

Figure 2 presents data of the exports and imports that add up to the total turnover of trade between an individual MS and Mercosur. In Comparison, Germany has the largest amount of exports as well as imports which adds up to a total of €15.4 billion and leads to a trade surplus of €9.1 billion. Poland is the only country that has a trade deficit of about €1 billion because it receives a lot of animal food and copper from Latin America (European Commission, 2019h). Italy has the second largest total turnover but exports less than France where 97,000 jobs depend upon exports to Mercosur. Moreover, it is noticeable that about 13,000 Italian companies are engaged in trading whereas it only a third of it in France (European Commission, 2019a, 2019c).

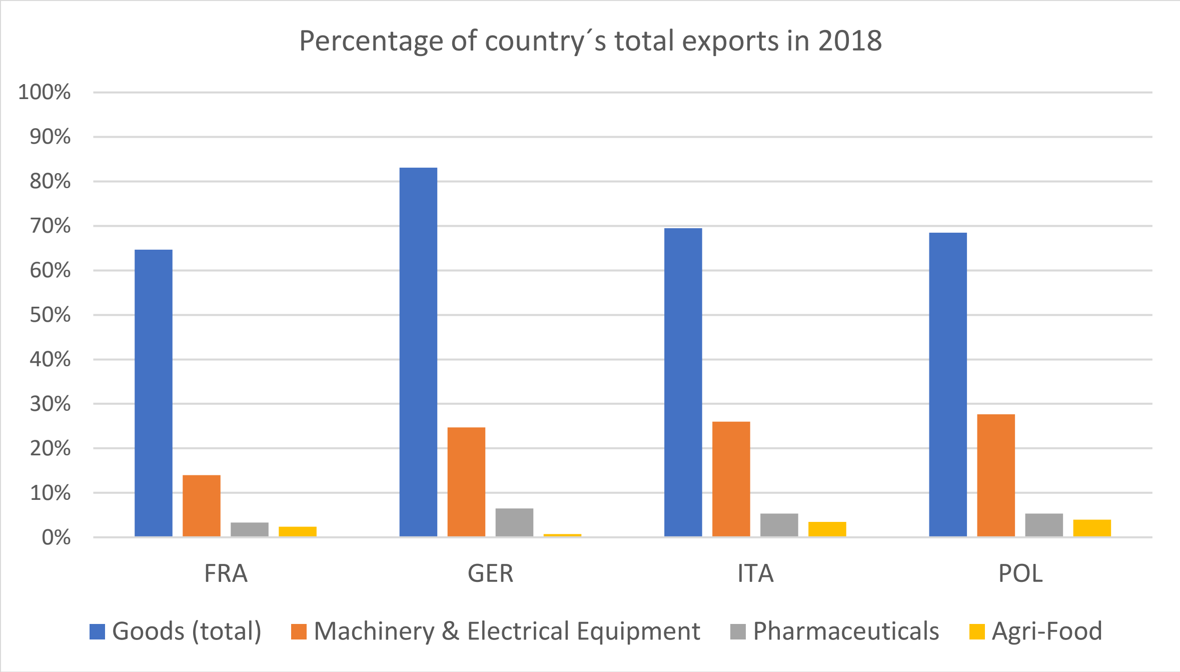

Figure 3 Percentage of country´s total exports in 2018
Sources: European Commission, 2019a/c/g/h; Own Representation

With respect to European exports, figure 3 shows clearly that more than 60% of the export value is based on goods. Trade in services including the sectors of finance, telecommunication or transport are less significant. Acknowledging that the EUMU reduces customs duties, European exports tend to profit a lot. All countries´ economies share the characteristics that the machinery and electrical equipment (M&E) sector has a higher share of export value than the pharmaceuticals followed by the agri-food sector. Germany has the highest share of exports in goods which to large degree is made up of M&E which supports the sector in German economy that employs 1.1 million people (European Commission, 2019g). German industries will profit significantly from the tariff reductions of 35% on cars, 14-20% on machines and up to 18% on chemical products which accumulates to annual savings of approximately €4 billion (Busch and Hoppe, 2020). Regarding agricultural products, Germany exports mostly prepared foodstuff and is one of the two largest EU beer exporters. Acknowledging this, the EUMA gradually removes tariffs of 27%, 35% or even 55% offering new business opportunities in this sector as well.

In France, the M&E share is relatively low but the transport sector exports equipment with the value of €1.76 billion which makes up 20% of all exports (European Commission, 2019a). Considering the relatively smaller market share of the pharmaceutical sector, proclaimed tariff reductions of 14% can still generate about €40 million savings for French exporters. Wines and spirits make up about a quarter of agricultural exports and may also increase under the regulations of the EUMA (European Commission, 2019a).

Italian agriculture exports are the biggest in absolute terms (€266 million) and make up a share of 5% of all Italian exports. Wines, fruits and olive oil are exported the most. The M&E sector is responsible for 40% of all Italian exports in goods which include dish washers, washing machines and refrigerators. Iron, steel and metal products as well as optical, measuring and medical instruments add up to a quarter of M&E products which underlines the importance of the latter (European Commission, 2019c).

Poland´s agricultural sector as has the highest share of the overall exports in comparison to the three other selected countries. Its 5.8% are worth €24 million which is by far the lowest value in absolute terms in contrast to the others though. Regarding the M&E sector, turbojets and steam turbines, carbon electrodes and brushes, electric motors and electrical transformers are the key economic areas for Polish exports. In the transport sector, Polish exporters are concentrated on tractors which is the leading product (European Commission, 2019h).

Considering the chapter on GI of the EUMA, the selected group countries almost combines half of all protections and their national products as it is demonstrated in figure 4. Out of 355 recognized product names, 66 refer to French products including 18 different types of cheeses and 36 wines and spirits. In its neighboring countries, 32 Italian wines and liquors and 17 German beers and wine regions are geographically identified. On the other hand, "Polska Wódka" and „Zubrowka" are the only Polish products on the list.

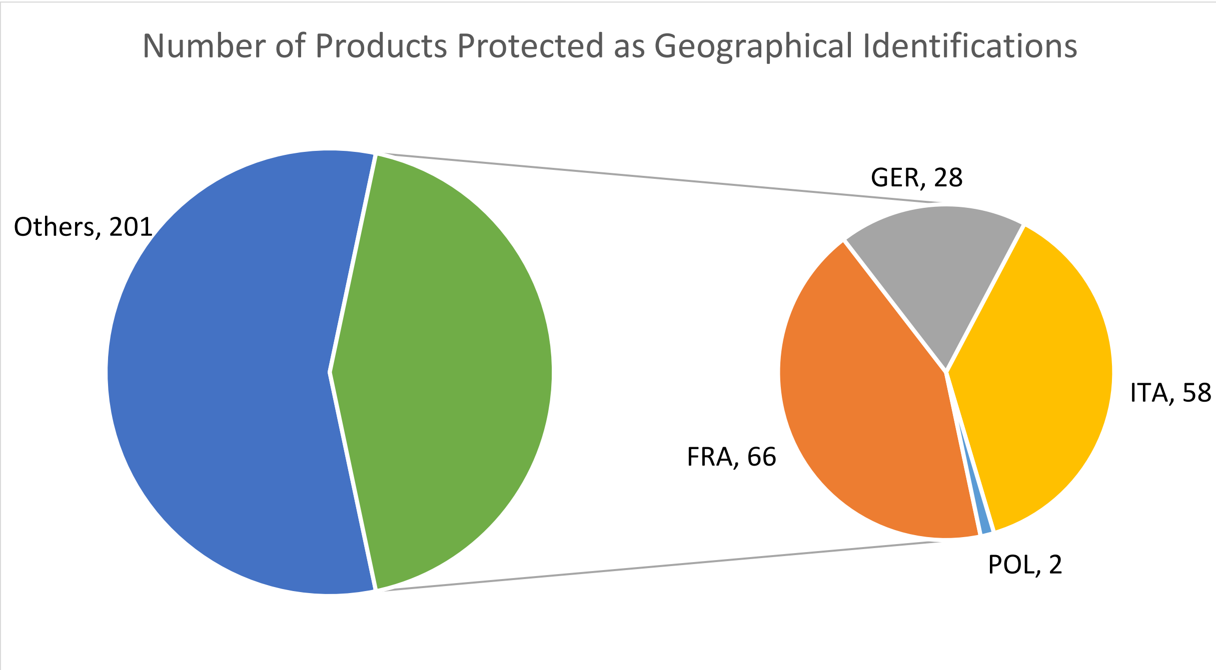

Figure 4 Number of Products Protected as Geographical Identifications (total 355) Sources: European Commission, 2019a/c/g/h; Own Representation

The access to public procurement also offers great opportunities for European companies because the commitments of Mercosur states include a more transparent process which facilitates the access to the public tenders. This tends to favor German companies in particular which show a high degree of competitiveness (European Commission, 2019g).

Conclusion

Acknowledging the limited scope of this work, it needs to be pointed out that there is little amount of studies and data available concerning the economic effects of this Foreign Trade Agreement within the European Union. Because of this, the focus of this paper was very narrow and concentrated on the economic aspects of EU exports of goods. Despite this, based on the conducted literature review, the understanding of the main principles of the EU-Mercosur Agreement and the data analysis, it may be concluded that the FTA offers economic opportunities for all four investigated countries. Germany´s machinery and electrical equipment sector may take advantage of the reduction of customs duties and further increase its exports including cars and special machinery France and Italy may profit in the same or similar sectors but could also improve its performance in the agricultural sector. In addition, Poland may receive the opportunity to balance its trade deficit by improving its performance in the exports of agri-foods. On the other hand, the agriculture sector may also be threatened by more competitive Mercosur agricultural products. It may be argued that these cases are in line with general assessment that the EU-Mercosur Agreement tends to benefit strong economic actors like EU industrial sectors and Mercosur agri-food businesses which further increases trade asymmetries between but also within the EU and Mercosur. This economic argument, in addition to a variety of social and environmental concerns, might slow down the political ratification process in the participating countries which would postpone the economic effects of the agreement significantly. It is therefore imperative that further research is conducted on the economic effects, including differing consequences for EU member states, to ensure a solid understanding of the matter which allows politicians to make informed decision on the ratification of the EU- Mercosur agreement.

Bibliographic References

Angelis, J. de, Azevedo, B. de and Toscani, V. (2019) *La mirada del sector privado sobre el acuerdo MERCOSUR-Unión Europea*.

Balassa, B. (1994) 'The Theory of Economic Integration: An Introduction', in Nelsen, B. F., Stubb, A. C.-G. and Stubb, A. C.-G. (eds) *European Union: Readings on the theory and practice of European integration,* Basingstoke, Macmillan, pp. 125–137.

Sapir, A. (2011) 'European Integration at the Crossroads: A Review Essay on the 50th Anniversary of Bela Balassa's Theory of Economic Integration', *Journal of Economic Literature*, vol. 49, no. 4, pp. 1200–1229.

The University of Manchester (ed) (2008) *Evaluación de impacto del comercio sobre la sustentabilidad (EIS) relativa al acuerdo de asociación en curso de negociación entra la comunidad europea y el Mercosur.*

World Trade Organization (ed) (1947) *The General Agreement on Tariffs and Trade: (GATT 1947).*

Internet references

Baltensperger, M. and Dadush, U. (2019) *The European Union-Mercosur Free Trade Agreement: prospects and risks* [Online]. Available at https://bruegel.org/wp-content/uploads/2019/09/PC-11_2019.pdf.

Brunsden, J., Schipani, A., Harris, B. and Mander, B. (2019) *EU-Mercosur trade deal: what it all means* [Online], Brussels, Sao Paulo, Buenos Aires. Available at https://www.ft.com/content/a564ca96-99e7-11e9-8cfb-30c211dcd229.

Busch, A. and Hoppe, T. (2020) *Freihandel: Wie das Mercosur-Abkommen gerettet werden soll* [Online]. Available at https://www.handelsblatt.com/meinung/kommentare/freihandel-wie-das-mercosur-abkommen-gerettet-werden-soll/25468668.html?share=whatsapp (Accessed 27 January 2020).

European Commission (ed) (2019a) *Accord commercial entre l'Union européenne et le Mercosur: L'ouverture de nombreuses perspectives pour la France* [Online]. Available at http://trade.ec.europa.eu/doclib/docs/2019/july/tradoc_158072.pdf.

European Commission (ed) (2019b) *EU and Mercosur reach agreement on trade* [Online]. Available at http://trade.ec.europa.eu/doclib/press/index.cfm?id=2039&utm_source=dlvr.it&utm_medium=facebook (Accessed 24 January 2020).

European Commission (ed) (2019c) *L'accordo commerciale UE-Mercosur: Una grande opportunità per imprese e persone in Italia* [Online]. Available at https://trade.ec.europa.eu/doclib/docs/2019/august/tradoc_158311.pdf.

European Commission (ed) (2019d) *Mercosur - factsheets* [Online]. Available at https://trade.ec.europa.eu/doclib/press/index.cfm?id=2038 (Accessed 24 January 2019).

European Commission (ed) (2019e) *Negotiations and agreements - Trade - European Commission* [Online]. Available at https://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/ (Accessed 24 January 2020).

European Commission (ed) (2019f) *New EU-Mercosur trade agreement: The Agreement in principle* [Online]. Available at https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157964.pdf.

European Commission (ed) (2019g) *The EU-Mercosur trade agreement: Opening up a wealth of opportunities for people in Germany* [Online]. Available at https://trade.ec.europa.eu/doclib/press/index.cfm?id=2039 (Accessed 21 January 2020).

European Commission (ed) (2019h) *The EU-Mercosur Trade Agreement: Opening up a wealth of opportunities for people in Poland* [Online]. Available at https://trade.ec.europa.eu/doclib/docs/2019/august/tradoc_158312.pdf.

Ghiotto, L. and Echaide, J. (2019) *Analysis of the agreement between the European Union and the Mercosur* [Online]. Available at https://extranet.greens-efa.eu/public/media/file/8650/6294.

Gonzáles, A. (2019) *The EU-Mercosur Trade Accord Sends a Signal to the World's Protectionists* [Online], Peterson Institute for International Economics. Available at https://www.piie.com/blogs/trade-investment-policy-watch/eu-mercosur-trade-accord-sends-signal-worlds-protectionists (Accessed 21 January 2020).

SE Consulting (ed) (2019) *Sustainability Impact Assessment in Support Association Agreement Negotiations between the European Union and Mercosur: Draft Interim Report,* London School of Economics and Political Science.

MERCOSUR (ed) (2019) *En pocas palabras - MERCOSUR* [Online]. Available at https://www.mercosur.int/quienes-somos/en-pocas-palabras/ (Accessed 27 January 2020).

O'Keefe, T. A. (2019) *The EU-MERCOSUR Association Agreement: The devil is in the details* [Online]. Available at https://theglobalamericans.org/2019/08/the-eu-mercosur-association-agreement-the-devil-is-in-the-details/ (Accessed 21 January 2020).

Rocha Gabriel, V. D. (2019) *The New EU-Mercosur Trade Agreement: A New Breath to Free Trade* [Online]. Available at https://www.e-ir.info/2019/09/04/the-new-eu-mercosur-trade-agreement-a-new-breath-to-free-trade/ (Accessed 21 January 2020).

The Economist Intelligence Unit (ed) (2019) *Mercosur-EU deal agreed at last* [Online]. Available at https://www.eiu.com/industry/article/1288193912/mercosur-eu-deal-agreed-at-last/2019-07-02.

World Trade Organization (ed) (2018) *WTO | Understanding the WTO - principles of the trading system* [Online]. Available at https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm (Accessed 24 January 2020).

ANNEX

Mercosur (2018)	**France**	**Germany**	**Italy**	**Poland**
Population (in thousands)	66000	82000	60000	38000
Jobs relying on exports to Mercosur (in thousands)	97	240	98	29
Total Mercosur Trade				
Exports to MERCOSUR in billion €	8,6	15,4	7,7	0,6
Imports from MERCOSUR in billion €	4,1	6,3	6	1,6
Turnover in billion €	12,7	21,7	13,7	2,2
Export Surplus in billion €	4,5	9,1	1,7	-1,0
Export of Goods				
Total Exports of Goods to MERCOSUR in billion €	5,56	12,8	5,35	0,411
% Export Goods/ Total Exports	64,7%	83,1%	69,5%	68,5%
Machinery & Electrical Equipment				
M&E Exports to MERCOSUR in billion €	1,2	3,8	2	0,166
% Export M&E/ Total Goods Exports	22%	30%	37%	40%
% Export M&E/ Total Exports	14%	25%	26%	28%
Jobs of Sector in MS (in thousands)	234	1100	725	290
Tariff Cuts (between 14-20%)				
Savings (14%) in million €	168	532	280	23,24
Savings (20%)	240	760	400	33,2
Export Pharmaceuticals in million €	287	1000	411	32
% Exp Pharm./Total Goods Export	5,2%	7,8%	7,7%	7,8%
% Exp Pharm./Total Export	3,3%	6,5%	5,3%	5,3%
Savings (14%) in million €	40,18	140	57,54	4,48
Agri-Food exports to Mercosur in million €	202	117	266	24
% Exp Agri-Food/Total Goods Export	3,6%	0,9%	5,0%	5,8%
% Exp Agri-Food/Total Export	2,3%	0,8%	3,5%	4,0%
Source	(European Commission, 2019a)	(European Commission, 2019g)	(European Commission, 2019c)	(European Commission, 2019h)