

## EFFECTS ON THE ARGENTINE REPUBLIC OF THE ENLARGEMENT OF THE EUROPEAN UNION

### EXECUTIVE SUMMARY

In May 2004 ten new members are incorporated to the European Union (EU) which, considered on the whole, represent a GDP which is four times greater than the Argentine GDP. With this expansion, the EU population will increase by 24%, its surface will increase by 28%, and the GDP will increase by only 5%. From the trade viewpoint, the expansion of the EU means a potential opportunity for the Argentine Republic as well as a tangible threat: having tariff preferences in a wider market once the Mercosur – European Union free trade agreement is entered into, and the possibility that the Argentine Republic is replaced as a supplier of the current EU (15 countries) by the new partners.

In this analysis, it must be taken into account that the potential impact on trade will not be abrupt, since the expansion process of the EU took place gradually, and the new partners have had tariff preferences in the EU-15 for a long time. In fact, the European Agreements, signed at the beginning of the nineties, provided an institutional framework for the bilateral relationships between the countries of Central and Western Europe, and the EU which resulted in the free trade of industrial products, while, for the agricultural products, instead, the parties agreed upon a gradual liberalization.

### TRADE

The new members devoted, on an annual average for the period 2000-2002, 67.5% of its exports to the EU-15 (91,861 millions dollars), which shows a level of trade integration similar to that of the current 15 members of the EU. On the other hand, Argentina allotted 20% of its exports to the EU (5,882 millions dollars) in 2003. There is a remarkable difference in the makeup of the Argentine sales and those made by the new partners to the EU-15: in the first case, 75% of the total amount exported is agricultural food, while in the second case, the total amounted to only

5%. Among these countries are the main exporters of agrifood to the EU are Poland, Hungary and the Czech Republic.

The imports made by the European Union reached, on an annual average for the period 2000-2002, 956,693 million dollars. Out of this total amount, 0.6% was provided by the Argentine Republic and 9.7% was supplied by the new members. The sector makeup of the imports made by the EU shows that, for the agricultural food sectors, none of the potential partners individually reaches the participation that Argentina had as a EU provider.

### AGRICULTURAL SECTOR

With its incorporation to the EU, the new partners initiate a slow process of institutional and structural assimilation which, in the case of the agricultural sector, implies the following: to adopt a new legal background, to organize a group of institutions necessary to administer the intricate CAP mechanisms, and to transform the different agricultural and industrial complexes at a technological, business and management level. These requirements will extend the time in which the total amount of the agricultural production in these countries will strongly compete in the market of the EU-15. With the purpose of aiding to the modernization of the agricultural sectors of the new members, the EU is currently carrying out a policy of rural development by means of the funding of important technical assistance projects.

However, in spite of the advances made, the modernization of the agricultural sectors in the countries of the Central and Western Europe is still incomplete; therefore, their full incorporation to the CAP will be gradual, since the EU-15 upholds that granting 100% of the direct payments as from the time of incorporation would have the effect of delaying their agricultural restructuring. The direct

payments will be introduced in these countries as 25% of the amount to be received by farmers in the EU-15 in 2004, 30% in 2005, and 35% in 2006. As from 2006, the direct payments in these countries will be gradually increased until reaching 100% in 2013. Despite the increase in the number of members, the EU has undertaken not to increase the agricultural budget, which implies, in the long run, a decrease of the aid by producer. Although, the net result will depend on the relative productivity of one Euro subsidy in the new partners in relation to the countries of the current EU.

### AGGREGATE IMPACT

The model of computable general equilibrium developed at CEI, was used to estimate the effects of the expansion of the EU on Argentina. At an aggregate level, no important effect is observed on the Argentine exports due to the different sector composition of the Argentine and Central Europe and Western Europe trade with the EU-15. At a sector level, the most important changes can be seen in the exports made to the EU of meat products, food products, and vegetable oil and fats. The remuneration of the productive land factor, which is an indicator of how the agricultural sector is affected, decreases in Argentina while it increases significantly in the future members.

### THREATS

After its expansion, the new members will not face any type of trade barrier to sale its products in the EU-15. By using a methodology combining information on commercial complementarity with information on trade flows, 681 million dollars were identified –equal to 14% of the annual average exported by our country to the EU in 2000-2002– as the Argentine exports more strongly threatened by the enlargement of the EU. Out of this total amount, 39% relates to agricultural food (the main being fruits<sup>1</sup>, beverages and meat<sup>2</sup>) and the remaining 61%

to industrial manufactures and mining products (the main being iron and steel, vehicles and its parts, and aluminum and its manufactures). The main products exported by Argentina to the EU, soy flour and bovine meat, do not appear to be threatened by the incorporation of the countries of Central and Western Europe to the EU<sup>3</sup>. The main threats relate to corn and sunflower flour, with Argentine exports to the EU in a total amount of 274 million dollars in 2003<sup>4</sup>.

Although the threats are not important for the main products which Argentina exports to the EU-15, it is possible that, in the future, the new partners increase their exports to the EU as a consequence of increases in its production levels. For the main products currently sold in Argentina to the EU, the production levels of the new members show a decreasing evolution during the last decade. For example, the soy production in the countries of Central and Western Europe hardly amounts to 0.3% of the Argentine production. Instead, these countries do show increasing production levels in some products such as corn, lemon, apple, sunflower flour, honey and crustaceans. The Argentine economic sectors which appear to be threatened by the expansion of the EU might be those for which Argentina should obtain better conditions for access to the EU market in a free trade agreement between Mercosur and the EU.

As to the main threatened products, a partial equilibrium analysis was made in order to estimate, at a desaggregate level, the changes in the trade patterns which may take place as a consequence of the expansion of the EU. The simulated scenarios combine three elements: i) the elimination of trade restrictions between the EU-25 countries; ii) increased productivity in the new members; and iii) a free trade agreement between Mercosur-EU. The results yielded by the model show, for example, that the displacement of the Argentine exports may reach 68 million dollars for corn and 23 million dollars for bovine products. The rest of the products analyzed do not show important changes in their EU exports. When the EU expansion combines with the Mercosur-EU agreement, a growth in the Argentine exports towards EU-25 is obtained.

<sup>1</sup> As to fruits, the threat is lessened because Argentina sells to the EU in the opposite season.

<sup>2</sup> Meat and rabbit or hare carcasses.

<sup>3</sup> In 2003, Argentina exported soy flour and bovine meat to the EU in an amount of 1,826 and 240 million dollars, respectively.

<sup>4</sup> It is worth mentioning that, in both cases, the threats can be labeled as weak, according to the parameters defined in the study.

## OPPORTUNITIES

Trade between Argentina and the new members is currently unimportant: in 2003, the Argentine exports amounted to 218 million dollars, while imports amounted to 82.1 million dollars. The main products exported by Argentina to the new partners are fats and oil, cereals, and vehicles, and its parts. From the viewpoint of the Argentine participation in these countries' imports, oil plants stand out with 5.9%, cereals with 4.1%, and fish with 3.9%. The incorporation to the EU should increase the average income level of the new partners, which will turn them into a 75 million people market, with a big potential to place the Argentine exports.

In order to analyze the commercial opportunities, the information on complementarity combines with information of trade flows. The strongest opportunities for the Argentine exports in the Central and Western

Europe amount to 1,552 million, equal to 5% of the total amount exported by Argentina in 2003. Seventy per cent of these trade opportunities relates to agricultural food (fruits, residues of the food industries, cereals, among others), while the remaining 30% relates to industrial and mining manufactures (different products of the chemical industries, furs and leathers, cotton, among others).

The report shows that the expansion of the EU does not impair, on the whole, the current Argentine sales to the EU-15 due to the different sector composition of exports to the EU from Argentina and the new partners: while Argentina specializes in agrifood, the new partners specialize in industrial commodities. For some sectors, however, the expansion might generate some displacement of its exports towards the EU-15. The free trade Mercosur-EU agreement might do more than compensate for these threats.