

# MERCOSUR - EUROPEAN UNION AGREEMENT: OPPORTUNITIES AND THREATS FOR ARGENTINA

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## EXECUTIVE SUMMARY

Trade relations with the European Union are of critical importance to our country. Historically, and aside from economic cycles and trade agreements that may have geographically redirected trade flows, the Old World is one of Argentina's main trade partners, both in terms of the origin of our imports as well as in terms of the destination of our sales, which points to the high degree of complementarity existing between the production structures of both regions. To this should be added other political factors -such as the importance of the European bloc in the international scenario- and economic factors -such as the possible effect on other negotiation forum, such as FTAA or WTO- , which enhance even more the importance of a free trade agreement between Mercosur and the European Union.

The concessions granted in a free trade agreement between two blocs may modify exchanges between the partners. On the one hand, obtaining tariff preferences tends to lead to an increase in exports towards the new partner; on the other hand, this may involve the loss of preferential access exclusivity for the older partners (in this case Mercosur partners), which means that sales to that destination face new competition which may partially or totally displace exports. This is what creates opportunities and threats for foreign trade, through changes in exports and imports, which in theoretical terms causes trade creation and trade diversion effects.

Mercosur-EU negotiations are based on a clear asymmetry in commercial terms, with the EU being the world's first exporter and the world's second importer, whereas Argentina is a "small" country, with total exports 33 times smaller than EU exports and imports 46 times smaller.

A second asymmetry is that whereas the EU is an important trade partner for Argentina, accounting for 17% of exports and 23% of imports, Argentina plays

a very minor role for the EU, accounting for about 0.5% of its total external sales and purchases.

A third difference lies in the structure of bilateral exchanges, with Argentine sales consisting mainly of foodstuffs, which are generally not very sensitive to an improvement in the income of buyers, whereas EU exports focus on chemicals, machinery and transport material, categories with higher income elasticity, so that their purchasing level may vary more easily at a time of economic growth.

On the other hand, the bilateral commercial relationship includes specialized subheadings in exports or imports, with a very low degree of intra-industry trade. Agriculture and minerals are essentially export-oriented categories, whereas industrial manufactures such as chemicals, transport material and machinery are mostly specialized in imports.

Furthermore, Argentine exports to the EU are largely consistent with the comparative advantages revealed by Argentina and the comparative disadvantages revealed by the EU, which is also the case with Argentina's total exports.

As regards access to the EU, exports are subject to a web of measures hampering the entry of products. First of all, a tariff structure with many components that are not *ad valorem*, with some varying according to the time of year, and products for which the tariff changes according to the type of inputs used. All of this leads to a tariff structure with little transparency. This type of tariff is predominant in agricultural categories, which is why they have a considerably higher equivalent average *ad valorem* tariff than the rest. Besides, it is in agriculture that the larger share of tariff peaks can be found.

The EU also applies a wide range of non-tariff barriers, in particular to agricultural categories, which clearly affects Argentine sales. Prominent among these

barriers are tariff quotas and special safeguards. Foodstuffs also face an increasing number of sanitary and phytosanitary measures, as well as labeling and traceability rules, which as a result of being of a more discretionary nature become a less transparent barrier that is hard to negotiate.

While benefiting from market access restrictions, the agricultural sector is also favored by other Common Agricultural Policy instruments such as price support measures, direct support and export subsidies. Public spending on these measures accounts for nearly half of the total budget of the EU.

Thus, both explicitly -through budgetary subsidies- and implicitly -through measures such as support prices and trade barriers, which enable farmers to sell at prices higher than international prices-, in the year 2000, the EU farming sector received the equivalent of 103 billion dollars in assistance. This means that EU products received 60% extra income than they would not have received if they had sold at international prices and had not had these different direct support mechanisms.

The analysis of the commercial impact on Argentina of an agreement between Mercosur and the EU was divided into two parts: the opportunities opening up for our products through improved access to the EU market and the threats arising out of a possible displacement of Argentine products by European products, both in the domestic market as well as in the Brazilian one.

Firstly, the subheadings with greater opportunities to increase their sales under the agreement are those with specific or *ad valorem* tariffs of 10% or higher. As a whole, EU imports in this group of subheadings amount to 54.2 billion dollars. From the Argentine perspective, these subheadings account for 28% of total exports to the EU; 35% of foodstuffs and 3% of other items. Accordingly, agricultural foodstuffs and fish products are the ones that could make the most of the opening of the EU market.

In the set of subheadings with strong opportunities, i.e. with a greater export increase potential -those in

which, in addition to a high tariff, there is complementarity between EU demand and Argentine supply- the prominent ones are meats, fruit, fish and grains. In this group, the European imports market amounts to 15 billion dollars and Argentina is already an important supplier.

Among the categories with weak opportunities -high tariff but no complementarity- the ones that stand out are products from the automotive and spare-part sector, grains, cocoa-based preparations and residual products of the food industry -only in the latter two is the EU currently an important destination market-. In this group, the market size of European imports amounts to 39.2 billion dollars.

In view of the possible resistance on the part of the EU to grant preferences in foodstuffs, tariff quotas are a way to improve access, either by enlarging the quotas allocated to Argentina or by receiving new bilateral quota preferences. Although on the one hand the quota alternative narrows the volume of exports that may enter at zero tariff or paying lower tariffs, on the other hand this ensures for the EU a limit on the increase of imports in a very sensitive sector, which receives the highest degree of protection on average and which benefits from various subsidy mechanisms. In other words, although this is not ideal, it seems the best politically possible solution.

Secondly, the greatest threats of sales displacement to Brazil would relate to subheadings in which Argentine tariff preferences are at least 10% compared to what is paid by the ones from the EU. Argentine products exported to Brazil, where the extra-zone tariff is 10% or higher, account for 67% of current total exports, 52% of foodstuffs exports and 74% for other categories. But in the latter the total value of trade and degree of Brazilian market dependence is higher.

With a strong threat level -which is where EU exports have shown complementarity with Brazilian imports- there are Argentine sales to Brazil amounting to 3.7 billion dollars. Prominent among them are subheadings for which the Brazilian market is very important, such as automobiles -which direct 87% of their sales to


Brazil-, machinery (52%), dairy products (74%), fruits (37%), flour (72%) and plastics (49%). With a weaker threat level –products that have not shown complementarity–, we find exports amounting to 1.1 billion dollars, prominent among them, due to the value of trade involved, subheadings in the automobile, machinery, grains and fish sectors.

Thirdly, imports from the EU may increase following the granting of trade preferences. The sectors most likely to increase their purchases are those for which Argentine extra-zone tariffs are 10% or higher and in which the EU has shown that it has capacity to satisfy the demand for Argentine imports.

The end result is a set of subheadings accounting for 61% of total current imports, mainly in non-food categories. Among the subheadings with the greatest

import increase potential –the ones in which Argentine imports showed complementarity with EU exports–, those relating to the automotive and spare-parts sector play a significant role, as well as mechanical machinery, electric machines and equipment, paper and plastics. Among the ones with the lowest net imports increase potential –those not showing complementarity–, the ones with the highest trade volume are electric machines and equipment.

In sum, both food and non-food items are present both as opportunities and in the two threat situations. However, there are differences in degree and ultimately in terms of the production profile: food items are the most important ones among those with the highest potential to increase exports to the EU; non-food items predominate among those that may reduce sales to Brazil, and stand out very clearly among those that may increase imports.



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