

Robert Schuman

*Economic Relations of the
European Union and Mercosur*

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The Jean Monnet/Robert Schuman Paper Series

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These monographic papers address issues relevant to the ongoing European Convention which will conclude in the Spring of 2003. The purpose of this Convention is to submit proposals for a new framework and process of restructuring the European Union. While the European Union has been successful in many areas of integration for over fifty years, the European Union must take more modern challenges and concerns into consideration in an effort to continue to meet its objectives at home and abroad. The main issues of this Convention are Europe's role in the international community, the concerns of the European citizens, and the impending enlargement process. In order for efficiency and progress to prevail, the institutions and decision-making processes must be revamped without jeopardizing the founding principles of this organization. During the Convention proceedings, the Jean Monnet/Robert Schuman Papers will attempt to provide not only concrete information on current Convention issues but also analyze various aspects of and actors involved in this unprecedented event.

The following is a list of tentative topics for this series:

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2. How will the member states figure in the framework of the Convention?
3. The necessity to maintain a community method in a wider Europe.
4. Is it possible for the member states to jeopardize the results of the Convention?
5. The member states against Europe: the pressures on and warnings to the Convention by the European capitals.
6. Is it possible that the Convention will be a failure? The effects on European integration.
7. Similarities and differences between the European Convention and the Philadelphia Convention of 1787.
8. The role of a politically and economically integrated Europe in the governance of the world.
9. How important is European integration to the United States today?
10. The failure of a necessary partnership? Do the United States and the European Union necessarily have to understand each other? Under what conditions?
11. Is it possible to conceive a strategic partnership between the United States, the European Union and Russia?
12. Russia: a member of the European Union? Who would be interested in this association?

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**Economic Relations of the
European Union and Mercosur**

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ECONOMIC RELATIONS OF THE EUROPEAN UNION AND MERCOSUR

Introduction

The “Southern Cone Common Market” was created in 1991 not with the aim, as its name would imply, of achieving just an economic integration of its member states, but rather of creating a meaningful entity encompassing the political, productive and social aspects of its member states. By joining forces, its four member states (Argentina, Brazil, Paraguay and Uruguay) represent the single largest market in Latin America, with 210 million inhabitants and a total GDP of US\$1.1 trillion, representing the fourth largest economic entity in the world.¹

Since the 1994 Protocol of Ouro Preto, Mercosur has followed the spirit of the European Union in its ambitious objective of creating a large supranational entity rather than remaining at the intergovernmental integration level sought by other regional blocs, such as NAFTA.

The EU has been working to strengthen its ties with Mercosur since 1992, with the signature of the Technical Cooperation Agreement. In the following years, the relationship between the two blocs has evolved considerably. In 1995, both parties signed an Inter-Regional Framework Cooperation Agreement, which initiated the process towards a definitive Association Agreement. A series of negotiation rounds was carried out starting in the year 2000 with the objective of hammering out the details for a free trade agreement.

Beyond the historical and political linkages between the Mercosur member states and Europe, the association with the European Union is important for several reasons. First, from a purely economic point of view, both regions are already intimately tied as the EU is Mercosur’s largest trading partner and source of foreign direct investment. Second, as previously mentioned, Mercosur’s framework draws significantly from the EU model. In this sense, the experiences from the EU can represent a valuable resource at the time of designing Mercosur’s institutions and implementing any necessary policies. Third, Mercosur’s member countries, and in particular Brazil, are interested in raising their profile in the international geopolitical arena. In this sense, an association with the EU would give Mercosur member states a significant degree of leverage and prestige. Finally, and not unrelated to the previous point, any progress in its association discussions with the European Union could strengthen Mercosur’s position in the context of the future FTAA negotiations.

¹ European Commission. External Relations Directorate General. Directorate General Latin America. Mercosur Chile Unit. Mercosur Desk. Mercosur-European Community: Regional Strategy Paper 2002-2006. CSP Mercosur. September 10, 2002.

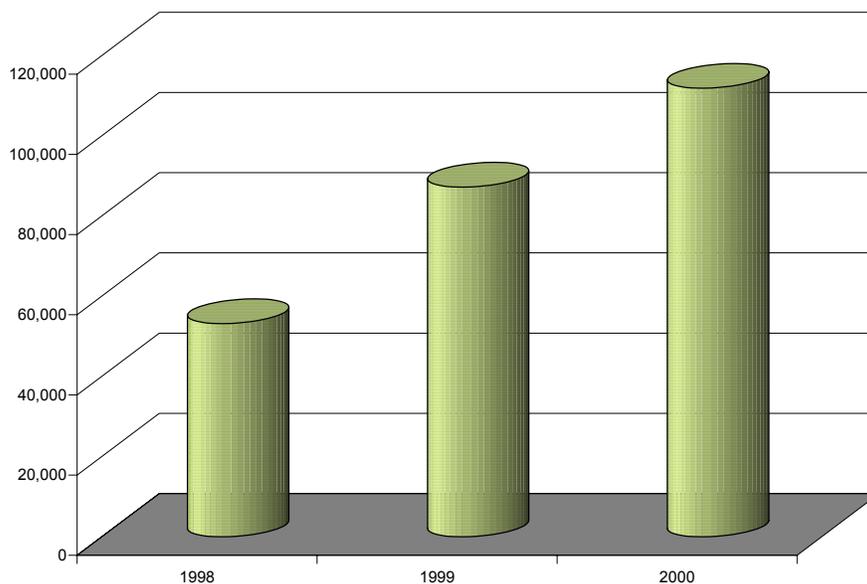
From the European point of view, any closer relationship with Mercosur would be valuable because, first, Mercosur comprises two of the three largest markets in Latin America, with product offerings that are largely complementary to those of the EU. Secondly, Mercosur is the only other integration agreement that shares the EU's values and ideals.² And third, it is an objective of the EU to avoid any deviation of commerce that might arise from the implementation of the FTAA.

This paper summarizes the three main aspects of the EU-Mercosur economic relations. These aspects are foreign direct investment flows, trade and foreign aid.

Foreign Direct Investment (FDI)

The European Union is the world's main source of foreign direct investment, accounting for over two thirds of the total world FDI outflows. In 2000, FDI from EU member states reached \$773 billion more than five times those from the United States (\$139 billion). This remains true even after excluding the Intra-EU investment flows from the total.³

European Union: Foreign Direct Investment with Mercosur (Millions of Euros)



Source: EUROSTAT, IMF.

² A.M. Klom. "Association negotiations between the Mercosur and the European Union: Rivaling Western Hemisphere integration or supporting Southern Cone integration?" Paper prepared for the workshop: Dollars, Democracy and Trade: External Influence on Economic Integration in the Americas. Los Angeles, CA, May 18, 2000.

³ Inter-American Development Bank (IADB). Department of Integration and Regional Programs. Division of Integration, Trade and Hemispheric Issues. Institute for the Integration of Latin America and the Caribbean Statistics and Quantitative Analysis Unit. Integration and Trade in the Americas. Special Issue on Latin American and Caribbean Economic Relations with the European Union. Periodic Note, May 2002, p. 21.

The combination of European supremacy as a source of FDI at the global level and the attractiveness of Mercosur as a target has had a significant impact on the inter-regional relations. The overwhelming presence of European firms in the Southern Cone started with the privatization process that was part of the “Washington Consensus” reforms in the region. Due to the nature of this process most of the investments made by European firms were highly concentrated in few sectors, and were not of a greenfield nature. An outstanding example is the acquisition of a majority stake in Argentina’s Yacimientos Petrolíferos Fiscales (YPF) by Repsol, a Spanish company for \$15.2 billion in 1999.⁴

European FDI to Mercosur increased dramatically in the second half of the 1990s going from 25% for the 1990-94 period to 70% in 1999. Spain has been the main source of capital for the region.

Mercosur is the recipient of 7.2% of the total accumulated stock of FDI from the EU. As of 2001, Mercosur receives approximately 75% of all European FDI flows to Latin America. These capital flows are concentrated on a few service sectors, such as banking, insurance, telecommunications, transportation and engineering.⁵

European flows of capital have diminished substantially since 2000, as a consequence of the general deterioration of the capital markets, both in the developed countries as well as in emerging markets. In addition, the economic problems in Argentina and the instability of the Brazilian financial markets have caused, in several cases, substantial losses to foreign investors in those countries and have led to a curtailing of new capital flows in most instances.

Trade

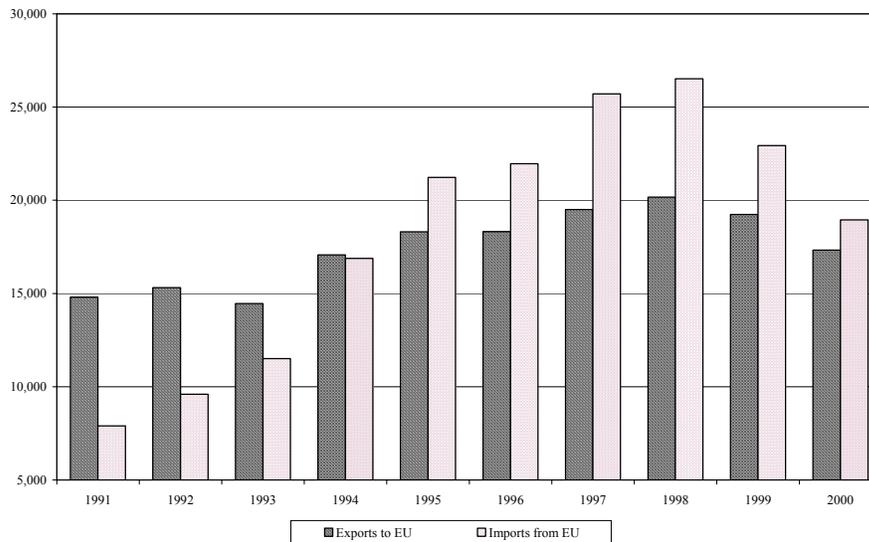
The European Union constitutes Mercosur’s largest trading partner, with over 25% of the region’s exports. However, the converse is not true: from the point of view of the EU, Mercosur is only its ninth trading partner in terms of total value.⁶

⁴ Ibid, p:23.

⁵ European Commission, p. 15.

⁶ EUROSTAT.

Mercosur's Trade with the European Union (Millions of US\$)

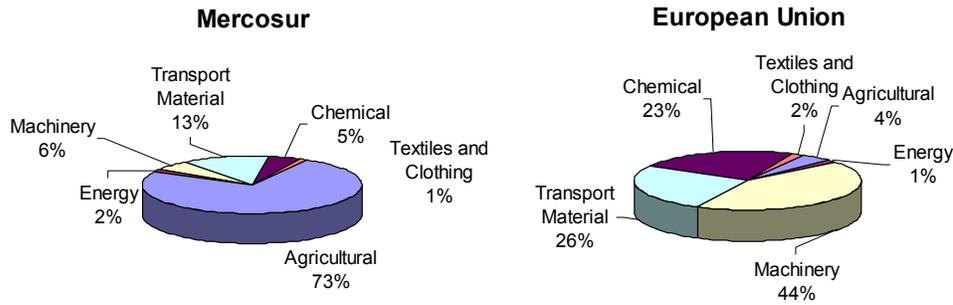


Source: IADB.

It is noteworthy, however, that between 1990 and 1998 imports from the EU to Mercosur increased more than 235%, from \$7.9 billion to \$26.5 billion. At the same time, exports from Mercosur also increased, albeit at a smaller rate, from \$14.8 billion to \$20.2 billion. These dynamics have resulted in a reversion of the trade surplus observed at the beginning of the decade, into a trade deficit. In the years after 1998, imports from the EU fell sharply due to the recession observed in the region, while Mercosur exports suffered as a consequence of several external factors, such as an outbreak of foot-and-mouth disease that affected beef sales to Europe, and the drop in the worldwide prices of coffee.

The composition of exports shows the degree of complementarities between the two regions. In the case of Mercosur, 73% of its exports to the EU are agricultural-based. In the case of the EU's exports to Mercosur, the composition is more disperse, with machinery representing 44% of total exports, followed by transport material (26%) and chemicals (23%).

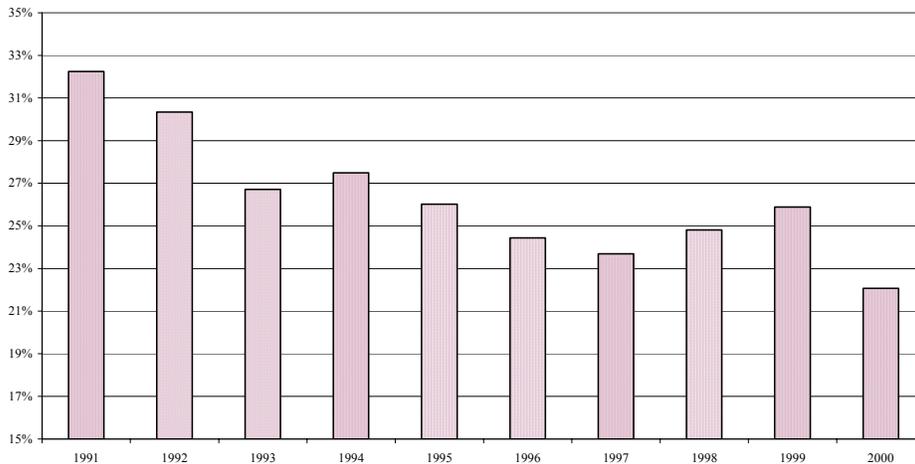
Composition of Mercosur and EU Exports, 2001



Source: EUROSTAT.

Analyzing the volume of exports from Mercosur to the EU, we find that these increased from an average of \$16.0 billion in 1990-1995 to \$18.9 billion in 1996-2000, despite a slight tapering down at the end of the decade. However, as a percentage of Mercosur's total exports, the picture is slightly different: the relative importance of Europe as a target export market for Mercosur declined almost continuously during the entire decade of 1991-2000.

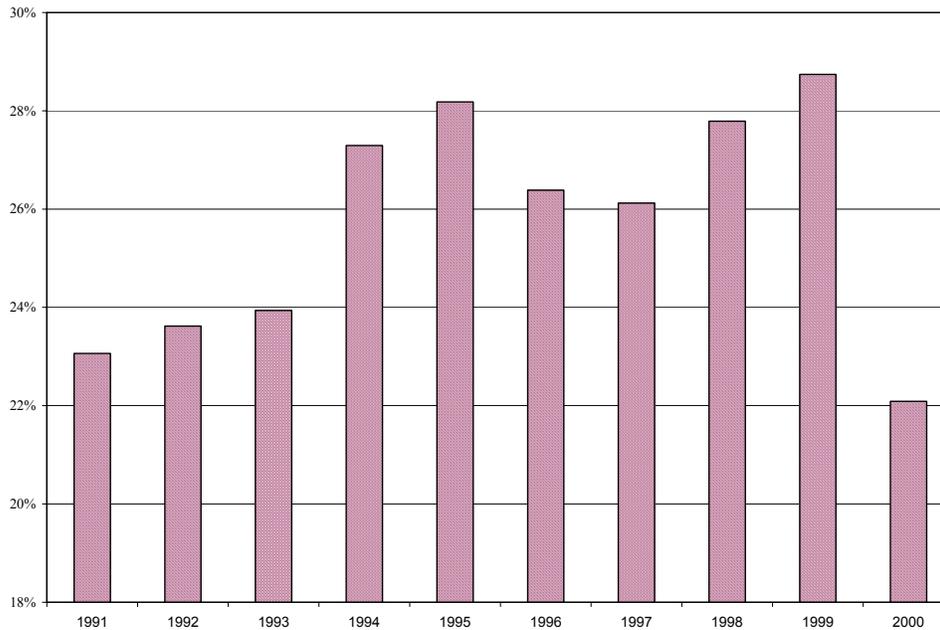
Share of the EU in Mercosur's Total Exports



Source: IADB.

This negative trend in the relative importance of the EU as an export market contrasts markedly with the behavior of the EU share in Mercosur's total imports. Excluding the year 2000, which was atypical due to the severity of the economic crisis in the Southern Cone countries, we observe a sharp increase in the relative importance of the EU as a source of imports for Mercosur.

Share of the EU in Mercosur's Total Imports



Source: IADB.

The above trends are especially important in the context of the negotiations towards the trade liberalization agreement between Mercosur and the European Union. The following section summarizes the recent evolution of these discussions.

EU-Mercosur Trade Negotiations

In 1995, Mercosur and the EU signed the Inter-Regional Framework and Cooperation Agreement that set forth the basis for the negotiations of a bi-regional trade agreement. The trade component of this agreement differs from the traditional trade agreements in the sense that it encompasses not only commercial aspects but also includes provisions that deal with issues such as macroeconomic stability, sustainable development, poverty alleviation and the consolidation of democracy and good governance.⁷

The Rio Summit of 1999 reaffirmed the interest of both parties in progressing towards bilateral, gradual and reciprocal trade liberalization. The Cooperation Council that met later that year established a Bi-regional Negotiations Committee to oversee and manage the negotiations and defined the methodology and calendar of the negotiations.⁸ The Negotiations Committee met seven times between April 2000 and April 2002.

⁷ Inter.-American Development Bank, p. 36.

⁸ <http://europa.eu.int/comm/trade/bilateral/mercosur/mercosur.htm>

First Round (Buenos Aires, April 2000)

The first meeting of the Negotiations Committee established the general methodology for the negotiations. While the main focus of the Committee is trade, the negotiations also comprise cooperation issues, focusing in particular on European technical assistance to Mercosur's efforts to adapt to any future requirements of its eventual inter-regional association with the EU.

The cooperation issues are classified into three different groups, each one of which is the focus of a specific Sub-Group of the Sub-Committee on Cooperation: (i) economic cooperation, (ii) social and cultural cooperation; and (iii) financial and technical cooperation.

The trade negotiations are carried out by three technical groups: (i) Technical Group 1, covering tariffs and non-tariff measures, rules of origin and customs procedures; (ii) Technical Group 2, including trade in services, intellectual property rights and investment promotion; and (iii) Technical Group 3, comprising government procurement, competition and dispute settlement. The initial task of all groups was to compile and exchange all pertinent data and to discuss the parties' objectives.

Second Round (Brussels, June 2000)

Progress was made in setting forth the methodology of meetings of the Sub-Groups of the Sub-Committee on Cooperation, as well as general exploratory discussions.

With respect to trade issues, this was the first meetings of all various Technical Groups. Information was exchanged. Mercosur submitted a proposal for specific objectives of negotiation in the areas of the three Technical Groups and the EC presented an initial list of non-tariff barriers.

Third Round (Brasilia, November 2000)

The discussion progressed on the matter of cooperation. Specific projects of interest for Mercosur were identified.

The three Technical Groups working on trade issues continued their process of information exchange and discussion on specific objectives, based on previously-exchanged information. As the preparatory stages culminated the various groups were approaching the stage where the active phase of the negotiating process could begin.

Fourth Round (Brussels, March 2001)

The sub-groups made progress on specific joint texts on social and cultural cooperation. There were presentations on various European projects of interest to Mercosur.

On the trade issues, both parties deepened the knowledge of their respective positions and started identifying common ground and areas of divergence. There was discussion about the need to create a mechanism to ensure continued technical treatment of certain issues being negotiated.

Fifth Round (Montevideo, July 2001)

The various subgroups continued drafting joint texts related to cooperation in several fields, such as customs, competition, statistics, science and technology and combat against drugs and organized crime.

The trade negotiations entered their active stage when the EU delegation presented its offer for the progressive and reciprocal liberalization of substantially all trade, without excluding any sector, over a 10-year period.

Sixth Round (Brussels, October 2001)

In the field of cooperation, several draft texts were agreed to, related to science, technology, energy, transport, telecommunications, information technology and information society.

With regards to trade, the Mercosur delegation presented its proposal and negotiating texts for tariffs, non-tariff barriers, services and government procurement.

Seventh Round (Buenos Aires, April 2002)

The meeting discussed a set of trade facilitation measures, to be adopted in the upcoming Madrid Summit in May 2002 between Mercosur and EU heads of state. These measures include customs, standards, regulations and conformity assessment, sanitary and phytosanitary measures, and electronic commerce.

Despite the apparent progress in the negotiations for an Association Agreement between Mercosur and the EU, the talks stalled in early 2002 as a result of the economic problems experienced by Argentina, which had repercussions in the other Mercosur countries. At the Madrid summit, the heads of state of EU and Mercosur countries reiterated their commitment to re-launch the trade negotiations. In July 2002, the EU trade and external relations commissioners met with the foreign ministers of Mercosur countries in Rio de Janeiro to demonstrate their support for an inter-regional pact. As a result of the conversations, it was agreed that the talks would resume in the second half of 2003.

Foreign Aid

Generally speaking, the EU and its member countries are the main source of foreign aid to Latin American countries. Between 1991 and 2000, Europe accounted for \$26.5 billion

in foreign aid to Latin America, representing 45% of the region's foreign aid inflows. The United States and Japan represented jointly 34% of the inflows during that same period. Direct aid from Europe to Latin America peaked in 1996 at \$3.2 billion and has gradually decreased, reaching \$1.8 billion in 2000.

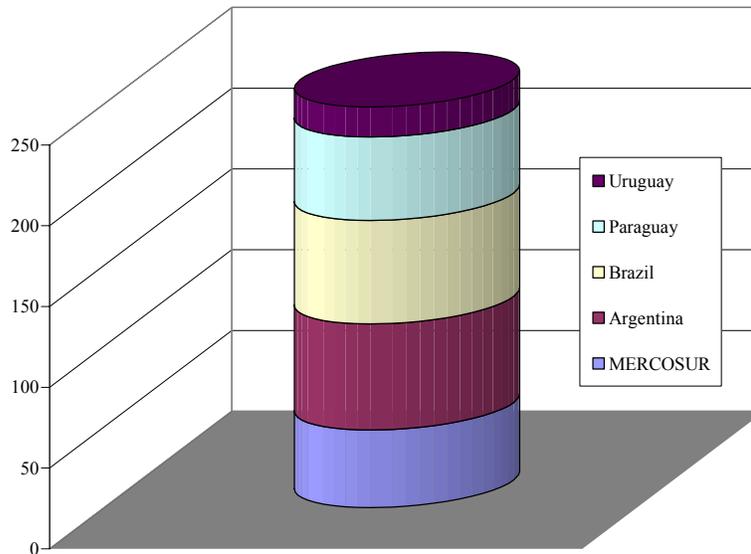
Within Latin America, and thanks to their relative prosperity when compared with other countries in the region, Mercosur members have not rated historically among the preferred targets of EU aid. In the period from 1991 to 1995, Mercosur represented 17% of the total net aid provided to Latin America by the EU. This percentage dropped to 11% for the period between 1996 and 2000.

As part of the negotiations for the EU-Mercosur Association Agreement, there is a new emphasis on EU aid for Mercosur. The Bi-regional Negotiations Committee established a series of priorities for EU-Mercosur cooperation. In conjunction with these priorities, the EU and Mercosur signed in June 2001 a Memorandum of Understanding setting forth the sectors in which the EU-Mercosur cooperation will focus. These are: (i) strengthening Mercosur institutions; (ii) assisting Mercosur in consolidating its economic and trading structures; and (iii) providing support for Mercosur's civil societies.⁹ This aid is going to be inscribed within the framework of the Regional Indicative Program for Mercosur and is in addition to bilateral aid being provided to Mercosur member states.¹⁰ The central purpose of this aid is to strengthen Mercosur's institutions and help them prepare for the eventual challenge of free trade with Europe. Total bi-regional aid for the 2002-2006 period is expected to reach €250 million and would be distributed as follows:

⁹ European Commission. Unión Europea-Mercosur: Una Asociación para el Futuro. Montevideo, Uruguay. May 2002.

¹⁰ European Commission. External Relations. "EU-Mercosur: European Commission adopts Regional Programme in support of further Mercosur integration". Brussels, September 26, 2002. http://europa.eu.int/comm/external_relations/la/news/ip02_1376.htm

Cooperation of European Union with Mercosur and Member States: 2002-2006 (Millions of Euros)



Source: European Commission.

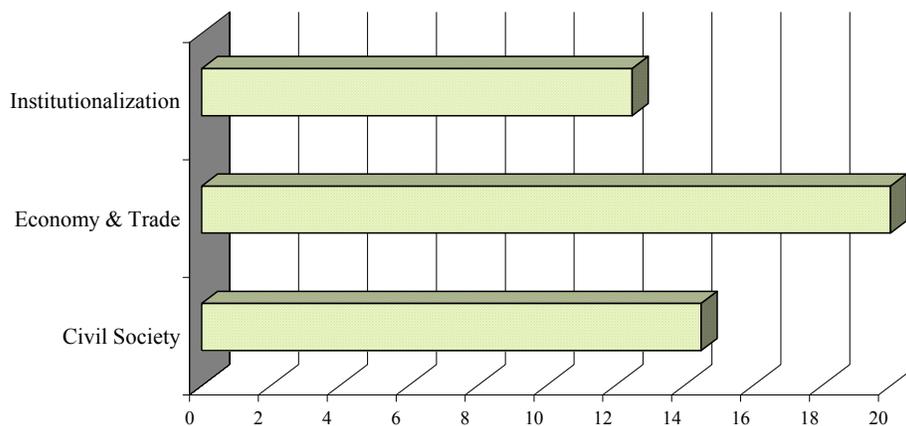
The specific projects with Mercosur that are being carried out comprise the following fields:¹¹

- Institutional Support to various Mercosur bodies:
 - ❖ Administrative Secretariat- SAM (€0.9M),
 - ❖ Joint Parliamentary Committee- CPC (€0.9M)
 - ❖ Economic and Social Consultative Forum- FCES (€0.9M);
- Customs Harmonization (€5.0M);
- Veterinary and Phytosanitary Rules (€11.2M);
- Technical Norms and Standards (€4.0M);
- Statistical Harmonization (€4.1M);
- Support to the Mercosur Single Market (€4.6M);
- Macroeconomic Co-ordination (€2.5M).

¹¹ Mercosur-European Community: Regional Strategy Paper 2002-2006, pp. 48-57.

The Mercosur aid funding is distributed as follows:

EU Cooperation with Mercosur 2002-2006
(Millions of Euros)



Source: European Commission.

Final Remarks

Mercosur is experiencing the negative effects of having gone through the initial stages of an integration process without having established a minimum level of policy coordination that would ensure that its members' economic policies were mutually compatible. Instead, Argentina and Brazil were content with a de facto convergence of macro variables, a convergence that was more the result of a series of coincidences rather than the effect of well-designed policies. A series of external shocks that started in 1998 triggered a chain reaction that unveiled Mercosur's inherent economic weaknesses and ended in massive foreign exchange swings in Brazil, in Argentina's financial collapse and in massive destabilization of Uruguay and Paraguay, which were affected by the crisis of their two main trading partners.

In the context of the serious economic and political crisis that the Southern Cone countries are experiencing, it is imperative that Mercosur strengthen and deepen its economic relations with the European Union. There is much to be learned from the European integration process especially in terms of institution building, governance and policy harmonization and coordination.

Given the substantial degree of currency depreciation that all Mercosur members have experienced, it is likely that the path to economic recovery will pass through an expansion in exports. An association with the European Union could expand the opportunities the Southern Cone countries need to regain the path to growth.