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Working group on European Union-Mercosur negotiations

Trade liberalisation in an EC-Mercosur Free Trade Agreement
Experts Workshop Briefing Notes

List of Experts and Papers

presented at the Experts Workshop, Paris, May 12th and 13th 2000

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Foreword

The negotiations between the European Union and the Mercosur on trade liberalization initiated in November 1999. The future of the political and economic relations and of cooperation between Europe and the Mercosur, which is one of the regions with the highest growth potential, will depend on the outcome of this dialogue. Therefore, the interests at stake are considerable. All the interests should be expressed in their diversity and be given full consideration in order to successful conclude the trade negotiations and start a new era of enhanced political and economic relations between the two regions.

In this view, the **Mercosur Chair** of the Institut d'Etudes Politiques de Paris (Sciences-Po) set up the **Working Group on European Union-Mercosur Negotiations** which constitutes a neutral interface between the official negotiators, the business community and the civil society.

The **Working Group** is a flexible structure of working contacts between the two regions, which intends to contribute to the preparation and to the monitoring of the European Union-Mercosur inter-regional negotiations and to the discussion of the positions of the two regional groups within the framework of the WTO. It aims at creating a permanent support group, which benefits from an independent academic forum and associates a broad spectrum of actors interested in the negotiation: the public administration, the political representatives, the private sector, and the experts originating from the academia and the leading international organizations.

This initiative follows the seminar jointly organized with the University of São Paulo (USP), held in Paris on May 1999 and titled "**The Political and Economic Stakes of the European Union-Mercosur Negotiations and the Agriculture Deadlock**". The seminar brought together around eighty participants such as officials from the legislative and executive branches of the States, negotiators and diplomats, top executives from the private sector and experts from the two regions. The proceedings of the seminar were the subject of the first Report of the Mercosur Chair that was widely circulated in Europe and in the Mercosur. The Report has been presented as a contribution of the Civil Society to the Summit of Heads of State and of Government, held in Rio de Janeiro in June 1999.

The **coordination** of the Working Group is ensured by an Expert of the Mercosur Chair. The core of the Working Group is about thirty specialists from the different countries of the Mercosur and the European Union. Participants undertake to contribute regularly on their own behalf, without representing any organization or institution. Confidentiality is guaranteed. The Working Group will produce studies and intermediate reports all through the EU-Mercosur and the WTO negotiation processes. The Mercosur Chair will publish the interim documents such as the Technical studies and the Annual Reports.

In the year 2000, the activities of the Working Group are organized as it follows. In the **Workshop** (Paris - May 12th and 13th, 2000), the Working Group Experts presented and discussed their technical research. In the **Seminar** (Rio de Janeiro - June 20th, 2000) the Experts discussed the results of their research with the representatives of the public and private sectors. In the **Annual Meeting** (Paris - December, 2000) the Experts, the representatives of the public and private sector and the officials of the European Union and the Mercosur will discuss the main issues of the Annual Report.

This publication presents the Briefing Notes that summarize the **Technical research** produced by the Experts of the Working Group. These Briefing Notes have been presented in the Seminar of the Working Group on Eu-Mercosur Negotiations jointly organized with the Centro Brasileiro de Relações Internacionais – CEBRI.

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EU-Mercosur after Seattle : A race with the Free Trade Area of the Americas

Alfredo Valladão

The anti-globalization backlash in the streets of Seattle during the last World Trade Organization (WTO) ministerial meeting left the whole trade liberalization processes without a compass for the future. In the absence a new round of talks - and besides the basic Articles XXIV of Gatt and V of GATS - there is no kind of an universal reference for the negotiations of the new themes of international trade, like services, agriculture, investments, government procurement, competition policy, e-commerce or « new issues »... Meantime, the melancholic mood in Geneva is strengthening the regional or inter-regional processes (FTAA, APEC, Transatlantic Economic Partnership, EU-Mercosur...) as a second-best way to further trade liberalization. Neither the emergent and the less developed countries, nor the economic sectors of the industrialized world that benefit from trade can wait for a hypothetical *Millenium Round*.

In fact, trade negotiations today are constrained by two conflicting drives. On one hand, to keep the liberalization ball rolling, at the multilateral and regional levels. On the other, to be very cautious in order to keep in check the opposition to free trade in industrialized societies, and to answer the main emerging countries concerns about being cornered by the big trade players into accepting unbalanced agreements. These tensions are giving a distinctive defensive flavor to the negotiations. The idea now is not so much to create new partnerships and to agree to mutual beneficial concessions, but to participate in every forum as a form of hedging and so as not to be left out. A *no-lose* mentality is substituting the former *win-win* approach. And this new mood is a real challenge to the project of an Inter-regional Association Agreement between the European Union and Mercosur.

The Mercosur countries were counting on a new WTO Round to try to redress a perceived imbalance in the world trade agreements. They still feel that the concessions they have made were not really reciprocated by the industrialized countries. But without that new Round, the only ball that remains in the game is the FTAA. For Mercosur, the hemispheric integration process is the only dynamic trade negotiation, with clear goals, political commitments and deadlines, functioning working groups, transparency of the proceedings and a broad agenda of ministerial meetings. Eighteen months only since the beginning of the trade talks, the FTAA Ministerial in Toronto (November 1999) went as far as to emphasize the final date to conclude the exercise (2005) and to ask the negotiators to produce a first draft of the concluding treaty for the next meeting, April 2001 in Buenos Aires. At the same time, were announced the first trade facilitation provisions for the whole hemisphere, based on the work of the Americas Business Forum (ABF).

Actually, the FTAA process has much more in it than trade. It works like an engine for a new Pan-American integration through the creation and strengthening of a growing number of networks of cooperation - governmental and non-governmental - which, little by little, are harmonizing positions on juridical, regulatory, administrative, political, social or environmental issues. Businessmen, diplomats, experts, academics, unions and NGOs are mobilized in these networks and, because human expertise and capabilities are not infinite, that means that they are becoming more and more absorbed by the FTAA horizon. Which in turn accelerates this process to the detriment of other integration initiatives. In this context, the biggest challenge for the Mercosur is to avoid been diluted in a future free trade area from Alaska to Tierra del Fuego. In fact, if the Mercosur integration doesn't go beyond a classic free trade area model, there is no reason why it could survive as a preferential trade agreement inside a much wider hemispheric FTA.

Today, in order to survive, the Mercosur is compelled to go beyond trade and to develop some kind of political-economic personality of its own. To simply opt out from the FTAA is not a realistic choice and the cohesion of the Southern Cone bloc couldn't stand such a chock. « Deepening » and « enlarging », this is the name of the game, a road not so dissimilar from the European Union experience. However the enlargement of Mercosur will have to face not only obvious political problems, but also tough trade realities. Most of the Central and South American countries depend heavily on their trade relations with North America. To convince these countries to play a Mercosur card in parallel with the FTAA one it would imply giving them some concrete hope of a large access to the huge Brazilian market. Yet, for now, there are no domestic political conditions in Brazil for such a step and, as president Cardoso announced in the Davosito Meeting (Rio de Janeiro, 7th May 2000), the integration processes in Latin America, *"all aim at the big hemispheric integration"*. As for deepening, it means clearly a new effort to further a Mercosur macro-economic coordination, probably with a form of monetary union down the road. But we all know that, in spite of an actual good will by the governments of the region, this kind of process takes time, and will have to compete permanently with the dynamics of the FTAA and with the rampant temptation in various countries in the region to jump into the "dollarization" dream.

In this context, the regional bloc's vulnerability is such that any intelligent opening by the strongest economic power, the USA, would be immensely popular in the Mercosur and even in Brazil. So much so that it could even threaten the basic principle of the FTAA negotiations – the *single undertaking* – and open the way for some form of *early harvests* sought after by the American negotiators. This worst case scenario is kept in check by the fact that the White House has been incapable, in the last years, to obtain a *fast track* mandate from Congress. But to think that this situation will last forever is clearly a losing bet. As the China trade vote showed, a United States President can get his way on trade when he really pushes for it. The next President will probably obtain the *fast track* – maybe under another designation - and more so if he is a Republican. Therefore Mercosur should be ready for a new Washington FTAA offensive by the end of the year 2001. Not much time to consolidate the bloc. In any case, it will need extra-hemispheric partners if it wants to keep some diplomatic elbowroom. With the WTO still in low gear, the trade talks with the European Union, launched in Buenos Aires last April, will be crucial for the survival of the Southern Cone integration process.

The trouble is the EU doesn't look very enthusiastic about these talks. Europe in fact is almost overwhelmed by its domestic problems (the weak euro, the political reforms necessary for the enlargement process and the shear complexity of this same process, the xenophobic right-wing menace in Austria and other member States, the negotiations with the Mediterranean and with the African countries....). There is no much room left for tackling the relationship with Mercosur. Then, there is a big imbalance between the two partners : the European market is much more important for Mercosur exporters than the reverse, even if many important European firms have been investing heavily in the Southern Cone in the last six years. The structure of the bilateral trade doesn't help either. Mercosur exports mainly agriculture commodities to Europe, so the debate tends to focus on the interest of the agribusiness sector which is in open conflict with the strong lobbies which benefit from the EU Common Agriculture Policy (CAP). On both sides there is not much political elbowroom to reach a compromise (even if, technically, the number of « problem goods » is very limited). On the other hand, the European direct investment in the Mercosur is concentrated in some specific areas as services (banking, telecommunications...) and automobiles where the are only a few big players.

In this context, the first step to start a fruitful dialogue should be to broaden and intensify the networks of common interests between the two regions. At the start of the negotiations there are still not enough actors involved and this situation gives a *de facto* veto power to the most active lobbies fighting against any EU-Mercosur agreement. But in spite of these roadblocks, both regions need one another. They both share the same political ambition : a "deep integration" project that goes far beyond a simple free trade area. The successful implementation of these projects and a strong cooperation between them can only reinforce both partners in all the other international negotiating fora. More specifically, Mercosur needs the European connection in order to balance its one-sided relationship with the US and NAFTA. The EU for its part, needs a Mercosur ally in its campaign to re-launch a WTO trade round so as to drawn the ongoing negotiations in agriculture trade (where it is in disadvantage) into the broad sea of a new *Millenium Round*. More important, the EU cannot just look at the fast pace of the FTAA negotiations hoping it won't get anywhere. After Mexico signed the NAFTA treaty, the Europeans lost half of their market share in that country. The same outcome in Brazil and Argentina would be catastrophic. But it is true that the decision making process inside the EU is so cumbersome, that it tends to wait for an American initiative – or *fast-track* – before it starts to seriously consider the issues at stake.

The reality is that for both Mercosur and the EU the bilateral talks are viewed as a defensive hedge in order to protect oneself against the risks embodied in other trade negotiations. The bilateral agenda put forward in April 2000 in Buenos Aires embraces every possible subject and still lacks focusing on the fundamental issues. Solely diplomats run the exercise with very little input from the private sector or other actors from the « civil society ». Business interests and others are infinitely more engaged in other negotiating processes, like the FTAA, the TEP or the EU enlargement to Eastern Europe. Only the protectionist lobbies are vocal and we know how much, without a countervailing force, they can paralyze any diplomatic initiative. Thus, the future of the EU-Mercosur relationship depends heavily on the capacity to get more groups of interest on board of the talks. In this particular moment, that means trying hard, without undermining the *single undertaking* principle, to arrive rapidly at some kind of *early harvests* at the negotiations table (business facilitation, technical cooperation, norms and regulations, cooperation in non economic fields, dynamic political dialogue...). Such *early harvests* are a way of keeping alive the bilateral integration process against the inevitable snails pace of the trade talks.

WTO - Framework: the constraints of multilateralism on regionalism

Vera Thorstensen

The impasse created in December 1999 in Seattle with the suspension of the multilateral negotiations to start a new round of trade liberalization has an immediate impact on the discussion on multilateralism versus regionalism.

Until the beginning of 2000, 120 regional trade agreements were notified to the GATT/WTO, the majority including the liberalization of goods, but some including also the liberalization of services. The EC-European Community involves 35 of these agreements, EFTA-European Free Trade Agreements includes 17, Central and Eastern Europe 35, the USA is party to 2 agreements and countries of the Americas are parties to 6 agreements. Even Japan, a country historically against trade agreements, is starting to negotiate a trade agreement with Korea and Singapore, and perhaps with Mexico and Canada.

There is an important discussion among economist and trade specialists about the question whether the multiplication of trade agreements is positive or negative for the international trade system. If, on one hand, it can be shown that processes of integration can create trade, on the other hand, it also can be demonstrated that such processes can divert trade, affecting the flow of exports of many countries. Moreover, the parties to these agreements can formulate their own rules, raising the discussion on how third parties will be affected by such rules, and who is responsible for the supervision and control of these agreements.

The GATT/WTO system, since its beginning in 1948, has specific rules to deal with regional trade arrangements, concerning trade in goods, which are included in Article XXIV of GATT. At the time of GATT, several Working Parties were created to examine these arrangements. With the establishment of the WTO, the Committee on Regional Trade Agreements was formed to continue this task, now enlarged by new rules related to services, which are included in Article V of GATS.

Basically the rules for the formation of trade arrangements are the following:

- Free trade areas or customs union should have as objective the facilitation of trade among the parties of the agreement and should not raise barriers to third parties not belonging to the agreement.

- Duties and other regulations on trade imposed at the institution of these agreements shall not, in the whole, be higher or more restrictive than duties and regulations applied prior to the formation of these agreements.

- Any agreement shall be promptly notified to the GATT/WTO and made available all necessary information. Any agreement shall include a plan and a schedule for its formation within a time frame of 10 years.

- The duties and other regulations on trade among the parties of an agreement shall be eliminated with respect to substantially all the trade.

- GATT/WTO shall examine these agreements against all the rules established by GATT/GATS and shall make a report about the compatibility of the agreements with the established rules. These reports shall contain recommendations as appropriated.

These rules seem to be simple to read and to apply but, after more than fifty years of GATT/WTO existence, they are still raising discussions among parties.

The main points of the discussion are the following:

-If the objective of trade agreements are to facilitate trade and not raise barriers to third parties, these third parties, when negatively affected, should be compensated or not ?

- If duties and other regulations of trade imposed to the agreement shall not, on the whole, be higher or more restrictive than the ones prior the formation of the agreement, how the general incidence of these duties and regulations is to be calculated and how affected third parties will be compensated ?

- If the parties of an agreement shall promptly notify GATT/WTO, when this notification shall be done: during negotiations, after signature of the agreement, or after ratification by the Parliaments or Congress. When the examination by GATT/WTO shall start?

- If duties and other regulations on trade are to be eliminated among parties of the agreement on substantially all the trade, how this rule should be interpreted ? Can an agreement be considered consistent with GATT/GATS if it excludes trade in one sector? Some examples are under discussion since some agreements are excluding sectors in agriculture and sectors in services of the related rules.

- What kind of measures are to be included in the rule of elimination of "other regulations on commerce" among parties. Can an agreement to be enlarged to a new party imposing its measures on anti-dumping, anti-subsidies and safeguard, without completing a new and full investigation? Can it impose its textile quotas to the new party ? Should a third party affected be compensated ? If the adoption of preferential rules of origin affects third parties, should these parties be also compensated ?

Some of the questions are being discussed in the Committee on Regional Trade Agreements. At the present time, the discussions are open and no conclusions could be reached about these systemic questions. Because these are important items in discussion, no agreement was considered compatible to WTO rules. As a consequence, affected third parties are bringing some points to be ruled by the Dispute Settlement Mechanism.

Despite the fact that no consensus could be reached by WTO members till the present time, one cannot conclude that there are no rules to the formation of regional agreements. The rules were already negotiated and are included in Articles XXIV of GATT and Article V of GATS. They are the basic points to be considered in any negotiation of a new trade arrangement.

In discussing the EU - MERCOSUL new trade relations, it is important to consider and discuss the impact of the GATT/GATS rules on regional integration, specially the inclusion of substantially all the trade (if some agricultural sectors could be excluded), and the impact of preferential rules of origin on trade flows.

To follow the discussions of the Committee on Regional Trade Agreements and the remarks about the agreements under examination as NAFTA, EC enlargement and CEFTA can be a good start to help and inspire the negotiations of this new agreement. It also can offer a preview of the questions that are to be raised after the notifications of this new agreement to the WTO.

The Free Trade Area of the Americas and Mercosur-European Union Free Trade Processes: Can They Learn Something From Each Other?

Robert Devlin

In December 1995 the Ministers of Foreign Affairs of Mercosur and the EU subscribed to an Interregional Framework Cooperation Agreement to strengthen relations between the two regions. The initiative set the stage for a Joint Communiqué of Heads of State during the Latin American and Caribbean-EU Summit in Rio de Janeiro in June 1999 in which it was agreed to launch negotiations "aiming at bilateral, gradual, and reciprocal trade liberalization, without excluding any sector and in accordance with WTO rules" and that the interregional negotiations should "constitute a single undertaking … " It also was decided that a first meeting of the Cooperation Council– first established by the above-mentioned Framework Agreement– would meet in November 1999 to discuss proposals regarding the structure, methodology, and calendar of negotiations. After this latter meeting and a Mercosur-EU Ministerial in Portugal in February 2000, a first meeting of the Biregional Negotiations Committee took place in Buenos Aires in April to set up the organization, calendar and substance of the negotiations.

Steps ahead of the Mercosur-EU process has been the Free Trade Area of the Americas (FTAA) process. It was launched as a central component of the Miami Summit meeting of 34 Heads of State of the Western Hemisphere in December 1994 when leaders decided to create a FTAA "no later than 2005" and that "concrete progress toward the attainment of this objective will be made by the end of the century". The goal is a "balanced and comprehensive agreement".

FTAA Trade Ministers met for the first time in Denver in June 1995 and decided to systematically prepare for active negotiations. This meeting and subsequent ones progressively established 12 preparatory working groups with precise terms of reference in all the potential areas of a modern comprehensive free trade agreement.

After several reviews of the progress of the working groups, Trade Ministers met in San Jose, Costa Rica in March 1998 and recommended that negotiations be launched at the May 1998 Hemispheric Heads of State Summit in Santiago, Chile. In Costa Rica Ministers also recommended the creation of nine negotiating groups, several special committees/consultative groups, an internal management structure and the establishment of an Administrative Secretariat in Miami to logistically support negotiations.

Negotiations began in Miami in September 1998. The initial phase of negotiations was reviewed by Trade Ministers in Toronto in November 1999; in addition, a series of business facilitation measures(customs and transparency-related) were approved to comply with the Heads of State mandate for "concrete progress" by the year 2000. A second round of negotiations was initiated in January 1999. The FTAA process is currently in a phase which is, *inter alia* attempting to draft bracketed texts of the FTAA agreement, discussing the agreement's architecture and considering new business facilitation measures. Meeting days for negotiations are now nearly continuous.

While the FTAA process has advanced steadily and is at a stage of progress consistent with its 2005 deadline, only recently has there been any degree of public awareness that the FTAA is a serious and disciplined endeavor with at least reasonable prospects of achieving a free trade area by 2005. Given the relative success to date, the question has arisen about whether there are lessons for the just initiated Mercosur-EU trade negotiations? Alternatively, are there possible lessons from the Mercosur-EU approach for the FTAA process?

The purpose of this paper is to preliminarily address these questions. There are serious limitations to doing so, however. First, the FTAA process is relatively advanced with more than 5 years of intense work behind it, yet it is still very incomplete and it remains to be seen whether the ultimate objective of a free trade area(FTA) is achieved. Meanwhile, the Mercosur-EU negotiations(MEU) have just begun in ernest. Hence, the evaluation of the former is based on an advanced process with incomplete outcomes, while the evaluation of the latter is based on only very initial steps of a process and formal planning. The economic and political contexts of the two negotiation processes are quite different as well.

The base study is organized as follows. Its first section examines the emergence of a new regionalism in the 1990s and highlights the special development role of North-South initiatives such as the FTAA and MEU in this new context. That is followed by an analysis of some of the similarities and differences perceived between the two processes to date at the levels of politics, economics, principles and institutions. Then an attempt is made to examine whether the two processes offer– subject to the caveats mentioned above-- lessons for each other. This summary focuses only on the last point.

The FTAA-MEU trade processes share many similarities in terms of their being part of a much broader political initiative mandated by Heads of State, their consistency with the characteristics of the North-South dimensions of the new regionalism, their Uruguay Round/WTO type agenda, certain aspects of their management structure, etc. But their differences are also quite marked in terms of the link between trade and the components of the broader political initiative, the political economy approach to the negotiations, principles, modalities and sequencing of negotiations in certain areas, and institutional matters. These differences reflect, *inter alia*, different political cultures, politics and resource constraints, strategic goals, different stages of the negotiation and quite different contexts.

The paper concludes that by and large, and based on existing experience, the two processes do not have that much to learn from each other. Both processes, as structured, seem coherent with their political contexts, objectives in trade, their stages of development, and technically capable of achieving trade goals as long as the effort is underpinned by sustained political commitment. Of course, the ultimate configuration of the agreement is the outcome of long and arduous negotiations which are far from completed. In any event, in observing where the two processes might learn from each other, the ideas below are really only at the margin of a successful trade process. Nevertheless some of them might be considered as a potential way to make a small contribution to a better process.

Perhaps one of the dimensions of the FTAA which at first blush could be interesting for the MEU process is the FTAA governments' unusual joint call for collective technical and financial support of the negotiations from multilateral organizations (in this case the OAS, IDB, and ECLAC in the context of their Tripartite Committee) for which all the governments are members directly or indirectly. This support--firmly neutral and non-intrusive--has eased the burden on financially strapped Trade Ministries– especially in Latin America and the Caribbean. But most importantly, it has made for a more level playing field among the countries in terms of the generation, distribution and presentation of homogeneous technical inputs for the deliberations of all 34 countries– 32 of which are developing nations-- in the FTAA negotiations. The Tripartite Committee(TPC) has also supported the set up of an Administrative Secretariat which has afforded homogeneous logistical services in a negotiation where the chairs of all the groups/committees rotate among the 34 countries every 18 months. This homogeneous support service is important since the new integration involves industrialized and developing countries where the technical and logistical resource capacities can be quite uneven.

However, even though the MEU process is apparently more plurilateral than one might think at first (Mercosur plus the EU Commission and 15 EU countries) and involves industrialized and developing countries, there may not be a real need for collective support mechanism such as the TPC. On the one hand, the EU has an established and proven mechanism for internal coordination of trade negotiations as does Mercosur. Moreover, both groups are in continuous negotiation elsewhere on the globe and therefore probably have most basic background information for exchanges and negotiation already organized, readily available and of acceptable quality. The EU also has a large cooperation program which is part of the negotiations and presumably could service Mercosur if needed. But if a collective support mechanism were deemed necessary, it probably could be mobilized by such an important group of countries

Another feature of the FTAA which may be of interest is the ongoing attention to regularly approving business facilitation measures during the negotiation process. This provides concrete outputs along the long road to an FTA, which has merits in its own rights. But it also serves the purpose of keeping the private sector engaged in the interim. The business facilitation agenda of the FTAA emerged after 3 years of a preparatory stage and was fed from early on by deliberations of the private sector organized America Business Forum which preceded each FTAA Ministerial. The process is monitored and promoted by the Business Network for Hemisphere Integration. The MEU process also has a parallel private sector movement (the Mercosur-EU Business Forum) which also could propose and promote concrete outputs favorable to business in advance of a trade agreement.

The FTAA has also benefited from pre-programmed Heads of State Summits, as it has regularly punctuated the process with political commitment at the very highest level. removing any doubt trade delegations might have about their county's commitment to the process. Regular MEU Heads of State Summits might serve the same purpose.

Finally, the establishment of the collective FTAA Home Page on the Internet has been a good public outreach mechanism to project the collective commitment and identity of the 34 governments in their joint endeavor. Notwithstanding this innovative achievement, public outreach is nevertheless one of the weaker dimensions of the FTAA process.

As far as the MEU trade process is concerned, the insertion of the free trade objective into the negotiation of a formal umbrella Association Agreement is an interesting way to tie together the political, cooperation and commercial dimensions of a broad initiative to tighten interregional relations.

Broad interregional initiatives have become a fashionable dimension of the new regionalism as witnessed by APEC, the Western Hemisphere Summit process and the Rio European Union -Latin American and Caribbean Summit. APEC has been

relatively successful with its initiatives in the area of cooperation, but not so on the trade front. The Western Hemisphere Summit has been very successful so far on the trade component, but much less clearly so on many other areas of Hemispheric agenda.

The EU approach appears to launch a big scale horizontal interregional initiative (Rio Summit) and follow this up with negotiation of geopolitically coherent, vertically integrated initiatives like the MEU Association Agreement. If successful, this could be quite suggestive for the Western Hemisphere's Summit process which remains a loosely federated and very uneven developed coalition of initiatives.

Finally, as mentioned, in its initial years there was relatively little public awareness and interest in the FTAA process in government, business, academia and civil society more generally. This has improved somewhat but still is at modest levels and still mostly the domain of "insiders". A program like that being developed by Science-Po's Mercosur Chair could be an interesting way to develop interest, debate, and ideas that can contribute indirectly to on-going trade negotiations and the broader political and economic issues surrounding them.

Strategic issues of an EU-Mercosur Free Trade Area

The costs of European protectionism

Patrick Messerlin [1]/

1. Introduction

This note summarizes the main results of a study (© Institute for International Economics, 2000) about *(i)* the level and evolution of the EC overall protection from 1988-90 to 1997-2000, *(ii)* the costs of this protection for the EC consumers, and *(iii)* the future EC approach of "regional agreements" with a focus on Mercosur-EC relations.

2. The Level and Evolution of EC Overall Protection in the 1990s

The section presents a quantitative assessment of the level of "overall" protection granted to the European output of farm and industrial goods. "Overall" protection refers to all the key trade barriers -- tariffs, non-tariff barriers (NTBs) and antidumping measures -- granted to the EC output of goods. The section gives also a sense of the recent evolution of EC protection since it covers the years 1990, 1995, 1997 and (only for tariffs) 2001.

The two major results are as follows: *(i)* the level of overall protection for the whole EC economy is roughly 13-14%, a much higher level (two to three times) than generally stated; this level is quite stable since 1990, despite limited tariff decreases since 1995 (which should continue until 2001 in accordance with the EC Uruguay commitments); *(ii)* the EC protection is very selective: rates of overall protection exhibit wide differences by sector, and these differences tend to remain stable over the period examined. These results are based on conservative assumptions: they rely on tariff averages which, even by sector, cover tens or even hundreds of different tariff lines so that peak protection rates are largely blurred; they ignore *non-border* barriers to trade (awfully difficult to quantify), in particular technical regulations (norms and standards), public procurement and subsidies.

These results deserve three general comments. First, the high level of EC overall protection flows from the systematic incorporation of NTBs and antidumping measures which are not included in the official estimates. In particular, a substantial part of *industrial* goods is still highly protected -- a point often hidden by the focus on protection of farm products.

Second, the stability of the EC rate of overall protection until 1995 is not surprizing, but it is interesting because it presents the fear of Fortress Europe and the hope of a more open EC after the Single Market Programme as equally wrong. In fact, the "communitarization" process of Member state trade policies which has been ongoing between the mid-1980s and the mid-1990s has allowed the Community to substitute its own trade barriers (mostly antidumping measures) to the old ones run by the Member states. The completion of the Single Market (expected to improve the competitive position of EC producers, and to induce the EC to open its borders), the dismantlement of the trade barriers between the EC and the EFTA countries in 1993 and the accession of three new Member states in 1995 have had no noticeable indirect influence on EC barriers.

Lastly, the quasi-stability of the EC rate of overall protection observed since 1995 is the most surprizing result. To some extent, it reflects the fact that the years 1997 and 2001 mirror only a partial implementation of the EC Uruguay commitments. However, three other possible explanations need to be mentioned: *(i)* the Uruguay commitments are less dramatic than it has been often (still is) said; *(ii)* the observed stability is often a consequence of the ability of antidumping actions to reverse trade liberalization; *(iii)* the ultimate level of the effective enforcement of key Uruguay decisions remains uncertain: the level of effective liberalization in farm and food products and in textiles and clothing will not be clear before the years 2003-05.

Two final remarks. First, large pockets of such high protection in agriculture, industry and services imply very high *costs* of protection. Second, such entrenched highly protected sectors mean that the coming WTO negotiations will be very difficult: they aim at opening sectors which have been very successful at remaining highly protected during the 40 last years. This essential *raison d'être* of the Millenium Round is not well perceived by the public opinion, nor by many decision-makers who wonder why a new Round is needed if the previous one has been so successful. In fact, there is still a lot of work to be done for eliminating high trade barriers, including in manufacturing.

3. The Costs of EC Protection for the European Consumers

During the WTO negotiations of the coming decade, reciprocity is unlikely to work with such Round-immune, worldwide trouble-making sectors which always argue that they are being hurt by a liberalization that they have been successful at aborting. *Unilateral* actions are necessary for coping with them. The first step of such actions is to recognize the problem at stake by revealing the domestic costs of protection of these highly protected sectors. Such a study should focus on the remaining peaks of protection because they are those generating the highest domestic costs and the hottest

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international *and* domestic tensions. Many of these highly protected products are intermediate goods (used as inputs by EC producers) in which developing countries have comparative advantage: this concentrated survival of protection may reflect the limited participation of the developing countries to past Rounds, and the capacity of EC firms to "passthrough" peaks of protection on downstream consumers.

The focus on EC high protection during the 1990s has pinpointed 22 products and services (5 in agriculture, 14 in manufacturing and 3 in services) characterized by a high rate of overall protection. The absence of available information on the relations between these products and services, and between them and the rest of the economy, has made necessary the use of partial-equilibrium models for estimating the costs of protection, although such models cannot catch income effects, nor the feedback effects from a better allocation of resources generated by freer trade (including dynamic interactions between economic growth and trade).

There are two major results about the *magnitude* of the costs of protection for the EC consumers: *(i)* the estimated costs of protection in agriculture and manufacturing for the EC consumers amount to 6% of the value added generated by these two sectors, when perfectly competitive markets are assumed in the protected sectors, 7% when imperfect competition is taking into account; *(ii)* estimating the costs of protection in the three services examined in detail suggests even higher figures -- almost one sixth of the corresponding value added; *(iii)* as a result, a conservative estimate of the costs of EC protection (including services) could easily represent 7% of the *entire* EC GDP, that is, the equivalent of the Spanish GDP.

Asking for protection (and granting it) has one essential motive: generating domestic income *transfers*. Analyzing protection would thus be incomplete without assessing the main winners and loosers in the EC. In this respect, there are two major results: *(i)* contrary to a belief widespread in Europe, protection is a costly instrument for "saving" jobs: the estimated average annual cost per job "saved" is astronomical -- roughly €220,000, or ten times the European average wage of the sectors in question; *(ii)* the instruments of import protection used by the EC have the crucial -- and very undesirable -- feature to grant large rents to vested interests: in fact, estimated rents are *larger* than tariff revenues collected by the EC authorities.

These conclusions fly in the face of the traditional views about protection and liberalization in Continental Europe, where protection is often perceived, and justified, as an expression of some kind of "public interest" (such as strategic goods, cultural differences, social stability, etc.) and where free trade is widely seen as favoring narrowly minded "private" interests. The reality of European protection is quite the opposite: massive private rents are derived from protection by a happy few, and resulting large costs are imposed on many European consumers who may begin to realize this point, as illustrated by the tone less favorable to farmers during the recent (March 1999) debate on reforms in agriculture. However, vested interests may be quick to adjust to this recent evolution by adopting a "smiling" face for promoting protection -- for instance, by flaunting themselves as protector of environment or food safety.

4. Concluding remarks on the EC fondness for regionalism

In the early 2000s, the well known EC "addiction to discrimination" seems to target Latin America, fitting the desire of Mexico and Mercosur members to balance their regional (NAFTA, Mercosur, and future FTAA) and extra-regional interests. Prospects for an EC-Mercosur agreement are difficult to assess: the nature of the future Agreement is still vague (it may not be full-fledged free trade area). No outcome is expected before 2005, and no substantial trade liberalization before 2010-2015 [IRELA, 1999]. There are two reasons for expecting slow and small progress.

First, all the conceivable "preferential" agreements of some substantial economic magnitude for the EC include partners which are (and will increasingly be) among the world strongest competitors of key EC producers. As a result, opening the EC markets to these exporters has the same economic consequences than opening them to all the WTO members (if these discriminatory agreements are not cosmetic or window-dressing devices). For instance, a substantial free-trade agreement with Mercosur will be almost as demanding in terms of competitive pressures and adjustements for the EC farm sector and certain industrial sectors than a WTO agreement with the same scope. Similarly, free-trade agreements with large Asian economies will be as biting for the EC manufacturing sector than a WTO deal. The other key point is that all these discriminatory agreements have the disadvantage to offer much more limited trade-offs than a WTO negotiation: the Mercosur economies cannot provide the same markets for EC exports than a world including Pacific Asia -- or best of all, the *entire* world.

Political benefits from all these initiatives for the EC are also hard to see (they constituted the main gains with ACP, Mediterranean and Central European countries). Asian and Latin American countries have made clear that a trade agreement with the EC should not be perceived by the EC as an act of defiance against the U.S. -- and even less as an act of allegiance to the EC.

In sum, the EC hyperactivity in discriminatory agreements may be on its (slow) ebb for two reasons: *(i)* the EC has realized that many of the past agreements have been an exercise in futility for its own economic interests, but a costly bargain for its partners -- hence a political burden for the EC in the long run; and *(ii)* all the new conceivable discriminatory agreements of some magnitude are less palatable than WTO negotiations, because they impose on EC firms the same level of competition and adjustment than an equivalent WTO liberalization without providing the same range and magnitude of possible trade-offs. The EC seems thus to be "condemned" to be a WTO supporter. Will it accept this evolution without reluctance, or will it resist to it?

The existing EU trade agreements: what to learn for Mercosur

Sheila Page

Relations of the EU with other regions

Its size, level of development, and now age have given the EU a particular role in relation to other regions, not only as a model (or anti-model), but also as a trading partner and aid donor with a strong commitment to a regional approach. It not only accepts regions as counterparts, but encourages their institutional strengthening. It is only recently, however, that the EU has moved beyond this to encouraging region-to-region trading arrangements in its relations with them.

EU-Asia

The only Asian region with which the EU has had long-term relations is ASEAN, but there are no trade ties, and the EU's aid programmes are by country and not tied to regional projects. Political cooperation with Asia has gone further but the Asia-EU summits have included Japan, China, and South Korea, as well as ASEAN. They were extended because of pressure from other Asian countries. The other Asian interests of the EU thus proved more important than regional solidarity.

North Africa and the Middle East

The European Community originally signed separate agreements with these countries, and only started to promote a regional area among them in the 1990s. The agreements did follow a common pattern and thus encouraged the individual countries to coordinate their approaches, but regional ties were not the priority.

ACP

The exception to the EU's regional approach in the past has been the countries involved in the Lomé Convention for Africa, the Caribbean and the Pacific. These have been treated as a single group. (While many of the ACP countries are members of informal regional groups only CARICOM and SADC have moved significantly in the direction of free trade. Therefore the basis for a regional approach did not appear to be present.) The EU did encourage FTAs within the group, most prominently in Southern Africa.

In 1997 the EC chose to support FTAs with regions among the ACP countries to succeed Lomé IV. The EU chose not to make the negotiating effort and concessions to extend the WTO waiver. Moving the ACP countries to the status of developing countries without special relationships with the EU would be seriously inferior because of the many developing countries which do have special relationships. In February 2000 they reached agreement only on the form of future negotiations with the aim of regional agreements to start in 2008 and finish transition by 2015. There is explicit provision to find alternatives if one or more ACP regions are not suitable or willing to sign agreements. It is thus a substantial retreat from the original objective of region-to-region agreements by 2005, opposed by most of the ACP countries. (The enthusiasm of the new Commissioners, especially Lamy in trade, is clearly less than that of the old.) Some of the ACP countries and regions already have relations with other countries.

EU agreements with individual countries

The EU signed two agreements with individual countries last year, South Africa, and Mexico. These illustrate the difficulties of resolving problems with 'sensitive' products and self-evidently do not fit the model of the EU encouraging regions; at least one, with South Africa, may obstruct an agreement with its region; that with Mexico was intended to restrain Mexico's integration into NAFTA.

EU-South Africa

This was not the first between a developed and a developing country, but the EU claimed a new principle of 'asymmetry'; it provides a 10-year transition period for the EU and 12 for South Africa. About 5% of South African exports to the EU, but at least a quarter of its agricultural exports are excluded. Agriculture was the principal problem on the EU side throughout the negotiations. Even after formal completion of the negotiations, further discussions were necessary with individual EU countries to satisfy domestic interests. No concessions were made on the EU side on subsidies to agricultural production and exports. South Africa, however, had clear non-trade interests in obtaining an agreement as part of its return from exclusion.

South Africa is a member of both a customs union (SACU), and a free trade area (SADC). During the course of the negotiations, it was *de facto* acknowledged that it would encompass SACU because of the impossibility of enforcing rules of origin. This was not favourable for the other members (which previously had better access to the EU, without reciprocal opening). They were not allowed to participate in the negotiations and the EU refused to accept responsibility for compensating them for any losses. Since 1997, the EU has had the intention of signing an agreement with SADC. As South Africa is by far the most important trader within SADC, the EU-SADC agreement will have to match it, but the other SADC

countries were not parties to the negotiations. The agreement with South Africa therefore preempts any region-to-region negotiation with SACU or SADC.

The South African negotiators explicitly recognised that their agreement would be eroded, by further multilateral negotiations, enlargement, and other bilaterals. The agreement itself 'eroded' the previous advantages of the EU's other partners. SADC has learned its lesson: it is seeking relations with the US, MERCOSUR and ASEAN.

EU-Mexico

Mexico is neither a region nor a politically special country. Agreement with the EU in the 1970s brought MFN treatment when Mexico was not yet in GATT. New negotiations began in 1995. Completion by November 1999 was exceptionally rapid. Under it, tariffs on all manufactures will be eliminated by 2007. Reductions in barriers to EU exports are thus expected to keep pace with those to the US. Only 62% of agricultural trade (at present 7% of the total) will be liberalised. The degree of asymmetry which Mexico has negotiated is less than for South Africa. For Mexico, FTAs are not a novelty: not only NAFTA, but the Group of Three and Chile, with Bolivia, Central America and the Caribbean on the agenda.

EU-Eastern Europe

The cultural, social and historical common interest with these countries makes agreement different in kind from the others. The unavoidable need to integrate them will put pressure on the Common Agricultural Policy, the CAP, which could lead to major reform and help all agricultural exporters, including MERCOSUR.

EU relations with Latin American Regions

This is the area with the longest history of EU encouragement of regions. Aid has been highly concentrated on regional initiatives since 1970. The EC established direct relations with the Andean Pact. This was regarded by the Commission as potentially similar to itself, and therefore received substantial assistance. In the 1990s, however, the level of aid going to Latin America fell, with a shift to poorer areas and within Latin America, to poorer countries. Trade agreements became the central tool of EU promotion of Latin American regions.

There are limits to the regionalism promoted: the agreements with Mexico, Brazil and Paraguay explicitly encourage agreements with the region, not with the US. There are also limits on the priority to regions. The Rio summit in 1999 was originally planned as a Summit with MERCOSUR, but then broadened to all countries in Latin America and the Caribbean.

EU-MERCOSUR

The start to negotiations was much more difficult and prolonged than those with Mexico, delayed by agriculture. The difficulties of the negotiations with South Africa, which is a much smaller producer and politically attractive, are an indication of those MERCOSUR can expect. The fact that the negotiations with Mexico (which signed its framework agreement after MERCOSUR) finished first shows that the agricultural hesitations of the EU are taking precedence over any commitment to helping another customs union. MERCOSUR may have an interest in holding back negotiations until after the EU admits Eastern Europe. But interests on the industrial side in both MERCOSUR and the EU may want to keep the timing in parallel with the FTAA. Following the FTA between MERCOSUR and Chile, negotiations with Chile have gone in parallel with those with MERCOSUR, and could lead to a separate agreement.)

Implications of other EU agreements for MERCOSUR

Contrary to the normal assumptions about FTAs, an EU-MERCOSUR agreement will not be a case of 'special' treatment. It would be one of several EU FTAs. Equally, it is not 'special' for MERCOSUR: MERCOSUR is also developing a range of ties. Should MERCOSUR and the EU continue to pursue other trading arrangements? Such simultaneous negotiations do have administrative and technical disadvantages. Trade negotiators are over-burdened and calculating the costs and advantages of each agreement becomes much more complicated, because the 'base' position is always changing. This may not matter if each sees the arrangements as part of a process towards full multilateral liberalisation, but would matter if the primary objective was to gain a permanent advantage relative to other areas. Realistically, both MERCOSUR and the EU must expect that the liberalisation that either makes to the other is likely to be extended to other partners:

The historical reasons or economic examples used to argue for special interests or relationships are not unique. The onerous negotiations with all areas and the existence of agreements with two countries, excluding the rest of their regions, are clear evidence that the interest of the EU in signing region-to-region agreements does not override other goals: the desire to establish links with South Africa or Mexico, or to maintain the CAP. Agreements with others may reduce barriers to MERCOSUR.

The institutional framework of Mercosur-EU economic relations (A look from Mercosur into the European Union)

Ramon Torrent

1.- The identity of the partner: European Community, European Union, Member States of the European Union.-

In the field of external economic relations, **the European Union is not a single actor with a unified policy. It constitutes a kind of conglomerate of sixteen actors: the European Community and the fifteen Member States.**

The European Community continues to exist; it has not been replaced or superseded by the European Union. It has an exclusive competence on some (but only some) aspects of external economic relations, in particular on trade in goods (and from 1.1.1999 on monetary matters).

The matters not covered by the exclusive competence of the Community continue to fall under the competence of Member States, which continue to keep their own individual, non harmonized, policies and legislation. This is the case, in particular, with a great deal of questions relating to services, foreign investment, intellectual property or economic cooperation (to give only an example, bilateral investment treaties are not signed with the European Community –even less with the European Union- but with individual Member States: Spain, France, etc.).

On these matters which continue to fall under their national competence, Member States can act separately on their own (the aforementioned example of bilateral investment treaties) but can also act in common within the framework of the European Union. This second possibility is followed in the case of so-called "mixed agreements". They are **negotiated** by the European Commission on a mandate given by the Council of the European Union and covering both matters of Community competence and of national (that is, Member States) competence. But they have to be **signed and ratified** by the sixteen actors: the European Community and the fifteen Member States.

So, a first strategic question arises. **Concerning trade in goods, Mercosur must necessarily deal with the European Community. But in other fields which continue to fall under Member States' competence, should the relations be strengthened with the European Union as a whole (that is, with the 15 Member States taken in common) or with some individual Member States?**. The advantages of dealing with the European Union as a whole are obvious. But the disadvantages should also be properly understood: the pace for the European Union as a whole will be set by the "slowest" Member States (that is, by the Member States less interested in such a strengthening). In the opposite sense, a strategy of dealing with individual Member States (or of giving some kind of a priority to such relations) can allow for a much faster and deeper strengthening of relations (as well as for the creation of some kind of "competition" or "demonstration" effect among the different Member States of the European Union which can play in favour of Mercosur States).

2.- The framework of Mercosur-EU negotiations

The so-called "EU-Mercosur agreement" already in place is not an agreement with a single actor on the European side (the European Union) but a "mixed" agreement with sixteen actors (the European Community and the fifteen Member States). It can be very useful as a political framework for relations with the European Union (European Community + Member States) as a whole. But it is "empty" of economic content.

Furthermore, its "filling up" will take place, in legal terms, as a result of one or more independent agreements negotiated, signed and concluded on their own terms. In this respect, the agreement with Mercosur is different from the agreement with Mexico which can be (and has been) "filled up" by a decision of the Joint Cooperation Council.

In other terms, **the "EU-Mercosur Bilateral Negotiating Committee" where negotiations are beginning to take place is not a body established within the framework of the present agreement. As a matter of fact, it is not a "body" at all: it is simply a meeting place for the 4 Mercosur States on one side and the European Community and the 15 Member States on the other**.

3.- The strategy for the future: a single "horizontal" agreement or a collection of specific agreements

In political terms, it is undisputed that the negotiations between Mercosur and the European Union will follow the logic of the "single undertaking" in the sense that no side should impose an "a la carte" agreement tailored to its individual interests. But this logic does not (and should not) exclude the possibility of getting to some specific agreements on some specific topics provided that they are in the interest of both sides.

The legal (and political) implications of the choice between specific agreements and a single "horizontal" agreement are extremely important and should never be overlooked. The importance lies in the fact that the position of each of the two sides to the negotiations are not equal in legal (and political) terms:

- Mercosur States have not yet effectively transferred to Mercosur their competences on any aspect of external economic relations; as a consequence, none of them can be "driven into" an agreement without its consent and acceptance.
- On the European Union side, this is not so. Member States have transferred to the European Community their external competences on some matters, in particular on trade in goods. On this specific issue, agreements are concluded **by the Community as such by a decision of the Council of the European Union taken by qualified majority**; that means that, up to a certain number, individual governments can be outvoted. But this is not the case if an agreement becomes "mixed" because it covers matters falling under Member States competence. Such an agreement has to be signed **by every one of the 15 governments and has to be ratified by every one of the 15 Parliaments.**

In short: an agreement liberalizing trade in goods can be approved by the European Community trough a decision by qualified majority of the Council; a "horizontal" agreement covering the whole range of external economic relations (trade in goods, services, foreign direct investment...) must be approved by the European Community and each and every one of the 15 Member States.

Mercosur States and those Member States of the European Union more interested in the strengthening of mutual relations should take into account this crucial issue when deciding on the best strategy for the development of future negotiations.

European Union-Mercosur : trade flows and structure of protection

Roberto Bouzas and Gustavo Svarzman

The growth of bilateral trade flows

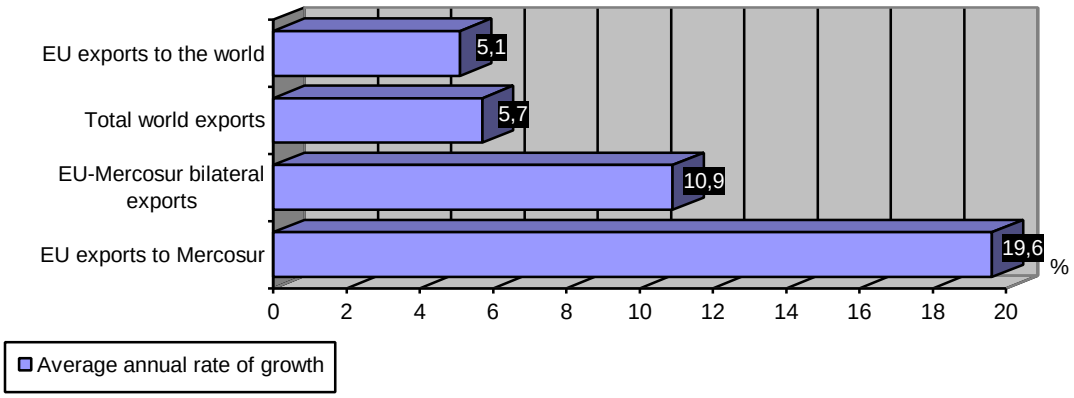
In the 1990/98 period trade flows between the European Union (EU) and Mercosur increased at a rate which doubled that of world trade. This rapid expansion was accounted for by the performance of EU exports, which increased at a rate nearly four-times that of world trade.

The rapid expansion of EU exports was not solely the consequence of fast Mercosur import growth. In fact, during 1990/98 the rise in *market share* explained over a third of total EU export growth to Mercosur. This led to:

- an increase in the EU share of Mercosur imports from the rest of the word from 25.8% to 34.2%;
- a twofold increase in the significance of Mercosur as a market of destination for EU exports to the rest of the world (from 1.4% to 3%); and
- the accumulation of large bilateral trade imbalances (the increase in the EU surplus in manufacturing trade failed to be compensated by a parallel increase in the deficit that the EU traditionally runs in categories such as food products and agricultural raw materials).

The rapid increase of EU exports to Mercosur was the result of several factors, including structural reform in the latter (particularly trade liberalization), the real appreciation of Mercosur countries´ domestic currencies and the structures of bilateral trade flows and protection.

THE PERFORMANCE OF EU EXPORTS COMPARED, 1990/98

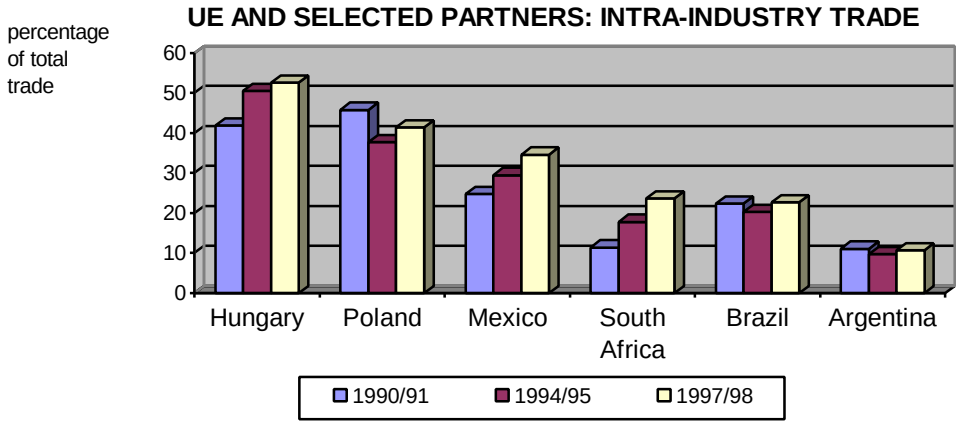


The structure of bilateral trade flows

EU-Mercosur bilateral trade flows correspond to a classic North-South pattern as reflected by a very low –and stable- coefficient of intra-industry trade. In this division of labour the EU specializes in the export of manufactures (especially human-capital and technology intensive products), while imports from Mercosur food products and agricultural raw materials. Except for the latter, during the nineties the share of Mercosur in EU imports contracted in all product categories. A more dissagregated analysis shows that nearly 60% of Mercosur exports to the EU is accounted for by "stagnant" products (from the standpoint of EU imports).

In contrast, human-capital and technology intensive manufactures account for over 90% of EU manufacturing exports to Mercosur and they are a key to explain fast EU export growth during the nineties. Products with significant trade leading the expansión of exports include motor vehicles and other transport equipment, electrical machinery and equipment and telecommunications appliances and equipment (that combined account for nearly a quarter of total EU exports to Mercosur).

Despite the fact that Mercosur is a marginal EU supplier on aggregate terms, it is the main EU supplier of food and beverages accounting for over 16% of EU imports from the rest of the world. The high share of Mercosur in EU imports of food products, and the largely one-way nature of trade flows, account for the fact that the bilateral sectoral trade imbalance explains nearly three-fourths of the total EU deficit in food and beverages trade. Mercosur also accounts for a high share of EU imports of individual products such as beef, meat subproducts, fruit juices and animal feeds.

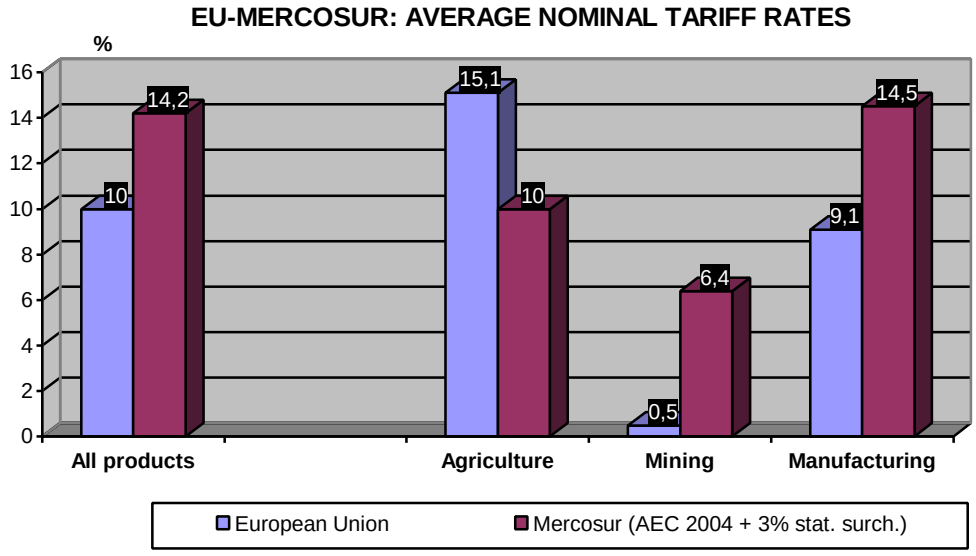


The structure of tariff protection

The EU and Mercosur display contrasting structures of protection which have undergone important changes during the last decade. As far as Mercosur is concerned the major one was the implementation of an ambitious trade liberalization program after several decades of inward orientation. The EU, in turn, introduced important reforms to the rules governing agricultural products´ support and foreign trade, under the auspices of the GATT/WTO. In contrast to the case of Mercosur, these reforms did not translate into a significant reduction of protection. The "tariffication" of previously existing quantitative restrictions and variable levies resulted in nominal tariff rates much higher than the average and far above those levied on manufactures. In addition, EU agriculture is also protected by a complex array of state aids to producers and export subsidies.

EU average tariffs over non-processed agricultural products and processed foods are, respectively, 59% and 170% higher than the average tariff rate. The gap is even larger when compared to the average tariff rate levied on manufactures. The fact that the average tariff rate levied on agriculture and food products is higher than that for other goods is accounted for by the high incidence of tariff peaks. Tariff escalation (ie: higher tariff rates according to the degree of processing) is another outstanding feature of the EU structure of protection. Tariff escalation is most frequent in the foods and beverages sector, but it also affects other natural resource-intensive sectors. Tariff escalation discourages the processing of raw materials and inhibits the development of activities that add value to natural resources. Finally, some products of export interest for Mercosur (such as processed cereals, beef and dairy products in the case of Argentina, and poultry, fruit juice, sugar and tobacco in the case of Brazil), have their access to the EU market inhibited by tariff-rate quotas (negotiated on a bilateral or multilateral basis) with prohibitive tariff rates for volumes over the quota.

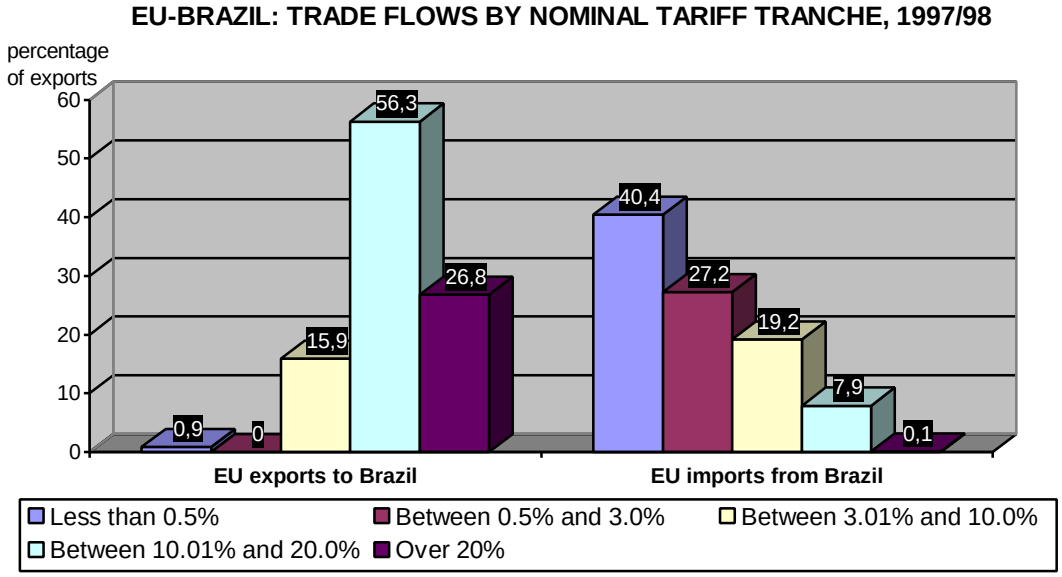
The structure of protection of Mercosur contrasts with that of the EU in that the highest average tariff rates are levied upon manufactures and, particularly, upon machinery and transport equipment. However, nominal tariff rates overstate the degree of protection conferred to domestic producers due to the existence of multiple special regimes such as temporary admission, special non-produced capital goods import programs and the "turnkey plant" regime (in Argentina). In addition, in the case of Mercosur most quantitative restrictions were eliminated in the early nineties.

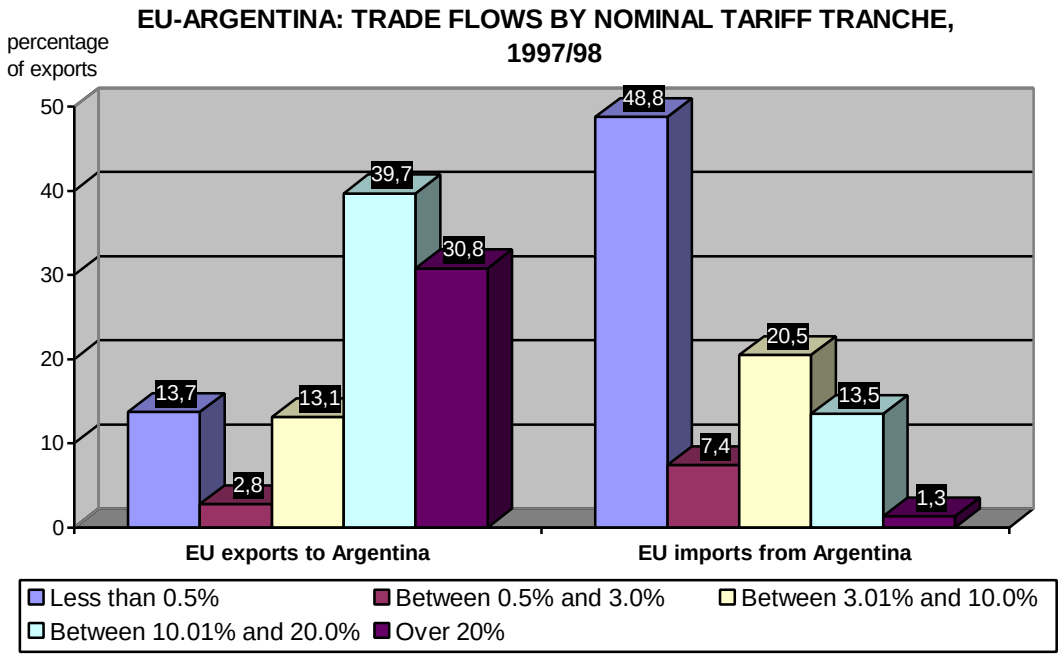


IV. Nominal tariff rates and trade flows

The EU average weigthed tariff rate levied upon imports from Argentina and Brazil is only 5% and 3.3%, respectively. Moreover, less than 15% of Argentine and 10% of Brazilian exports to the EU pay tariffs over 10%. Yet the relatively low tariff rates levied on Mercosur exports to the EU are not a good indicator of market access conditions due to the presence of tariff-rate quotas with prohibitive tariffs for volumes exceeding the quota. A relatively high share of Argentine and Brazilian exports to the EU are subject to tariff-rate quotas.

In contrast, the average weighted tariff rate levied on EU exports to Argentina and Brazil is 14.8% and 21%, respectively. Over a fourth of Argentine and Brazilian exports to the EU fall within the higher-than-20% tariff tranche, while nearly three-quarters of exports pay tariff rates over 10%.

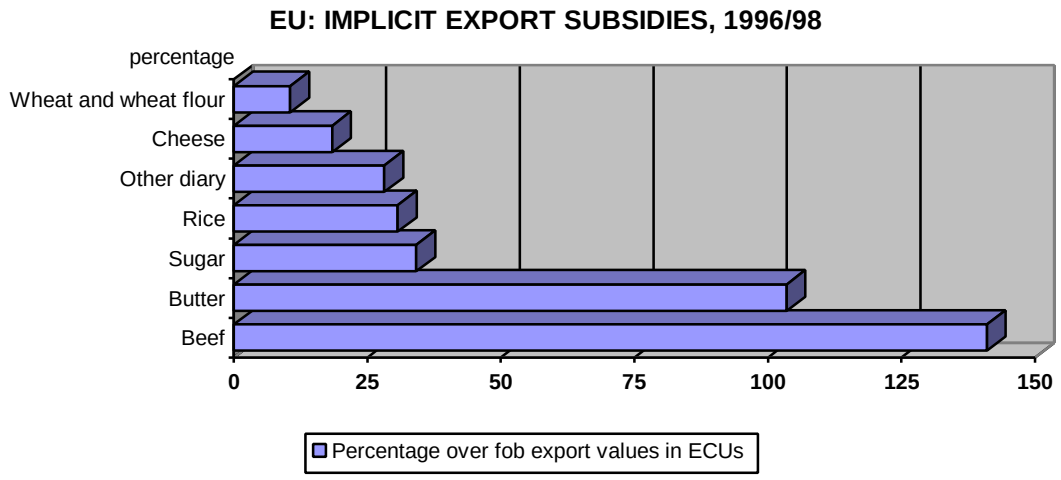




V. The impact of export subsidies

The implementation of the Common Agricultural Policy (CAP) by the EU since the early sixties and its further development have had a severe impact on Mercosur exports, both directly by restricting access conditions into the EU as well as indirectly through the effects on world markets. According to the OECD, the EU is currently responsible for 40% of OECD countries´ total transfers and aids (direct and indirect) to agriculture. Similarly, the EU accounts for 91% of export subsidies notified to the WTO.

The implicit rate of subsidy to EU food exports reaches in particular cases very high levels, both in absolute and relative terms. In the case of beef and butter, for example, during the 1996/98 period export subsidies represented on average 141% and 103.5% of total fob export values. Since many of the products receiving these benefits overlap with Mercosur potential exports, these policies inhibits the access of Mercosur exports to third markets.



VI. Concluding remarks

- Bilateral trade (and particularly EU exports to Mercosur) increased rapidly in the nineties. This pace is unlikely to be sustained if Mercosur fails to improve substantially its export performance. Such improvement is impaired both by supply and demand constraints.

- Mercosur is the largest food supplier of the EU. However, the EU structure of protection has been effective in limiting EU import growth (particularmente of higher value-added products). This has negatively affected Mercosur export growth potential.

- These effects were aggravated by the existence of large aids to producers as well as export subsidies, both of which worsen Mercosur access conditions to the EU and world markets.

- In contrast, the comparatively high nominal tariff rates that Mercosur levies on imports from the EU have not been an effective deterrent to export growth, which have expanded rapidly in the nineties. Yet in the present circumstances it is unlikely that growth will be sustained in the future.

- The structures of protection of the EU and Mercosur suggest that a significant growth potential for bilateral trade exists. Yet this is parallel to the existence of influential domestic sectors opposed to trade lideralization. To ensure a rapid growth of trade flows along time, those sectors who have shared in past trade expansion will need to cooperate and turn more vocal and effective in blocking protectionist interests.

- Bilateral trade repression through quantitative restriction, prohitive tariff rates and production and export subsidies no only affect negatively those engaged in the export-import business, but also threaten EU foreign direct investors. Foreign investors are best served if Mercosur maintains a current account position which is sustainable in the long-run.

Economic effects of a Mercosur-European Communities Free Trade Agreement: A Computable General Equilibrium Model analysis

Paolo Giordano and Masakazu Watanuki [#]

In June 1999 at the Rio de Janeiro Summit, the Head of States and of Governments of the European Union and Mercosur launched the negotiations for a wide Inter-regional Association Agreement. The study is focused on the trade liberalization aspects of these negotiations.

The mechanism of trade liberalization

Trade liberalization is a complex diplomatic game aimed at transformation of the trade regime. The elimination of tariff protection produces four types of economic effects: (i) a production effect: producers adjust to the new set of relative prices by changing their production structure; (ii) a trade effect: the elimination of tariffs causes an expansion of imports; (iii) a government revenue effect: the government loses the tariff revenue; and (iv) a welfare effect: household consumption is affected through the change of real income.

Framework and main features of the computable general equilibrium model

The UE-MERCOSUR computable general equilibrium model originally developed for this study takes into account these effects to evaluate the economic impact of a Free Trade Area between Mercosur and the EC (MEC FTA). The model considers five regions and eleven sectors. The five regions are the European Union, Argentina and Brazil representing the Mercosur, the United States and Mexico. The rest of the world is considered as a residual. Individual sectors are aggregated in three macro-sectors: the agribusiness, the industrial and the service sectors.

Economic structure, trade links and protection structure

The *ex-ante* analysis of economic structure, trade patterns and structure of protection is of great importance for the evaluation of the trade liberalization impact on national economies.

The low average wage and the high wage ratio between skilled and unskilled labor, confer a comparative advantage to the Mercosur in the production of agriculture and low value added industrial commodities. While the high average wage, the low wage ratio between skilled and unskilled labor and the low capital return confer a comparative advantage to European countries in the production of high value added industrial goods.

The striking feature of the trade relations between the EC and the Mercosur is the asymmetry in the relative weight of the inter-regional trade for the two regions. Mercosur absorb only 1% of total European exports, while it send to the EC, its major trading partner, 26% of total exports. Both regions have a different bilateral export structure when compared with the multilateral one. The EC exports more industrial goods to the Mercosur than on average. Mercosur presents a structure of exports to the EC highly skewed toward agribusiness commodities.

In the EC the average protection imposed on trade with the Mercosur countries is very high, particularly on Argentina. In fact, Mercosur countries concentrate their exports to the EC in the food-crop and in the food-processing industries that face the highest levels of protection in Europe. Mercosur countries have, on average, higher levels of protection than the EC and the EC faces higher than average tariff barriers in the Mercosur.

Design of alternative scenarios

Trade liberalization is modeled as the complete removal of tariff barriers between trade partners, except in one variant scenario where trade liberalization between Mercosur and the European Communities (EC) excludes the agribusiness macro-sector.

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Scenario 1 considers the formation of a FTA between the EC and Mercosur. Scenario 2 considers the formation of a FTA between the EC and Mexico. Scenario 3 considers the formation of the Free Trade Area of the Americas (FTAA) involving the countries of the Western Hemisphere. Scenario 4 is a variant of Scenario 1. It considers the formation of a FTA between Mercosur countries and the EC with the exclusion of the agribusiness macro-sector. This scenario captures the medium-term effects of a longer than average timing in the phase-out of tariffs in the agribusiness sector.

Simulation results

After having calibrated the model in order to replicate the benchmark data, a new equilibrium solution considering the tariff elimination with trade partners is generated. The study analyzes the impact on trade, on structural adjustment and on factor income and welfare.

Impact on trade

Under the MEC FTA, European countries increase total exports by a negligible amount (0,22%), still higher than in the case of a FTA with Mexico (0,05%). The EC further expands exports in the Mercosur, which has been its most dynamic external market in the last decade. European exports to Argentina grow by 13% and those to Brazil by 14%. Exports increase in all sectors, including in agricultural products. The most dynamic European exporting sector is the light manufacture (+25%). In the agribusiness, exports in animal products experience the fastest growth in Argentina (+23,7%), while other agricultural products (+24,5%) are the most dynamic in Brazil. Simulation results show that services exports to the Mercosur fall slightly.

By gaining the free access to their major trade partner, Mercosur countries expand total exports to the world in all sectors (+4%). Argentina expands exports to the EC by 11%, while in Brazil they increase by 9%. The sectoral composition is very similar across countries. Export gains are concentrated in the agribusiness sectors, with a dominance of the food crops sector (+19%) followed by the food processing industry (+14%).

It is particularly interesting to compare the sectoral composition of export gains under different scenarios. In particular, the simulation results show that in the MEC FTA Mercosur countries expand trade mainly in the agribusiness sectors while in the FTAA industrial exports are more dynamic. This suggests that if these processes proceed in parallel they can reinforce each other, as industrial interest gain more from the FTAA while agribusiness gain more from the MEC FTA. On the other hand, European and Mercosur countries have moderate defensive incentives for the negotiation of a MEC FTA. In fact, both regions suffer from low trade diversion when each region negotiates a preferential trade agreement with other countries.

Tariff removal alone is not sufficient for the EC to take full advantage of the Mercosur service market. Indeed, actual nominal protection on non-tradable sectors is close to zero. The elimination of non-tariffs barriers and the inclusion of investment provisions in the free trade agreement will certainly help European service exporters to expand their operations in the Mercosur.

It is worth emphasizing that the agricultural deadlock of the MEC FTA process is part of a wider multilateral issue. In fact, contrary to the conventional wisdom, liberalization with Mercosur countries may offer to the European producers, especially in the food processing industry, the possibility for compensate for their losses due to the multilateral trade liberalization in agriculture.

Impact on structural adjustment

Economies need to adjust as a result of trade liberalization. It is particularly interesting to compare the structural adjustment effects under the complete and the partial MEC FTA scenarios.

Under full liberalization, the impact on manufacturing sectors in the EC is greater from the impact on agricultural and services sectors, with the largest positive effect on food processing followed by machinery and equipment. The EC may face a negative impact only on food crops, since the removal of tariffs results in a jump of imports from Mercosur. When agriculture is excluded, the overall impact on sectoral adjustment is moderate and skewed toward industrial sectors.

Mercosur countries experience a larger impact on agribusiness sectors, including food processing, relative to manufacturing industries. Under full liberalization, in Argentina the food crops and the food processing sectors experience a considerably positive impact. Although the magnitude of the impact is larger in agriculture than in manufacturing, under partial liberalization, the impact becomes larger on most of the manufacturing industries. Brazil undergoes a quite similar impact. Among agricultural commodities food crops and food processing experience the largest adjustment under full liberalization. Under a partial agreement, the impact on agricultural sector in Brazil is still larger than on manufacturing industries, but the latter experiences a greater impact than with full liberalization.

Impact on welfare and factor income

Under the MEC FTA, Mercosur countries' GDP grows by a considerable amount. Efficiency gains from trade cause the GDP to raise by 0,7% in Argentina and by 1,3% in Brazil. In the EC the overall effect on GDP (0,22%) is smaller since trade with the Mercosur accounts for a smaller portion of European GDP. Under partial liberalization all countries still reap positive welfare gains. However, the GDP increase is less than under full liberalization and the distribution of the opportunity costs is uneven across countries. The comparison of the GDP gains in the two scenarios show that Brazilian GDP gain is 35% lower, while European and Argentinean GDP is 28% lower than with partial liberalization.

Simulation results show that trade liberalization has a positive overall impact on factor returns. In the EC the capital holders are likely to reap the largest benefits (+0,12%), skilled and unskilled labor returns increase by less than 0,01%, while land return only increase by 0,019%. Due to the structure of trade specialization, in Mercosur land return increase by 2% in Argentina and by 2,5% in Brazil. Unskilled labor benefits more than skilled labor in both countries and capital experience the lowest factor return increase.

The simulations finally show that in the EC the return for land, the specific production factor in agriculture, is unlikely to benefit from partial liberalization.

Policy implications

The EC and the Mercosur have a complementary structure of comparative advantages. Trade flows are currently concentrated in the sectors that enjoy the highest level of nominal protection. Inter-regional trade liberalization will therefore require a very intense negotiation to reap the potential gains stemming from international specialization. Early harvest negotiations on selected issues may sustain the momentum for the final single-undertaking agreement.

The simulations of inter-regional trade liberalization show that both regions are likely to expand exports in all sectors. Besides the expansion in industrial exports, the EC is likely to expand exports in agribusiness commodities, in particular in niche food processing goods. From the EC standpoint the inter-regional agreement may therefore produce economic gains for agribusiness. Mercosur countries may, on the other hand, increase traditional exports and substantially boost economic growth. Partial liberalization is therefore likely to reduce welfare gains in both regions, while a broad agreement including investment and services liberalization provisions is likely to expand welfare.

The inter-regional agreement is likely to be characterized by cross-fertilization interactions with other regional or multilateral liberalization processes. If WTO-compatible and consistent with other preferential agreements under negotiation, the FTA between the EC and Mercosur may generate positive systemic effects on the international trading system. In fact, the FTAA and the MEC FTA may mutually reinforce each other, and the negotiations between Mercosur and the EC may be a useful exercise for multilateral negotiations in agriculture.

The political economy of Mercosur and trade negotiations with developed countries

Pedro da Motta Veiga

The paper focus on two issues. First, it discusses the political economy of Mercosur's negotiation stance in trade talks within the FTAA process and with the European Union, focusing solely on the case of Brazil, which has some advantages and disavantages.

From the discussion of the factors that shape Brazil's and Mercosur' s negotiating position, it derives a quite synthetic mapping of costs and incentives associated in the sub- region with trade negotiations between Mercosur and the EU as well as within the FTAA. Of course, such perceptions of costs and benefits can, among policy-makers, be informed by economics analyses and models, but they owe essentially to specific strategic views that rank the importance of each cost and each benefit. Always drawing upon Brazilian experience, the paper focus on the ¨mainstrean¨ or hegemonic perception of the costs and benefits associated with the FTAA and the negotiations with the EU, the one that shapes Brazil - and to a large extent Mercosur - negotiations stance in both processes.

Second, some scenarios for Mercosur trade negotiations agenda in the next few years are set, trying to identify those that could foster EU-Mercosur trade negotiations.

What makes for Brazil's stance in trade negotiations ?

In what refers to the first issue, in preferential talks with developed partners, Mercosur´s prevailing negotiating approach has been shaped by caution or, more accurately, by a defensive stance. How can this stance on the part of Mercosur be understood, when contrasted with, for instance, the active approach of Mexico when discussing free trade agreements with its partners in North America in 1994, and recently with the European Union? In the case of Brazil, which factors shape the country's negotiating strategy within the preferential liberalization initiatives in which it is involved ?

There are two factors behind this stance:

- the first is the hegemonic foreign policy paradigm, characterized by competition with the USA and the objective of developing the nation's industrial capacity as a key condition for independent activities within the international system.

At the foreign policy level, continuity prevailed with no ambiguity, despite the major regulatory changes Brazilian economy has gone through during the Nineties. The globalist paradigm that dominated Brazil's foreign policy since the 1960s, remained in this position and framed the political logic Brazil's participation in Mercosur, as well as in other preferential liberalization initiatives underway.

- the second involves the political economy of the liberalization reforms in Brazil, and particularly the supremacy that the import-competing sectors have managed to maintain over export sectors, in the field of trade reform;

In Brazil, resistance among entrepreneurial, trade union, bureaucratic and corporate interests consolidated during the long and quite successful period of protectionist industrialization had marked effects on the implementation of liberal reforms during the Nineties. The main outcome of the negotiated style of the transition in Brazil consisted of the survival, even after reforms, of protection structures and incentives, both benefiting these same import-competing sectors that were privileged by industrial and export policies over earlier decades (auto-assembly, chemicals, electro-electronics and capital goods sectors).

In terms of Mercosur's external negotiations, the convergence between the prevailing view of foreign policy and the hegemony of import-competing sectors in national and sub-regional trade policy results in: (i) encouraging the establishment of preferential links with the other countries in South America; and (ii) conferring on agreements outside this regional scope the status of initiatives that in principle are not functional to the core objectives of Brazil's foreign policy.

It is interesting to note that a project such as Mercosur, which represents the initial Brazilian reaction to the new challenges of a globalized world, has firmed up in the Brazilian view as a single experience and to a large extent as a project which excludes other non-multilateral initiatives, particularly when involving negotiations with developed partners.

How can this phenomenon be explained? Initially, the risks associated with the sub-regional project and the competition from

Brazil's partners in Mercosur are limited, from any standpoint, lightening concerns over the risks of the liberalization process. At the regulatory level, integration has barely restricted the freedom enjoyed by Brazilian policy-makers to deploy policy tools considered as domestic in the microeconomic area.

In addition, through increased intra-regional trade in manufactured goods and new flows of FDI fostered by a "market-seeking" logic, Mercosur is consolidating as a regional production hub for industrialized goods basically targeted to the extended domestic market - which still enjoys a reasonable level of protection against imports - and, to a secondary level, to other South American markets.

The net outcome of the set of trends - the consolidation of an industrial pole in Mercosur with Brazil as its hub, and the other countries in South America as potential spokes - confers an evident functionality to the sub-regional integration, for Brazil's industrial development strategy.

From a governmental perspective, extending the liberalization process to include more productive economies is seen as a threat to the ongoing consolidation of a new regional economy in South America and to the leadership Brazil could have in a new political design in the region. From the standpoint of the private sector, for the entrepreneurial interests benefited by privileged access to an extended an still-protected domestic market, extending the liberalization project to include other countries, particularly the developed ones, is viewed as a threat to their market shares in the regional market.

In such a context, the prevailing (in Brazil) view on the potential costs and incentives associated with each of the liberalization initiatives - the FTAA and negotiations with the EU - gives priority to the following points.

The main incentive for Mercosur joining the FTAA is the risk of exclusion, which would imply a strong downgrading of Mercosur countries "relative market access" in NAFTA as well as other LAIA countries. Those are the most important markets for manufactured exports from Mercosur. The upgrading of Mercosur RMA in the US market (vis à vis NAFTA countries) is in general seen as a secondary incentive, as are possible impacts of the FTAA on Mercosur domestic competitiveness and productivity, fostered by new flows of imports and investments.

The main costs assotiated with FTAA involve: (i) an upsurge of imports from NAFTA countries, with disruptive impacts on Brazilian industry; (ii) the erosion of trade preferences in LAIA countries that will actually occur at he end of the FTAA liberalization process at the benefit of non-LAIA countries; (iii) the risks of dilution of Mercosur within the FTAA project, as Mercosur does not go beyond a FTA in many areas; and (iv) the consolidation of a secenario where the whole Hemisphere becomes , both economically and politically, an US zone of influence.

In the balance of potential costs and benefits of the FTAA process the former are in general stressed and this perception shapes a very much defensive stance of Brazil in those negotiations. In the case of negotiations with the EU, the same hegemonic view confines the incentives to negotiate to two features. First, increases in agricultural exports, which depend on the removal of imports barriers in the EU. Second, the offsetting of the rising influence of the USA in the Americas which would result from the introduction of the FTAA. This is a political incentive that can be complemented on economic grounds as the FTAA raises concern on trade and investment diversion. In Brazil, however, the political argument prevails clearly over the economic one.

Scenarios for Mercosur's trade negotiations by 2005: impacts on EU-Mercosur talks

With the failure of the WTO Ministerial Conference, held in Seattle, on December 1999, the environment for trade negotiations has gone through a deep change that could generate long-lasting impacts on Mercosur trade negotiations agenda. By December 1999, the most plausible scenario for Mercosur's trade negotiations combined the participation to the Millenium Round and some efforts to relaunch the sub-regional initiative, hurt by a deep crises. Negotiations within the FTAA and with the European Union were barely taken into account as factors able to shape the environment of trade talks Mercosur would face in the next few years. From Seattle on, this scenarios does not hold anymore.

In the emerging environment, other scenarios seem plausible and a first step in the scenario-setting exercise involves the identification of the key variables (or driving forces) that shapoe the evolution of Mercosur's trade negotiation agenda in the next years:

- the internal evolution of Mercosur: cohesion and deepening of the bloc are the main uncertainties relating to this variable.
- the FTAA negotiations.
- the multilateral negotiations in the WTO.

- the main trends in trade policies in Mercosur and within the European Union. The balance between liberal and protectionist forces is the main issue here and, in the case of the EU, this applies specially to the evolution of the Common Agricultural Policy.

The combination of plausible evolutions of the driving forces generates different scenarios. In this case, three types of scenarios emerge from the exercise:

- multilaterally-driven scenarios (MDS);
- bilaterally-driven secenarios (BDS); and
- regionally-driven scenarios (RDS).

The multilaterally-driven scenarios relie heavily on the hypothesis of the launching of a new comprehensive Round in the WTO, which would deter regional and bilateral liberalization initiatives, provoking a "wait and see" attitude from Mercosur and the European Union and reducing the incentives to speed up the FTAA process. After Seattle, those scenarios, whatever precise shape they could have, seem have low chances to drive Mercosur's negotiation agenda in the next few years.

BDS lie on the hypothesis of shifts in Mercosur and/or in EU trade policies relevant to the negotiations, those shifts leading to more flexible stances in sensitive issues: agricultural issues, in the case of the EU, industrial goods liberalization, in the case of Mercosur. This hypothesis does not seems plausible reducing the chances for this type of scenario to emerge.

RDS are the most credible scenarios emerging from this exercise. The driving force in such scenarios is the competition between Mercosur and the FTAA as regional liberalization projects. The hypothesis underlying them is that, in an environment of multilateral vacuum and domestic policy inertia, the internal dynamics of Mercosur integration and the rythm of the FTAA process are the key uncertainties as far as the future of Mercosur's trade negotiations is related. The Table below presents the main features of each RDS scenarios

Scenarios	***Main feature***
FTAA/Mercosur race	Competition between both proceses continues: centrifugal pressures from FTAA on Mercosur x centripetal dynamics of Mercosur deepening is the main tension.
Mercosur wins the race	FTAA looses momentum while Mercosur succeeds in deepening efforts.
FTAA wins the race	Mercosur is diluted within the FTAA

The impacts of the alternative RDS on EU-Mercosur negotiations are all but neutral. The only scenarios where those negotiations make sense for Mercosur is the "FTAA/Mercosur race" one. In a scenario where Mercosur wins the race against the FTAA, incentives to negotiate an agreement with the EU would be very small, specially if the restrictions to negotiate bilaterally agrocultural issues remain in place (which is an hypothesis in RDS). In a "FTAA wins the race" scenario, Mercosur would tend to lack credibility to negotiate as a political entity.

Of course, a BDS pushed by shifts in the partners' trade policies would also allow for an environment favorable to negotiations. As stressed, however, this does not seem a plausible scenario for the next few years.

Policy implications

Three main policy implications arise from the previous sections.

First, at the level of Brazil's policy-making, it is time to reassess the hegemonic view on trade and industrial policy which lies under Brazilian's trade negotiation strategy. This view largely expresses the interests of import-competing sectors and the prevailing trade negotiation strategy is its external dimension. Brazil urges to increase exports and to gain competitiveness: if its trade policy and trade negotiation strategy help reproducing the anti-export bias that survived the liberalization reforms of the Nineties, it's time to address this policy issue.

Second, EU-Mercosur trade negotiations will hardly play more than a secondary role in the trade negotiation agenda of Mercosur in the next few years, unless a major liberalization shift takes place in the Common Agricultural Policy. A liberal revision of trade policy in Brazil could foster the negotiations, but it is likely that FTAA members would be best placed to reap the benefitis from this shift.

Third, the strenghtening and deepening of the sub-regional integration should receive top priority from Mercosur's policy-makers if industrialization and developmental concerns are to be addressed in an "open regionalism" paradigm. Whatever the scenario to emerge and specially under the assumptions underlying RDS, the best (and maybe the only) way to preserve Brazil's national interests is to merge them into a sub-regional project.

European interests on an EU-Mercosur FTA

Maria João Seabra

The process that led to the formal opening of negotiations between the EU and Mercosur was a clear demonstration of the difficulties that the setting up of a FTA between the two regions will face. Putting together the interests of 15 member states, with different approaches towards the Mercosur and with different internal pressures will be difficult, especially when the Union is also confronted with the challenge of enlargement and of deepening the integration process.

The future scope and path of the EU-Mercosur FTA negotiations will depend much on a combination of interests, both of the economic sectors and of the member states. Inside each member states the different positions of the industrial and agricultural sectors will be confronted and each one will try to influence the respective governments. This divergence will also be felt at the European Union wider level, since both lobbies will try to influence the EU institutions.

The EU has some specific interests in a FTA with Mercosur. Along with the political importance of such an agreement, the EU might expect some clear economic advantages from the liberalisation of trade with the Mercosur countries. Mercosur is the most important EU's economic partner in Latin America. During the 1990s, European exports to the Southern Cone countries have been growing significantly *and t*he same trend is found on foreign direct investment, being Mercosur the main destiny of European FDI in Latin America. EU exports to Mercosur are highly value-added, being of special importance the automobile, machinery and equipment and services sectors. Confronted with the possibility of expanding their market share in the region, it is not surprising, therefore, that industrial lobbies in Europe are supporting the FTA. The Union of Industrial and Employers' Confederations of Europe has stated its support to the EU-Mercosur negotiations expecting mutual benefits for both regions. UNICE "called on Mercosur governments, the EU Commission and EU member states to make every effort to start negotiations between the two regions to facilitate trade, services and investment flows" and "urged the EU and Mercosur, with the intention of creating a future free-trade area, to seek continued improvement in market access in order to eliminate tariff and non-tariff barriers, in conformity with WTO rules". [2]

This support to the EU-Mercosur FTA is reinforced by the prospects of the creation of the Free Trade Area of the Americas. The FTAA could have a strong impact of the EU share in Mercosur markets. Following NAFTA, EU's share on Mexican trade fell significantly and the same might occur if an FTAA agreement is reached before the EU-Mercosur FTA.
On the opposite side, the European agriculture lobby is opposing the FTA, fearing the competition of the highly competitive Mercosur agriculture and fisheries products. Food products already represent 35% of Mercosur exports to Europe, despite the trade barriers imposed by the EU. The opposition of the agricultural sector is reinforced by the fact that EU's enlargement and WTO talks will also have a strong impact on CAP.

The divergence between agriculture and industry has a direct translation in the positions of the EU member states. That is the reason why France, the country that benefits more from CAP and with the strongest agricultural lobby, is also the country which resisted more to the formal opening of negotiations between the EU and Mercosur. France is also the country were the agricultural lobby is more strongly politicised. Although France is not the only country concerned with the impact on agriculture of the FTA, it is not predictable that any other member state will resist so fiercely to an agreement with Mercosur on this sector. Even if France appears to be the strongest opponent to the FTA, it should be emphasised that is not that difficult, in this negotiation as in any other involving the EU, for other countries to «hide» behind France. As in any other negotiation, each member state will try to protect their sensitive sectors. The opposition or support to the FTA will, therefore, depend on the analysis of the costs and benefits for the individual member states, including political costs and benefits.

At the same time, even though agriculture is the most difficult issue on the negotiations, it should also be remembered that other sectors could raise problems. Here, again, the same type of reasoning applies – in the eventuality of a consensus over agriculture, at the last minute other demands can appear, not as strong but also potentially prejudicial to the FTA.

The conciliation of positions among the member states will therefore depend on each government's ability to conciliate their internal pressures with the larger demands of the integration process. Different positions of the member states over the FTA negotiations will hardly provoke a serious crisis inside the Union. But the impact of FTA on CAP, seen in the broader context of enlargement and WTO talks, might cause problems to the relations between the member states.The tension between those favourable to the Union-Mercosur FTA and those who are against it, at the different economic sectors level as well as the member states level will be present during the entire negotiation process. But, at the same time, the political importance of this process, being the first FTA between integrated regions, should not be overlooked. Supporting regional integration is one of the milestones of EU's foreign policy, and achieving an agreement with Mercosur would enhance the potential of the

[2] UNICE statement on EU-Mercosur/Chile/Mexico relations, 15 September 1999.

EU as an actor on the international stage. In the end, the formation of the EU interest will depend on the conciliation between the member states interests, the integration interest (widening and deepening) and the EU interests at the world scene – both economically and politically.

Los intereses del Mercosur en sus negociaciones con la Unión Europea.

Félix Peña

1. Las negociaciones del Mercosur con la Unión Europea, se insertan en un cuadro más amplio de acciones orientadas a consolidar, a profundizar y a ampliar el espacio económico integrado. Son planos estrechamente vinculados entre sí y que se refuerzan mutuamente. Sólo a través de su consolidación y de su profundización, puede el Mercosur aspirar a competir con otras regiones emergentes en la atracción de inversiones, y a ser interlocutor válido de los Estados Unidos en el ALCA, y de la Unión Europea en el desarrollo de la zona de libre comercio interregional.

2. En tal perspectiva, tres cuestiones básicas requieren de respuestas satisfactorias por el Mercosur, a fin de que sea creíble en sus interlocutores internacionales:

    2.1 La primera se refiere a si efectivamente se trata de una unión aduanera, conforme al artículo XXIV del GATT y, en tal caso, en que tiempo se habrán perfeccionado los elementos que la caracterizan. Este interrogante surge como consecuencia de que subsisten restricciones al libre comercio, especialmente no arancelarias y de sectores no incluídos plenamente; de que subsisten perforaciones al arancel externo común y elementos que no son propios de una unión aduanera, como los certificados de origen y el doble cobro del arancel a los productos provenientes del exterior y internados en uno de los países miembros se destina al mercado de otro socio; y de que los socios siguen negociando individualmente con terceros países en el ámbito de la ALADI.

    2.2 La segunda cuestión se refiere al cumplimiento del objetivo establecido en 1990, en el sentido que el libre comercio irrestricto suponía la coordinación macroeconómica. Poco o nada se avanzó en este plano. La devaluación del Real puso en evidencia que el libre comercio irrestricto, objetivo alcanzado para una parte sustancial del intercambio recíproco de bienes, debía coexistir con una situación de disparidad –que por momentos fue pronunciada- en las políticas y en las paridades cambiarias entre los socios. Puso en evidencia además que no existía consenso entre los socios en el diagnóstico del problema y en la forma de encararlo de manera mutuamente satisfactoria.

    2.3 La tercera cuestión se refiere a la capacidad de las instituciones del Mercosur para alcanzar el consenso necesario para adoptar decisiones efectivas y eficaces, que permitan avanzar en el proceso de integración, y para administrar y resolver conflictos comerciales originados, en particular, en asimetrías cambiarias y sectoriales entre los socios, que producen mayores efectos como consecuencia de la diferencia de dimensión relativa de sus mercados.

3. En los tres planos se observan recientemente progresos conceptuales y políticos sustanciales en el marco de la idea de relanzar el Mercosur. Tales progresos generan condiciones más positivas para encarar negociaciones comerciales internacionales, en este caso, con la Unión Europea.

4. Un primer interés que se observa en el Mercosur con respecto a las negociaciones de libre comercio con la Unión Europea, es precisamente poder demostrar que puede ser creíble como interlocutor válido en el plano del comercio y de las inversiones internacionales. Este interés estuvo presente desde el inicio mismo del proceso de integración subregional, cuando los gobiernos eligieron presentar al Mercosur en Europa, en abril de 1991 y luego en 1992, en ocasión de la reunión ministerial en Guimaraes, iniciándose el camino que condujo a las negociaciones iniciadas en abril de este año.

5. Este interés está vinculado a uno más amplio de negociar como una unión aduanera, en el marco del proceso del ALCA. Refleja un sentido de equilibrio en sus negociaciones comerciales internacionales, en las que tanto las que se desarrollen en el ámbito de la OMC, como en el hemisférico y en el interregional, se conciben no cómo caminos alternativos y eventualmente, contradictorios, sino como parte de una misma estrategia de inserción en todos los mercados mundiales.

6. Este interés, que sólo puede lograrse con un Mercosur con legitimidad interna y con credibilidad externa, adquiere toda su dimensión en la perspectiva del objetivo de atraer inversiones y tecnologías, incidiendo en las estrategias y comportamiento de competidores globales con múltiples opciones a la hora de decidir donde invertir y desde donde operar. Ello implica enviar señales de calidad en las políticas macroeconómicas y de previsibilidad en las reglas de juego que inciden en el comercio y las inversiones. Anclar políticas y reglas de juego en acuerdos internacionales en la OMC,

en el Hemisferio y en la subregión, es un objetivo de importancia estratégica para los países del Mercosur.

7. Ello conduce a los países del Mercosur a valorizar el hecho de negociar con la Unión Europea, como una señal muy clara a los mercados, en el sentido que la integración regional puede ser creíble, revirtiendo una larga tendencia de los países latinoamericanos a lo que, con razón, puede denominarse "integración-ficción". Ser reconocidos por la Unión Europea como interlocutor válido para negociar como una unidad, y avanzar en las negociaciones, aunque el proceso sea prolongado, tiene valor para el Mercosur en la perspectiva de otros frentes negociadores externos, en particular, con los Estados Unidos en el ámbito del ALCA.

8. A su vez el inicio de las negociaciones con la Unión Europea, genera efectos de integración en el propio Mercosur, ya sólo podría avanzarse en la medida que efectivamente se consolide y profundice la unión aduanera, y se avance en la coordinación macroeconómica.

9. Las negociaciones son visualizadas como un proceso de mediano y largo plazo, en cuanto a los efectos de mayor apertura del Mercosur a las importaciones originadas en la Unión Europea. Los intereses sectoriales más específicos, es decir aquellos donde el Mercosur puede obtener claros beneficios con las negociaciones con la Unión Europea, están fuertemente concentrados en el comercio de productos agrícolas y agro-industriales. Se visualiza en ellos la mayor cantidad de obstáculos significativos al acceso a los mercados europeos, particularmente por el efecto de restricciones no arancelarias en sus múltiples modalidades. Pero también en ellos se observan los mayores efectos distorsivos sobre la capacidad del Mercosur de competir en terceros mercados con productos en los cuáles tienen claras ventajas comparativas. Ellos son consecuencia de los subsidios que se otorgan a productores y exportadores europeos, como resultante de la política agrícola común, a pesar de los progresos relativos alcanzados en la Rueda Uruguay.

10. Los otros intereses específicos de los países del Mercosur en sus negociaciones comerciales con la Unión Europea, están vinculados al incremento de la cooperación europea en el marco de lo previsto en la materia por el Acuerdo Marco de Madrid. Ello involucra un sustancial aumento de los recursos financieros destinados a proyectos de cooperación, especialmente los destinados a la participación de las pequeñas y medianas empresas en redes de comercialización y producción de alcance interregional. En este plano, los intereses empresarios del Mercosur se orientan al desarrollo de acuerdos sectoriales de cooperación empresaria, previstos en el Acuerdo Marco de Madrid, que puedan ser instrumentos eficaces orientados a facilitar exportaciones industriales del Mercosur hacia Europa y terceros mercados, como resultante de las propias inversiones europeas en los países socios. El cuadro actual es, por el contrario, el de inversiones europeas concentradas en servicios y en exportaciones intra-Mercosur, con un fuerte impacto en la importación de bienes de capital, partes e insumos industriales de los propios países europeos, y con un bajo impacto en las exportaciones extra-Mercosur.

Issues in Market Access Negotiations

Antoni Estevadeordal and Ekaterina Krivonos[*]

Market Access negotiations between the largest and most influential regions in Europe and Latin America (both in terms of population and economic size) are likely to have important effects ranging from political influence to economic returns. A potential free trade agreement between EU and MERCOSUR should also be seen in light of a growing global economy and the increasing importance of regional integration schemes around the world, in particular North-South agreements, as 'building blocks' towards global free trade.

The EU is MERCOSUR's largest trading partner it accounted for over a quarter of the region's imports and was the destination for roughly the same percentage of its exports. MERCOSUR, on the other hand, is the EU's seventh largest trading partner worldwide and its largest partner in Latin America. In 1998 EU exports to the Southern Cone constituted 27 US$ billion, exceeding the imports by 6 US$ billion. European exports to MERCOSUR have grown three times faster than the European imports since 1990. Moreover, the structural composition of the trade is very asymmetric. European exports are concentrated mostly in machinery products while the main exports of MERCOSUR to the EU are agricultural and food products.

The structure of trade protection in the two regions differs substantially. While the formal negotiations will take place between two customs unions, the degree of harmonization of external policies is much higher in the EU than in MERCOSUR. In the EU, external trade policy is primarily the responsibility of the Commission. In the Southern Cone, decisions on many trade issues are still taken by the national governments.

In general, there is a sharp asymmetry between the tariff structures in the two regions. The MERCOSUR operates with 11 different rates ranging from 3 to 23 per cent. The structure of EU tariffs, on the other hand, is much more open. It includes specific and mixed tariffs, and each MERCOSUR member is subject to different rates under the EU-GSP-regime (with some sectors in each country excluded from preferential treatment because of the graduation mechanism). The average external tariff in MERCOSUR is 15.3 percent compared to 3.0 percent in EU. The EU applies zero-tariffs to a large percentage of imports. However, for some sectors, namely agriculture, fisheries and food products, the EU has higher dispersion rates and substantial peak tariffs. In the Southern Cone, the bulk of products are covered by an intermediate range of tariffs, between 10 and 20 percent.

Non-tariff measures (NTM) are more difficult to quantify and comparison between the regions is a difficult exercise. In the paper, we constructed several indices of NTM incidence based on available data, indicating the importance of these measures in bilateral trade. Although based on preliminary data, it is fair to say that both regions will have to invest a considerable amount of time prior to formal negotiations agreeing on a common definition of NTMs and identifying methods for exchanging information in this area.

The analysis of the tariff structure of both regions allow us to draw some general conclusions regarding the prospects for an eventual market access negotiation between the two regions (equivalent analysis regarding NTM negotiations is still ongoing). We would like to highlight several of these.

Consistency with common internal policies: The market access provisions of the agreement will have to be consistent with EU internal policies and with the ongoing implementation of common policies in MERCOSUR. On the EU side, these constraints will be related mostly to issues such as agriculture, fisheries, competition, state aid in the context of the "Agenda 2000". For MERCOSUR, the key areas of concern will be mostly related to industrial matters.

WTO compatibility: Art. XXIV of GATT/WTO requires that FTAs should cover "substantially all trade" and avoid the exclusion of any significant sector. The conventional target is to liberalize at least 90 % of the bilateral trade during a transition period of no more than 10 years.

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Consistency with other extra-regional preferential agreements: Agreements already in force and those under negotiation will have an important effect on this particular negotiation. Both parties will have to ensure that the agreement does not undermine the relations that they have already established with third partners and that it does not complicate other ongoing processes where preferential market access negotiations are an important component.

Reciprocal Tariff Liberalization: Because tariffs are substantially higher in MERCOSUR than in the EU, it may seem that the former will have to make more concessions than they will receive, making the overall tariff bargain uneven. However, since the EU market is substantially larger than the MERCOSUR market, a 1 percent tariff reduction by the former, especially in products of interest to MERCOSUR countries, is worth more than a similar reduction by the latter. The EU-MERCOSUR tariff negotiation is a clear example of a classical North-South bargain, by which large benefits may accrue from giving access in industrial products in return for market access in agricultural goods.

"Early-harvest" in tariff negotiations: First, Parties could agree on eliminating most nuisance tariffs (defined as rates below 3 percent). For the EU, this would represent 18.7 percent of tariff lines in agriculture and 25.3 percent in industrial products. For MERCOSUR, these percentages would be 1.8 and 5.1 percent, respectively. Second, parties could pledge to seek deep tariff reductions where rates exceed a certain level, for example 15 percent, focusing in particular on highly protected sectors. For the EU this would represent 5.3 percent of tariff lines in agriculture and 4.3 percent in industrial products; for MERCOSUR these percentages would be 2.0 percent and 53.6 percent respectively. Third, as an early-harvest negotiating move, both parties could agree on liberalizing sectors in which zero-for-zero bargains can be struck. However, there are only 1 percent of tariff lines in which both parties have non-zero tariff rates below 5 percent.

Modalities for tariff liberalization: The EU-Mexico agreement has a phase-out scheme based on equal annual cuts applied to an initial negotiated base rate. In the case of the agreements signed by MERCOSUR with Chile and Bolivia, the tariff elimination program is based on margins of preference to be applied to MFN rates in force in every period. If the EU-Mexico model is chosen, then negotiations will start with the choice of an initial base period for tariff negotiations. This base rate could be linked to rates negotiated under future WTO negotiations, the applied MFN rates at the beginning or at the end of negotiations, or some combination of both criteria. It is also important to agree on a base period for the trade data for purposes of evaluating the degree of preferential trade affected by the tariff elimination process. Also, based on this trade benchmark each party could provide a list of products representing a minimum percentage of its bilateral imports that will be included in an immediate tariff liberalization schedule upon entry into force of the agreement. Finally, and most importantly, both parties will have to agree on different staging categories that will apply to different products. Looking at previous agreements, there is substantial room for designing phase-out periods based on linear cuts, non-linear cuts with transitional periods, convex elimination programs with accelerating speed to liberalization, and very specific phase-out schedules for very specific products.

Inversión extranjera directa

Roberto Lavagna *(*)*

I. Punto de Partida

La **relación** existente entre el comercio y las inversiones extranjeras (propuesta por Estados Unidos) ha quedado reconocida desde el lanzamiento de la Rueda Global de Negociaciones de Uruguay y fue finalmente plasmada -si bien en forma parcial ya que abarca una parte reducida del campo sobre las inversiones extranjeras directas (IED)- en los acuerdos sobre TRIMs (Trade Related Investment Measures).

Posteriormente deben computarse dos intentos frustrados. Por un lado, el fracaso de las negociaciones del acuerdo multilateral sobre inversiones (MAI) negociado dentro del la OECD por especial oposición de Francia, Bélgica y otros países europeos (la "excepción cultural" fue uno de los principales obstáculos).

Foro de negociación inadecuado con clara sub-representación del mundo en desarrollo, disciplinas excesivamente detalladas, un enfoque de "listas negativas" que impicaba que el acuerdo abarcaría todo menos lo explícitamente excluido por los países y la pretensión de establecer un sistema especial de solución de controversias entre los inversores y los Estados, llevó al colapso negociador en 1998.

Por otro lado, el tema comenzó a ser introducido en la OMC desde 1996 por Canadá, Japón, Noruega y Suiza, con claras resistencias de Estados Unidos (que aun creía posible el acuerdo en la OECD y, luego del 98, rechazaba un acuerdo que contuviera sólo principios generales) y de países en desarrollo como India, Pakistán, Egipto y Malasia que creían ver limitaciones a sus políticas de desarrollo.

El bloqueo en Seattle del lanzamiento de la Nueva Ronda dejó las cosas en el estado en que estaban post Marrakech, esto es, una normativa TRIMs limitada y asimétrica y diversas propuestas para una nueva negociación.

II. La "asimétrica" normativa TRIM

Un analisis de las normas TRIMs permite advertir que hay fuertes asimetrías entre derechos y obligaciones en materia de inversiones y que en la práctica **no toman** "*...en consideración las particulares necesidades comerciales, de desarrollo y financieras de los países en desarrollo Miembros...*", tal como lo exige el acuerdo TRIMs.

Pueden darse tres ejemplos altamente relevantes sobre estas claras falencias que generan asimetrías y justifican nuevas negociaciones globales:

1º las disposiciones del acuerdo TRIMs están básicamente referidas a la trasparencia, al trato nacional y a la fijación de restricciones cuantitativas (contenido local, criterios de cumplimiento, etc.). **Estas disposiciones limitan la capacidad de los países en desarrollo de asegurar que estas inversiones no habrán de contribuir a lo largo de su vida útil, o al menos en un período determinado no inferior a 10 años, a generar problemas de balance de pagos.**

Desde una óptica global, pocos hechos son más dañinos en términos de la liberalización del comercio internacional que las recurrentes crisis de balance de pagos y las restricciones que de ellas pueden surgir incluso en términos de la propia normativa de la Organización Mundial de Comercio (Artículo XVIII). Otro tanto ocurre desde la óptica estricta de los países en desarrollo ya que la volatilidad del crecimiento, con ciclos de *stop and go* detonados por imposibilidad de cerrar la brecha externa tienen efectos redistributivos internos negativos y afectan la *performance* promedio en materia de crecimiento y de desarrollo.

Normas internacionales ligadas a la inversión que no contemplen el "daño" o la "posibilidad de daño" siempre y cuando éste sea debidamente demostrado y habiéndose establecido la relación causa-efecto, resultan ser discriminatorias hacia los países receptores de la inversión extranjera directa y pueden afectar la liberalización comercial mundial.

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Recuérdese que a mediados de la década de los años 80 el comercio mundial era inferior al de inicios de dicha década como consecuencia de las múltiples crisis de balance de pagos y la crisis de la deuda de 1982. Más cercanamente puede recordarse igualmente el efecto de crisis devaluatorias sucesivas. Desde 1992 en adelante (devaluación de la libra esterlina y otras monedas europeas) y particularmente de la crisis mexicana de 1995, los desequilibrios externos han generado numerosos efectos de "destrucción" de comercio y otros no menos graves de "desvío" de comercio.

Estos antecedentes hacen necesario incluir criterios que hagan consistentes la IED con los equilibrios externos;

2º los diversos textos propuestos para la reunión de Seattle por los países favorables a una nueva negociación sobre inversiones (básicamente la Unión Europea, Japón, Suiza), enfatizan los derechos de los inversores pero desatienden los derechos de los países en desarrollo y de menor desarrollo cuya capacidad política y técnica de negociación puede ser inferior a la de los grandes conglomerados empresarios.

Las medidas sobre TRIMs, impiden la fijación de criterios de *performance* a los países pero no impiden que los contratos de inversión incluyan, por ejemplo, cláusulas de indexación de precios no sólo en monedas duras sino además, ligadas a la inflación de terceros países ajenos a la inversión. Ello con independencia de que por diferencias de tasas de inflación entre el país tercero y el país receptor se dañe el costo, la competitividad y, en definitiva, el comercio exterior del país donde se hace la inversión.

Este caso dista de ser hipotético. En años en que las privatizaciones de servicios públicos han sido importantes, son muchos los casos en que los contratos afectan la competitividad sistémica. Otro caso es la exigencia de establecer en los contratos no sólo las lógicas cláusulas de estabilidad jurídica necesarias para el inversor sino además cláusulas de estabilidad en materia de impuestos aún cuando éstos fueran fijados con carácter general y por métodos institucionales transparentes.

El primer caso sugiere la existencia de una aproximación al margen -y no dentro- del funcionamiento del libre mercado. El segundo caso sugiere criterios que hacen a los mercados menos *"contestables"* porque tienden a crear beneficios que disminuyen la posibilidad de entrada de nuevos oferentes.

Los criterios sobre la IED no deben llevar la protección al límite de afectar el funcionamiento del libre mercado.

3º Si hay reglas sobre las inversiones no suficientemente compensadas con reglas generales sobre política de la competencia hay un riesgo creciente de concentración económica que puede inducir a desvíos de comercio a partir de países con normas sobre la competencia más débiles que permitan ganancias extraordinarias. Otro tanto puede ocurrir en el caso de privatizaciones si no hay normas que fijen que los subsidios implícitos o explícitos de las privatizaciones no deben aumentar los subsidios existentes al momento de la privatización a favor de las empresas en poder del Estado. También este hecho puede generar desvíos de comercio no compensados por efectos de creación.

Los desvíos de comercio basados o derivados de normas de protección excesiva de la IED son contrarios a los fines de la OMC.

III. El futuro

Una vez incorporados estos criterios más amplios y la noción de asimetrías, parece no sólo válido sino **necesario y posible, abrir negociaciones en dos etapas**, con un criterio incremental (tal como lo propusiera Nueva Zelandia) y dentro de los principios generales de no discriminación, trato nacional y trato diferenciado a los países en desarrollo (como consta en la propuesta de la Unión Europea):

- una etapa educativa y de trabajo analítico que incluya:
  - la preservación del poder de los gobiernos para regular la actividad de los inversores dentro de su territorio;
  - la trasparencia, estabilidad y predictibilidad de los regímenes de inversión;
  - una *"lista positiva"* de sectores incluidos en los acuerdos
  - un mecanismo de solución de disputas de Estado a Estado con exclusión de las disputas inversor-Estado, los que quedan en la esfera ajena a la OMC.

- Una etapa de negociación propiamente dicha si los países acuerdan con lo concluido en la etapa primera y manteniéndose siempre dentro del principio de *single undertaking* que rige el lanzamiento de una Nueva Ronda.

SÍNTESIS

Se puede y se debe abrir una nueva negociación pero el *core* de su agenda debe estar más centrada en combinar la protección de la IED con la necesidad de preservar equilibrios externos de los países, asegurar mayor competencia y evitar inducir desvíos de comercio ajenos a las normas OMC.

Competition Policy and the EU-Mercosur Trade Negotiations

José Tavares de Araujo Jr.[3]

1.The Global Context

With the exception of the United States, competition policy is a relatively new subject everywhere. Some countries such as Canada, Australia and New Zealand have had antitrust laws since the turn of last century, but their role as public policy instruments became relevant just in recent decades. In most industrialized countries, these laws were enacted for the first time after the Second World War. However, in the United Kingdom, for instance, the annual workload of the Monopolies Commission until 1965 seldom included more than two investigations, while merger review procedures were introduced in the European Union only in 1990. Around the world, 31 countries had competition laws in 1989, and in 1997 about a half of the 136 members of the World Trade Organization were yet to pass such laws in their territories (see WTO, 1997).

In contrast with the infant stage of antitrust institutions in most countries, technical progress engendered a pervasive trend toward global competition during the second half of the twentieth century. Among other consequences of this paradox, a defining feature of the current multilateral trading system is the lack of mechanisms for checking global mergers, international cartels and anticompetitive practices of transnational corporations. According to the U.S. International Competition Policy Advisory Committee (ICPAC, 2000), *"In 1999 global mergers and acquisitions were at an all-time high, with approximately $3.4 trillion in activity announced worldwide"* (p. 3) and *"approximately twenty-five percent of the more than 625 criminal antitrust cases filed by the Department of Justice since fiscal year 1990 were international in scope."* (p. 167) In 1998, the European Commission examined twenty merger cases in which the relevant geographic market covered the world economy.

2. Possible Approaches for Cooperation

Beyond the facts that the Mercosur experience in the area of competition policy is more recent than the European and some members of the former trade block do not have antitrust laws, the main contrast between these experiences is that competition policy is still far from playing a central role in the Mercosur integration process. Considering the present situation, an eventual cooperation program between the two blocs should include three components to be developed in two stages. In the first stage, the control of international mergers and anticompetitive practices affecting both regions could be started through a joint assistance agreement among the European Union, Argentina and Brazil. A second component to be carried out during the first stage could be an institutional strengthening program focused on two subjects and two industries in which the European experience has been particularly rich, namely, the interplay between competition policy and regulatory reform in telecommunications, and the monitoring of state aids in the automobile industry.

There are at least three aspects of the European telecommunication policies that are worth sharing with the Mercosur authorities:

- The division of labor between the antitrust authorities and the regulatory agencies;
- The establishment of implementation periods for eliminating restrictions inside the common market; and
- The monitoring of entry barriers in the different segments of the telecom industry.

The case of the auto industry is interesting because it illustrates a situation in which both trade blocs faced a similar problem and opted for different solutions. The amount of subsidies granted by national governments to this industry is a time-honored issue on the European policy agenda. From 1977 to 1987, for instance, the producers of motor vehicles received about ECU 26 billion from public funds for supporting their activities inside the common market (cf. *Official Journal*, C 279, Sept. 15, 1997). In the early eighties, the Commission tried to impose some discipline on these grants by installing a monitoring system based on ex-post notifications, but this initiative was short lived, due to the opposition orchestrated by France, Germany, Italy and United Kingdom, the leading manufacturing centers in the Community. Finally, an agreement was reached in 1989 with the approval of the *"Community framework on State aid to the motor vehicle industry"* (see *OJ*, C 123, May 18, 1989) that defined the following rules:

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- All projects related to the assembly and manufacture of motor vehicles and engines with a cost exceeding ECU 17 million are subject to prior notification to the Commission.
- The objectives pursued by the aid in question may include rescue and restructuring, regional development, innovation, pre-competitive R&D, environment and energy saving, and vocational training.
- The Member States are requested to provide the Commission with an annual report containing all forms of support granted to the auto industry.
- The assistance received from the European Investment Bank should obey the framework's guidelines.
- Based on the preceding information, the Commission verify the compatibility of the subsidies received by the auto industry with the competition rules of the Treaty.

In the case of Mercosur, the adoption of common policies for the auto industry has been postponed several times, and the present deadline is 2005. During the nineties this industry was marginally affected by the trade reforms in Argentina and Brazil, but has secured great part of the privileges enjoyed during the period of import substitution policies, such as high tariffs, import quotas, tax incentives and the like. As a result, it has turned into a continual source of trade disputes both inside Mercosur and at the multilateral level. The interim protocol agreed for the period 2000-2005 includes an assorted set of tariffs on vehicles and parts, rules of origin and some export performance targets, but not a single discipline on subsidies. Indeed, the current stage of Mercosur policy instruments for this industry is similar to the European situation in the early eighties, and closing this gap would be an important step for the success of a trade agreement between the two blocs.

A second phase of the EU-Mercosur cooperation program would be started after the introduction of competition laws in Paraguay and Uruguay. At that moment, the initial agreement with Argentina and Brazil could be reformulated, not only to allow the participation of Paraguay and Uruguay, but also other Latin American countries that already have competition policy institutions. Under these circumstances, new topics could be included on the trade negotiating agenda, such as, for instance, the relationship between competition policy and antidumping measures. It should be noted, however, that the simple existence of competition policy institutions in all member countries is not a sufficient condition for abolishing antidumping measures within a free trade area. As the European integration process has illustrated, the complete removal of antidumping and countervailing duties becomes politically feasible only after the harmonization of all mechanisms that affect the domestic conditions of competition, including monetary and fiscal policies.

Key negotiating issues

Dispute settlement in a future EU–Mercosur free trade area

Klaus Bodemer

Introduction

1-The growing complexity and interdependence of national, supranational and international commercial relations has led to growing legal regulation of this area. This development is reflected not only in the growing number of standards but also in the **emergence and expansion of new legal sub-systems** superimposed on existing systems. This frequently gives rise to difficult legal conflicts (see, for example, the World Trade Organization and the banana dispute).

2-The subject of legal-institutional capacity is of utmost importance in any system of integration. Such a system needs the legal capacity to implement fully what has been agreed and to make it clear to society and administrations in general that the undertakings given will be complied with. In respect of this legal question, the principal discussion is about the **effectiveness of a dispute-settlement mechanism**. This is without a doubt a very sensitive subject. The handling and resolution of disputes that arise among the members of an integration mechanism, and of possible differences in legal interpretation, is an important and delicate subject. Failure to comply with undertakings given, adoption of regulations or measures incompatible with the legal standards agreed, or imposition of restrictions based on unclear provisions that can be read in different ways, can become a major obstacle to the integration process. A complacent or negligent attitude to this subject favours stronger economies by leaving the solution of such problems to political negotiations between states of unequal power, or to the pressure of conflicting interests. Therefore, the legal regime in which these programs of integration have to be embedded must be safeguarded by arbitration mechanisms guaranteeing the just settlement of disputes between member-states and protection of the economic players' legitimate interests.

3-In an ideal case, and leaving aside individual circumstances (and obstacles), disputes of this nature would be settled by an act of jurisdiction governed by common standards established and executed by **independent tribunals**, with powers of arbitration compulsorily accepted by member-states and verdicts that are final and conclusive. Only in this way would adequate control of legality be guaranteed, could differences in the interpretation of legal texts be resolved, and any non-compliance or infringements by the various parties be dealt with.

4-In political reality, however, the situation is much more complicated. The various integration systems have reacted very differently to this challenge, with the degree of integration (free-trade zone, customs union, common market, political union) playing a not inconsiderable role in the specific design of dispute settlement mechanisms. Finding a solution is even more difficult when the parties to the treaty – as in the planned free trade agreement between the EU and Mercosur – are members of differently constituted integration structures (in the EU case an economic and monetary union on its way to political union, in the case of Mercosur an incomplete customs union).

5-Of particular interest as reference points for a future EU-Mercosur arbitration procedure, in addition to the established internal dispute settlement mechanisms of the EU and Mercosur (the former with many years', the latter with only embryonic experience), are the treaty regulations and practical experience of the North American Free Trade Association **(NAFTA)** and of GATT and subsequently the **WTO**. This is because NAFTA, like the EU-Mercosur free trade association, is a) an intra-regional free trade zone and b) an example of
North-South cooperation. And GATT and latterly the WTO as a global free trade regime supplies, as it were, the model framework and point of reference for any solution in the sub-regional and inter-regional area. **The legal-institutional design of these two dispute settlement systems and the way they have been handled so far give us some ideas for the practical form of a similar system in the framework of the EU-Mercosur agreement.** Needless to say, these two integration set-ups developed in very different ways and are tied into economically, politically and socially very different contexts.

6-It should also be noted that the EU-Mercosur free trade agreement does not yet exist, but is rather a project for the future. Negotiations on the subject, initially on procedural matters and timescale and subsequently on contents, have begun only in the last few months. They can be expected to last several years, with their pattern, timing and possibly their content being determined substantially by the FTAA process and by the WTO millennium round getting under way again.

II. The EU dispute settlement system

7-The EU chose the aforementioned optimal solution for its dispute settlement system (see point 3), in the form of the **European Court of Justice (ECJ)**. The ECJ, against the judgements of which there is no right of appeal, supervises compliance with treaties and over the years has developed into an important EU organ. It can be called upon by EU bodies

and member-states, but also by companies or private individuals directly affected by EU directives or decisions. National courts of member-states apply to the court for preliminary rulings on the interpretation of legal provisions. If the ECJ identifies violation of a treaty, the member-states concerned undertake to take all necessary steps to implement its verdict.

8-Just as in national constitutional law and in international law, at the European level, too, member-states cannot be forced to implement a judgement. Instead, community law functions on the basis of member-states' voluntarily carrying out their obligations. Despite this, in nearly ever case member-states abide by ECJ decisions. The court has repeatedly handed down pioneering verdicts confirming that community law takes precedence over national law. In combination with national courts it is an important "motor" for the development of community law, one which partly compensates for the Council of Ministers' lack of decision-making fervour.

III. The DSS of the Mercosur

9-The DSS implemented by the **Asunción Treaty** (March 1991) included in the **Annex 3** three mecanism: 1.) „direct negotiation" among the parties; 2.) an analysis of the controversy by the Common Market Group (CMG) (maximum of 60 days), and 3.) an analysis of the controversy by the Comon Market Council (CMC). In late 1991 specific procedures were detailed in the **Brasilia Protocol** for Dispute Resolution. The Protocol expanded significantly the scope of issues which can be dealt with from controversies around implementation of the Treaty to those arising out of non-compliance and problems of interpretation. Resolutions are **definitive** and **obligatory**. If one State refuses to comply the affected party can adopt **temporary measures**. The Brazilian Protocol also established that the national section of the CMG will be the mechanism for individuals to make claims regarding trade issues.

10-The **Ouro Preto Protocol** (December 1994) agreed on **General Procedures** to make claims to the Trade Commission, which will accelerate dispute resolutions between member countries. If no settlement can be found within the terms of the General Protocol, the issues will be dealt with the Brasilia Protocol (to the fases of the proceeding see the chard). In reality, the mechanism of the Brazilian and Ouro Preto Protocol are very complicated; perhaps therefore they no had great importance. The first decision of an arbitral panel was in 1999 about the import system of Brazil, the second in September of the same year about export subsidies of Brazil. In both cases the decisions were very „salomonic" and based upon the whole package of norms of the Mercosur Treaty.

IV. The DSS in the NAFTA

11-The NAFTA employs a **number of dispute settlement models**, though none involving the establishment of a permanent judicial organ comparable with the ECJ. Most of the NAFTA procedures are accessible only to the governments of the Parties, but some provide direct or indirect access to private parties. The NAFTA Supplement Agreements with respect to the environment and labor (NAALC, NAAEC) establish novel dispute settlement procedures that can be used to address wether the Parties have persistently failed to enforce their laws.
Of central importance is **the potential conflict between the NAFTA and WTH -DSS**, and the impact that such conflict might have on the WTO-System.
There are in particular three chapters dealing the DS mechanism. chapter 20, 19 **,** and 11. **Chapter 20** contains the general mechanism for the settlement of disputes. Pursuant to Art.2005 (1) of the NAFTA, disputes between the parties arising both the NAFTA and the GATT may be resolved at the discretion of the complaining Party pursuant to either the WTO/GATT or NAFTA DS Procedure. If a third NAFTA Party request DS under the NAFTA, a dispute will ordinarily be settled pursuant to the NAFTA. Matters involving the relationship of the NAFTA to specified environment agreements, and matters involving sanitary and phytosanitary measures or standard measures relating to the environment, healthy, safety or conservation must be settled under the NAFTA procedure at the request of the respondent.

12-Following a **consultation** and **conciliation** period, at the request of a Party, an **arbitral panel** is established. Five panellists are selected by the disputing parties, generally from a list of experts that the Parties will have agreed upon by **consensus**. The panel receives **written and oral testimony** from the Parties, may request (subject of consensus of the Parties) the input of **outside experts**, and renders a **majority decision** to the Parties that recommends actions to be taken by a Party whose measures have been found inconsistent with the NAFTA. Such decision is **not subject to appeal**. A Party is expected to comply with the decision of an arbitral panel, preferably by reforming or removing an offending measure. If a complaint-against Party fails to comply satisfactory with a panel decision, the complaining Party may suspend the application to the Party complained against of the benefit equivalent effect until such time as they have reached agreement on a resolution of the dispute. A **panel cannot compel compliance with the recommendation**.
For private parties (investors) it is not possible to participate in the compliance/ execution of the decisions. Al ist confidential, including the initial and final reports. Besides it is very difficult to calculate the procedure in advance (there are until now only five cases).

13-The **Chapter 19** is established for **Anti-Dumping** (**AD**) and **Countervailing Duty Matters** (**CDM**). The Parties may initiate claims based upon final AD/CVD determinations by national administration authorities. **Private parties have the right to initiate a DS procedure, but the execution is in the competence of the national government**. This mechanism is

counterproductive con respect to the effectiveness of the system. **Chapter 19 is strengthening the position of the government at the cost of the private parties**.
The **Chapter 11** deals with disputes about investments between the member States and the correspondent enterprises.

14-The two **Supplement Agreements** - the North Atlantic Agreement on Environment Cooperation (**NAAEC**) and the North Atlantic Agreement on Labor Cooperation (**NAALC**) - fills a gap in the WTO system by providing that Parties will maintain high levels of environment protection, high standards regarding the treatment of labor and by providing a mechanism pursuent to which the Parties may bring complaints for persistent failure to apply labor laws. and protect the environment. The principal difference between the NAALC and the NAAEC is that under the Labor Agreement private Parties not have the right to petition the Secretariat for the preparation of a factual report as they do under the Environment Agreement.

V. Potential disputes between a regional (NAFTA / EU) and a multilateral (WTO) DSS

15-Inherent in the NAFTA DS mechanism is the potential for conflict with the WTO DSS. This is a reformed mechanism which substantially modifies the prior GATT mechanism by making **the adoption of panel reports virtually automatic**, by creating a standing **Appellate Body** and an **appeals procedure**, and by strengthening the rules intendet to assure that WTO DS-decisions are implemented by Members. The DS Body is composed by all WTO Members. Under prior GATT rules, decisions or DS panels were adopted only by **consensus** of all parties, including the parties to a dispute. This gave the losing party the ability to block adaption of a panel report. Under the new procedures, a **negative consensus** is required to block adoption of a report, virtually assuring that reports will be adopted.

16-The new DSS of the WTO can be characterized as a **compulsory** and **binding system** with a **stringent time-scale**, according to which, **deadlines** have been set for all the major steps in the procedure. It is a system that, contrary to ist predecessor, provides for **legal appeal** and for **clear rules of implementation** of the rulings of panels and the Appelate Body. It makes clear the procedure for withdrawal of concessions based on failure of the implementation. Possible **compensation** and **retaliation** have also been regulated in greater detail than before. Finally, it is an **integrated system**.

17-The changes of DS in the WTO increases the likelihood of conflict with NAFTA DS- decisions because the NAFTA Parties will not be able to block the adaption of WTO panel reports and thereby prevent conflicts from reaching full fruition. (The situation is particular problematic in respect to environment issues). NAFTA and WTO panels may develop different answers to the same questions arising under the same agreements, and different answers to the same questions arising under different agreements.

18-The potential of conflict between regional DS-decisions and WTO DS-decisions does not arise uniquely in the NAFTA context. The same situation pertains as to the European Union and ist ECJ DSS and the WTO. **In the EU system disputes** between member States regarding trade matters **are resolved solely by the ECJ**. There is no formal mechanism for resolving DS conflicts beyond application by judges and arbitrators of the rules of international law which establish a hierarchy of norms. Such rules would seem to make clear that, at least as respects obligations to third country Members of the WTO, **Parties to the NAFTA and EU Member States must give priority to WTO rules over regional rules**. Recourse to general rules of international law regarding the hierarchy of treaty norms is unlikely to provide clear answers to questions of the priority of NAFTA and WTO rules and decisions as among the NAFTA Parties. The general rule of international Law (see Vienna Convention on the Law of Treaties) concerning interpretations and the effect of success agreements on prior agreements are sufficiently dependent on the intention of the treaty parties that the relative weighting of contextual factors will strongly influence decisions.

19-Moreover, **reliance on general rules of international law to resolve conflicts between multilateral and regional organizations may not be a sound idea in practice**, because of the intensity of political friction likely to accompany an application of these norms.

20-The principle mechanism presently available in the WTO Agreement for reconciling conflicts between WTO and other rule systems is the **waiver mechanism** by which the WTO Members may on a one-time or continuing basis permit certain members to avoid application of the WTO norms. But this would no appear to be an attractive long term solution to the problem of conflicting rules. Trading rules are most effective in promoting economic development when there is sufficient stability in expectations, to allow private parties to rely on these rules. **A case -by- case waiver system would not be likely to enhance stability in expectations**.

Key negotiating issues

Rules of origin in international trade: main elements for the EU MERCOSUR trade negotiations.

Claudio Dordi and Laura Beretta

1. Introduction.

Rules of origin (RoO) are those laws, administrative regulations, criteria and practices used to determine the nationality of a product. Two factors contributed to the increasing importance of rules of origin:

1) the globalisation of industrial production
2) the application of different trade policy instruments depending on the nationality of goods.

As to 1) it is well known that the phenomenon of globalisation is characterised by the splitting up of production processes over many countries as well as by the sourcing of parts and components considering the most cost-saving location. As to 2) it is well known that rules of origin are a secondary trade policy instrument: their main function is to ensure that the benefits of the said instruments are confined to the targeted countries. Rules of origin are divided into two categories, according to the trade policy aim they serve:

-non preferential RoO functional to the application of non preferential trade policy measures (anti-dumping, discriminatory quantitative restrictions, custom duties, marks of origin,.etc.)

-preferential RoO applicable both in the context of regional trade arrangements (i.e. MERCOSUR, NAFTA etc.) and in the regimes which afford preferential treatment to developing countries (i.e. General System of Preferences). In regional trade agreements RoO are fundamental to avoid trade deflection [4] in FTAs and in CUs with many products exempted from the application of the CET.

In the negotiating process of a EU-MERCOSUR FTA three distinct problems have to be taken into consideration:

i) the complexity of the methods normally utilised for the determination of origin;
ii) the fragmentation of the legal sources;
iii) the extent of restrictiveness which can be determined by the contracting States.

As to i) the complexity is due to the following circumstances:

- there are several methods to determine the origin of goods
- each method is often utilised in connection with the others or as an alternative.

There are at least three methods for determining origin: 1) the technical test (i.e., the product resulting from a process or operation in the exporting country must have its own specific properties and composition that it did not have before the process or operation took place), 2) the economic test or percentage criterion (i.e., the evaluation of percentual value which the process or operation undertaken in the exporting country must have added), and 3) the custom classification test - CTC - (i.e., the process or operation in the exporting country results in a product that is classified under a different chapter/heading/subheading of the custom tariff classification than before the process or operation). Moreover, the concrete application of the above described methods is difficult *per se*. This is mainly due by either the technical complexity of the methods themselves or the uncertainity and vagueness in which both business and customs operators are left.

As to ii) a comparison between some of the most relevant regional integration agreements shows that rules of origin are structured and applied in many different ways. See the following table illustrating the architecture of NAFTA, MERCOSUR and EU rules of origin.

[4] In absence of RoO exporters would entry the FTA through the country where the custom duties are more convenient. Then they can trans-ship goods to the final destination within the FTA. This phenomenon leads to the transformation of a free trade area into a custom union with a CET equal to the lowest external tariff applied by the member states.

Criteria	EC	NAFTA	MERCOSUR
General structure	Rules of origin based on: - CTC (unique). - CTC + percentage for some products - Percentage (unique) - Technical (unique) - Alternative rules: either percentage or technical	Rules of origin based on: 1) CT chapter, heading, subheading (unique) 2) As 1)+percentage 3) percentage + technical 4) Alternative RoO for the same product	Rules of origin based on: 1) CTC 2) CTC+percentage 3) Percentage
CTC	CTH[5] and CT chapter	Change of chapter, CTH and CT at subheading level.	CTH
Percentage	Import content (25-30-40%)	Domestic content: net method (50%) or transaction value (60%)	1) Domestic content (60%) 2) Import content (40%) Or Domestic content (50%) [goods disciplined under bilateral agreements and Paraguay exc.)
Technical	Positive only	Positive only	Positive only for some products

As to iii) it has been demonstrated that rules of origin influence the trade flows, the investment flows and the firms' strategic business decisions.

2. The distorting effects of rules of origin on trade and investment flows.

Particularly restrictive rules of origin may deny trade preferences to products processed in a member countries of a FTA. This situation may occur although the processing operations underwent in the said country are substantial. See the following rule of origin as an example:

Heading	Description of product	Working or processing carried out on non originating materials that confers originating status
5401 to 5406	Yarn, monofilament and thread of man-made filaments	Manufacture from: - chemical materials or textile pulp

According to a technical analysis[6] about 40% of the ex-factory price of the yarn can be attributed to the chemical raw material. This means that the operation to be performed on non originating chemical materials in order to satisfy the origin requirement must add at least 150 per cent of the value of such materials.
Such a kind of rule implies the following effects:

- an incentive for foreign exporters to switch from low cost non regional to high cost regional inputs in order to take advantage of the preferential rates
- an incentive for foreign producers to locate production processes inside the FTA in order to benefit from the preferential treatment (investment incentives).

The application of a such restrictive rule has to be taken into consideration by a profit-maximising firm in the following three fundamental decision making processes:

-the sourcing of both raw materials and intermediate products
-the location of plants
-the choice of the final sell-out markets.

[5] In the old EC preferential rules of origin CTH was the general criterion to determine the origin, with many exceptions allowed. Such a general rule is no longer included as the complete harmonised system is covered by annex II to the protocols.
[6] See UNCTAD, Document UNCTAD/ITD/GSP/31, p. 34.

In order to maximise the benefits deriving from the different alternatives provided by the existence of numerous preferential trade agreements, firms should determine the origin of their final product in advance, so that they can account for it as a factor of production in their strategic plans.

3. Negotiating MERCOSUR-EU rules of origin: some considerations.

Negotiating rules of origin in a new FTA is a complex task: the eligibility of a particular process to be sufficient to determine the origin of a product containing also non originating materials is not a technical decision but a political one. The final rule of origin is the result of a compromise between the governments involved representing the exigencies of their national sensitive industries, such as:

-manufacturing industries demanding for the originating status of the goods processed in their own countries;

-industries demanding for the raw materials to be considered relevant in the determination of origin although they have undergone substantial transformation in another country;

For example, in WCO negotiations aiming at harmonising non-preferential rules of origin, there are two positions in the determination of the origin of coffee:

-producing countries willing to maintain the origin of the raw bean regardless of the manufacturing process performed in other countries;

-processing countries stressing the importance of trademarks and blends: they generally mix beans from different origins and mention them on their packages for consumer information. According to them if the first rule is to be followed, this would imply that a rule of origin based on the raw beans could change frequently for coffee with the same trademark and the same taste.

Trade and foreign direct investment in the manufacturing sector

Alberto Brugnoli* ** and Laura Resmini*****

In recent years EU exports to MERCOSUR have been growing at a faster rate (an annual average higher than 13 percent from 1995 to 1998) than to any other external markets. MERCOSUR exports to the EU, however, increased by just 6 percent annually. Consequently, MERCOSUR countries have accumulated a large trade deficit with the EU (6.4 billion euros in 1998).[7]

EU imports from MERCOSUR come substantially from Brazil (72.9 percent in 1998) and, even if less significantly, from Argentina (23 percent in 1998). The same geographical pattern is followed by EU exports to MERCOSUR, 63.8 percent of which were directed to Brazil and 31.2 percent to Argentina in 1998. [8]

In the last thirty years, the composition of MERCOSUR exports to the EU has changed considerably. In 1970, they consisted prevalently in commodities (53.9 percent) while nowadays the industrial sector has taken the leading role (63.2 percent), even if a considerable portion is still related to commodities (36.7 percent) and particularly to the agricultural sector (28.2 percent). In the industrial sector, traditional goods[9] exports account for the 55.4 percent of the total (among them, almost 75 percent refers to food, beverages and tobacco categories). Scale intensive products[10] exports account for the 25.7 percent, while technical progress diffusing goods[11] for the 10.8 percent and durable goods[12] for the remaining 8.1 percent. The EU still represents the first market for the traditional goods exports of MERCOSUR members (29.8 percent of the total) but the growth - mainly driven by Brazil - of the other industrial good categories exports to the EU has been impressive over the last thirty years. This fact assumes a grater significance when one thinks that Brazilian exports of technical progress diffusing products to the USA have recently substantially increased.[13]

In the manufacturing sector, EU exports to MERCOSUR deeply involved industries characterised by the presence of small and medium enterprises[14] (SME), which account for no less than 35% of European exports to the region.[15]

EU foreign direct investment (FDI) into MERCOSUR grew exponentially during the 1990s, from 597 million euros in 1993 to 6,684 million euros in 1997. This dramatic increase in inflows has began to challenge the traditional dominance of United States multinationals in the region. In 1997, the EU share in total FDI inflows into MERCOSUR was 45 percent, only five percentage points below the share of the United States, which at the beginning of the period under examination accounted for about 67 percent of total FDI inflows into MERCOSUR. A direct consequence of the huge increase in the FDI flows has been the consolidation of European capitals invested in the area. In 1997 EU stocks reached the record level of about 16,000 million euros.

The geographical perspective highlights a strong concentration of FDI in Brazil and Argentina. Brazil clearly plays the lion's share as recipient country. Argentina ranks second, but it is very far from Brazilian levels. Uruguay and Paraguay still play a

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7 ISLA calculations based on EUROSTAT databank, EUROSTAT, *Intra and Extra-EU Trade*, monthly data, CD-ROM, Office for official publications of European Communities, Luxembourg, 1999.

8 *Ibidem.*

9 Food, beverages, tobacco, materials of rubber, cork and wood manufactures, pulp and waste paper, essential oils, perfumes and flavour materials, leather products, textiles (except synthetic), construction materials, mineral manufactures n.e.s., glassware and pottery, pearls and precious stones, machine tools for working metal, prefabricated buildings, furniture, travel goods, articles of apparel and clothing accessories, footwear, miscellaneous manufactured articles n.e.s. excluding arms and ammunitions.

10 Tyres, wood pulp, synthetic fibres, metalliferous ores and metal scrap, petroleum products, organic and inorganic chemicals, dyeing, tanning and colouring materials, soaps and detergents, fertilisers, plastics, chemical material and products n.e.s., articles of rubber n.e.s., paper and paper board, synthetic and artificial filament yarns, cement, glass, iron and steel, non ferrous metals, manufactures of metal n.e.s.

11 Medical and pharmaceutical products, perfumery cosmetics or toilet preparations excluding soaps, power generating machinery and equipment, tractors, civil engineering and contractors' plant and equipment, parts for textiles machinery, printing and book binding machinery, professional, scientific and controlling instruments, photographic apparatus, electronic machinery and information technology.

12 Textiles and leather machinery and parts thereof n.e.s., paper mill and pulp mill machinery, machine tools working by removing metal or other materials, parts and accessories suitable for use solely or principally with metal working machine tools, electrical machinery, apparatus and appliances n.e.s. and electrical parts thereof, office machines, road vehicles, arms and ammunitions.

13 ECLAC, *Indicadores Económicos*, Santiago, 1999.

14 In the EU, 99.8 percent of enterprises have less than 250 employees; they represent 66.0 percent of the EU employment and 65.0 percent of the EU turnover.

15 OCDE, *Globalisation and small and medium enterprises*, Paris, 1997.

minor role as receiving countries. Paraguay, however, position is not very far from the first two countries, when the size of the host economies is taken into account.

The industrial sectors which are the core of the present internal policies both in the EU and in the MERCOSUR will have to be considered carefully during negotiations, in order to pursue outcomes consistent with the same policies. EU industrial policy is not very well-structured, but recently at least two issues may be identified. One is the attempt to encourage the development of SME, with a specific attention to the creation of networks among them. The second is the promotion of innovation. The measures implemented clearly invest all sectors; in the manufacturing sector they have been mainly addressed to (and exploited by) the SME of the traditional and technical progress diffusing sectors. As far as MERCOSUR members are concerned, industrial policies have been directed at promoting FDI inflows as well as joint-ventures between foreign and domestic firms of every size and sector. As a matter of fact, up to now, capital inflows have been driven mainly by privatisation processes which have attracted many large multinationals in the infrastructure, telecommunication, energy and banking sectors. On the contrary, the manufacturing sector has attracted a small share of total FDI inflows, mainly in the chemical, automotive, food and beverage, metal, refined petroleum, machinery and electrical equipment sectors. Consequently, in the manufacturing sector, industrial linkages between domestic and foreign firms, which are essential for the diffusion of spillover and demonstration effects, have been relevant but far from what they could be. Time for a change seems to have come if one considers that privatisation processes are quickly running to their end and MERCOSUR members need to further develop the still young network of SME which only may assure a process of widespread industrialisation. Negotiations should accelerate the integration process above all in the traditional and technical progress diffusing sectors. In these sectors, EU counts the majority of its innovative SME, which do not only wish to export goods but also to create international joint-ventures capable of exploiting the many opportunities offered by the global economy. The same sectors which are already leading the commercial internationalisation of MERCOSUR enterprises, are probably the ones which might soon drive also their internal widespread industrialisation and productive internationalisation.

As a consequence of the above considerations, negotiations will have also to address simultaneously sectors which are vertically and/or horizontally integrated, in order to help the members of the two areas to understand the reciprocal advantages deriving from the liberalisation of complementary sectors better.

Moreover, since European SME FDI could be more profitably addressed to sectors characterised by the presence of regional clusters, countries a broad set of policy instruments for the development of SME should be strengthened in MERCOSUR, in order to develop the existing local concentrations of firms.

The two blocks are involved in the negotiations of many other agreements. Among them, the Free Trade Area of the Americas (FTAA), whose talks are scheduled to end in 2005, is the one which promises to cause the most dramatic trade diversion effects for the EU if, by the same deadline, most EU-MERCOSUR trade sectors will not be liberalised.

Given all of the considerations above and since the ongoing FTAA negotiations specifically include a chapter on investment, negotiations between MERCOSUR and the EU should have among their main objectives the establishment of a normative framework for the promotion of investments between the two sub-regions, including at least the same topics scheduled for the FTAA.

Negotiations will have to follow a progressive path. The easier problems will have to be dealt with first. Only gradually will the most crucial ones be faced, in order to investigate adequately the matters of concern and to create the necessary consensus to the acceptance of innovative rules in the sectors influenced by the presence of the strongest lobbies.

Trade policy and specialisation in agricultural goods in the bilateral relationships between the European Union and MERCOSUR

Marcel Vaillant

1. MERCOSUR's major exporting sectors are, at a global level, food, beverages and tobacco (sector 1 CCP, UNCTAD), raw materials from agriculture (sector 2) and mining (sector 4), the rest are importing sectors. The trade patterns with the EU show a similar rather more accentuated profile –food is more export oriented and manufactured products are more imported oriented. Thus, there is a well defined structural pattern in trade relationships between MERCOSUR and the EU which is characterised by selling food and raw materials in exchange for manufactured products.

2. During the nineties there was a slowdown in exporting activities from MERCOSUR to the EU in agricultural goods, while at the same time the opposite trend is observed for MERCOSUR's imports from the EU. In a more detailed analysis at product level, it is shown that MERCOSUR's agricultural exports are concentrated in a few of commodities whereas the EU's exports are more diversified including products more differentiated and highly processed products (in general, for final consumption).

3. MERCOSUR's exports to the EU included in the chapters 1 to 24 of the Harmonised System account for (on average for the mid nineties) more that half of total exports. The more important chapters taking into account the average share in the period are: 23 (residues and waste from the food industries, prepared animal fodder), 12 (oil seeds and oleaginous products), 9 (coffee, etc.), and 2 (meat and edible meat offal)

4. In the case of Brazil and Paraguay, exports of agricultural products are very concentrated. The main exporting activities are tropical agricultural products (coffee, sugar and soya). In Argentina and Uruguay exports of agricultural products are more diversified. In the case of Argentina, oleaginous products (sunflower, soya, etc.) are the most important, followed by cereals (wheat, maize). In Uruguay, boneless cuts of beef (chilled and frozen), fish fillets (frozen) and citrus fruits (fresh oranges and mandarins) are the activities that account for the major part of total exports. For the MERCOSUR as a whole more than two thirds of this total are accounted for just six products: soya and derivatives (120100 and 230400 HS); coffee (090100); orange juice (200911); tobacco (240120); and boneless cuts of beef (020130).

5. In 1994 the average tariff for food and agricultural goods, most favoured nation (MFN), in the EU was 9.3%. In this case, the tariff for agricultural products provides a partial information on the protective measures in use for these items. It is important to consider the incidence of CAP on domestic prices, production and trade. In the EU there two lines of non-tariff measures applicable (at EU and national levels) but are those at the communitarian level that seek to protect the sectors more vulnerable to the external penetration. In the case of agriculture, the majority of the non-tariff measures in practice are part of the CAP. The protectionist devices are diverse: tariffs and quantity restrictions; production controls; price support; export subsidies; compensation payments.

6. Since 1992 the CAP, it has been subject to revision for internal and external reasons. In fact, there has been a reduction in the protectionist instruments that distort the producer and consumer prices. It has been acknowledged that this process of transformation will continue over the coming years. In spite of the changes mentioned, the CAP stills accounts for more than a half of the EU budget. In 1997, according to the WTO´s information, the average equivalent tariff , including those products affected by quantitative restrictions, was 20.8% (see chapter 3 section 3.3). The variability of these tariffs among the main agricultural and food products is high (ranging from 0 to 375.6%). Those chapters with high tariffs equivalent are: cereals (10) with an average tariff above 60%; dairy products (4) and meat (2) with a tariff above 40%; live animals (1) and residues and waste from food industries (23) between 30 and 40%; and finally between 20 and 30% tobacco (4), preparations of vegetables (20), preparations of meat (16) and preparations of cereals (19).

7. Among the set of products exported from MERCOSUR to the EU those with high nominal MFN protection are: fruit juice (especially citrus); preparations of meat; coffee; fresh citrus fruits, and fish chilled and frozen. In the group of zero tariff products are soya and derivatives; wheat; sunflower seeds. The level of protection is much higher when considering the information on equivalent tariffs. Those with a higher than average level of protection, (20.8%), are the following: bovine meat (107.5%); rice (92.3%); wheat (76.8%); sugar (61.8); cheese (60.2%); maize (48.7%); fruit juice (31.0%)

8. MERCOSUR's import demand from the EU contained in chapters 1 to 24 of the Harmonised System account for between 6% and 7% of the total imports from this origin (see chapter 4 section 4.1). Three of the chapters account for half of the imports of agricultural goods and fishing activities (22 alcoholic beverages; 4 dairy products; and 11 milling products).

9. The set of agricultural and fish products imported from the EU shows more diversification than exports and it differs for every member country in spite of their generally similar profile. According to information for 1996 from LAIA, shows that only

six products account for one third of the imports of MERCOSUR (chapters 1 to 24): whisky (220830), malt (110710); milk powder (04221); chocolate (180690), ethyl alcohol (220720); barley products (110429).

10. The reduction of trade barriers in the MERCOSUR member countries has followed several channels of liberalisation. In general, unilateral liberalisation preceded other strategies of reciprocal liberalisation (preferential or non discriminatory). The process of regional integration has not interfered with, but has instead reinforced, the liberalisation process, given more credibility to the process in terms of the commitment assumed. During the nineties unilateral liberalisation went on but, as has been mentioned, was accompanied by the regional integration process, for which reason it has not received much attention. During the first half of the nineties tariffs fell from about 18% to 13% for the MERCOSUR as a whole. In MERCOSUR the average tariff for the agricultural activities (sectors 1 and 2 CCP) are lower than for all products. Moreover, they are lower for raw materials from agriculture (sector 2) than for food, beverages and tobacco (sector 1).

11. The products imported by MERCOSUR are split into two groups. The first one includes 30 products with similar trade policies in the four member countries. Among products with above the average tariffs are sugar; chocolate; bottled water. In the second group, comprising 15 products, are those that according to the available information (1994 and 1995) have not yet been harmonised for the whole MERCOSUR. In Brazil, those with high tariff and non-tariff barriers are: peaches in syrup; dairy products, and wine. In Argentina the products with the highest tariffs are peaches in syrup; wine, and ethyl alcohol. In Paraguay, high levels of barriers are found for soya oil; rice, and sugar (unprocessed). Finally, in the case of Uruguay the highest levels of tariffs are for dairy products, wine, and ethyl alcohol.

12. The tariffs in the EU for tropical agricultural products (coffee, soya beans, tobacco) and fish are lower than the average, and equal to zero in some cases (soya beans and its derivatives). However, the tariffs for agricultural products from temperate climate are much higher. The trade specialisation patterns in the agricultural and fishing activities in MERCOSUR's member countries vary, and hence they are differently affected by protectionist policy. The differentiated effect between MERCOSUR members is found again for agricultural imports from the EU (the EU exports in agricultural products from temperate climate to these countries); these trade flows are distorted also by trade policy such as the export subsidies previously mentioned.

La multifonctionnalité de l'agriculture, le jeu des définitions

Catherine Laurent

Pour l'OMC (glossaire 1999) la multifonctionnalité de l'agriculture est le " *concept selon lequel l'agriculture a de nombreuses fonctions outre la production d'aliments et de fibres ; par exemple protection de l'environnement, préservation des paysages, emploi rural, etc.*"

Dans de nombreux pays on observe que la production de biens primaires aux conditions du marché (ou s'en rapprochant) ne permet plus que les autres fonctions de l'agriculture soient remplies de façon jugée satisfaisante par les citoyens. Ces défaillances du marché se traduisent par différents types de conséquences jugées socialement inacceptables, ainsi :

- certaines fonctions antérieurement assurées de façon jointe par la production agricole ne sont plus prises en charge (par exemple entretien du territoire dans certaines zones) ;
- l'évolution des pratiques agricoles, notamment sous l'effet des exigences accrues en matière de compétitivité, a engendré de nombreux effets négatifs (environnement, sécurité alimentaire, bien être animal, etc.) qui sont dénoncés depuis de nombreuses années sans que l'on observe d'amélioration marquante ;
- la contribution de l'agriculture à l'emploi rural (via des emplois à temps plein ou partiel), son rôle dans la cohésion économique et sociale, et sa fonction de refuge pour des ménages pauvres s'amoindrissent, contribuant ainsi à l'accroissement des disparités et des dynamiques d'exclusion.

Pour nombre d'acteurs il paraît donc nécessaire de concevoir et mettre en oeuvre des mesures correctrices adéquates. Le débat porte donc sur l'opportunité et nature de ces mesures.

Cependant, au plan international, les discussions sur la multifonctionnalité de l'agriculture restent passablement confuses. Cela tient à ce qu'il y a entre les différents pays des conflits d'intérêt importants et des désaccords sur la place relative du politique et de l'économique dans l'élaboration des accords internationaux. Mais cela tient aussi à ce qu'il n'y a pas de définition partagée de la multifonctionnalité. Cette note vise donc à faciliter les débats en exposant les différents registres d'argumentation et les définitions auxquels se réfèrent les discours sur la multifonctionnalité de l'agriculture.

Premier registre d'argumentation : le débat est purement *rhétorique*. L'effet Lampedusa de la multifonctionnalité de l'agriculture

Nombre d'acteurs considèrent que la "multifonctionnalité de l'agriculture" est simplement une formulation nouvelle destinée rendre plus présentables des politiques de soutien au revenu, à la compétitivité etc. qui ne peuvent plus être exprimées dans les mêmes termes.

On peut dénommer ce phénomène "l'effet Lampedusa de la notion de multifonctionnalité" en référence à G.T. Lampedusa qui a développé ce thème dans sa chronique de la vie d'aristocrates siciliens à l'époque du Risorgimiento. *"Si nous voulons que tout continue, il faut d'abord que tout change"*[16]. L'effet Lampedusa de la multifonctionnalité est dénoncé - ou utilisé- dans diverses circonstances (par exemple critiques de la position européenne dans les négociations sur la libéralisation des échanges commerciaux).

Lorsque les discussions se situent dans ce registre d'argumentation, le terme de "multifonctionnalité" est utilisé dans les sens les plus insolites jusqu'à devenir parfaitement incompréhensible. La "multifonctionnalité" peut par exemple être une expression synthétique désignant la position européenne dans les négociations internationales.

Nul n'est à l'abris du soupçon d'utilisation d'un effet Lampedusa. Ni les défenseurs de la reconnaissance de la multifonctionnalité, ni ceux qui y sont opposés : certains parlent aussi d'effet Lampedusa en évoquant la position de pays qui mettent en avant la pauvreté d'une partie de leurs agriculteurs pour défendre une dérégulation du marché international bénéficiant essentiellement aux plus grandes de leurs exploitations.

Mais l'existence d'un éventuel effet Lampedusa ne peut occulter que dans de nombreux cas, le discours sur la multifonctionnalité de l'agriculture renvoie à un débat de fond sur la place de l'agriculture dans la société.

[16] *Le guépard.* Seuil. 1968.

Deuxième registre d'argumentation, le débat sur la multifonctionnalité est celui *d'une nouvelle stratégie économique pour l'agriculture*

La question porte ici sur les modalités de l'intervention publique pour soutenir (transitoirement ou de façon permanente) des activités économiques dont la société souhaite qu'elles se poursuivent.

Cette première approche parfois qualifiée d'approche *positive*, s'appuie sur l'observation et la description des diverses fonctions de l'agriculture qui sont ainsi visées. Ainsi dans les travaux qui se déroulent à l'OCDE (2000) sur ce thème définit-on provisoirement les éléments clé de la multifonctionnalité comme : *"(i) the existence of multiple commodity and non-commodity outputs that are jointly produced by agriculture; and (ii) the fact that some of the non-commodity outputs exhibit the characteristics of externalities or public goods, with the result that markets for these goods do currently not exist or function poorly".*

Dans d'autres instances, les définitions s'appuient sur des *listes positives* d'éléments plus ou moins hétéroclites. Ces listes peuvent inclure notamment (mais cela dépend des cadres nationaux), outre la production de denrées, la sécurité alimentaire (garantie de la qualité des produits -assurance qualité, traçabilité- et maintien d'un potentiel productif), l'entretien du territoire (caractéristiques paysagères, cadre de vie, etc.), la contribution positive à la protection de l'environnement, au bien être animal, au maintien d'un tissu économique et social rural, au maintien d'un capital culturel, à la diversification des activités rurales.

Le raisonnement se situe résolument dans la sphère de l'économie. Dans un certain nombre de cas, ces approches stipulent explicitement que la reconnaissance du caractère multifonctionnel de l'agriculture doit se faire dans le respect du cadre des négociations pour la libéralisation des échanges commerciaux. C'est par exemple de sens de la position officielle de la FAO exprimée à Maastricht en septembre 1999.

Troisième registre d'argumentation, le débat sur la multifonctionnalité atteste *d'une stratégie politique sur l'économique, le social et les processus biotechniques*.

S'appuyant sur les constats qui motivent l'approche précédente, le troisième registre d'argumentation situe clairement le débat à un autre niveau : il s'agit de réfléchir à la place de l'activité agricole dans une société dont les objectifs ne sont pas seulement économiques et dont les instances de régulation légitimes sont les institutions politiques.

La question centrale devient alors celle de la reconnaissance de ce que les activités humaines ont des fonctions diverses dont l'analyse économique ne peut rendre compte entièrement. Elle s'inscrit dans une réaffirmation explicite des fonctions régaliennes de l'état et, en cela, s'oppose clairement aux approches qui souhaitent subordonner l'exercice du pouvoir politique des Etats à des règles du jeu fixées par des experts économiques.

La définition de la multifonctionnalité est alors centrée sur cette liaison entre un projet de société et les fonctions économiques, sociales et environnementales que peut remplir l'agriculture. La "vision française de la multifonctionnalité" s'inscrit explicitement dans ce dernier registre.

Dans cette optique, on peut définir *la multifonctionnalité de l'agriculture comme l'ensemble des contributions de l'agriculture à un développement économique et social considéré dans son unité (et incluant le maintien des ressources naturelles)* ; *la reconnaissance officielle de la multifonctionnalité exprimant la volonté politique que ces différentes contributions puissent être associées durablement de façon cohérente selon des modalités jugées satisfaisantes par les citoyens.*

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Souvent la confusion des débats sur le multifonctionnalité de l'agriculture ne résulte pas de l'ambiguïté des positions des acteurs pris individuellement mais de ce que les discours sont interprétés comme émanant d'un registre d'argumentation qui n'est pas celui dans lequel se situe l'interlocuteur. C'est évidemment une situation assez classique. Garder à l'esprit l'existence de ces différents registres d'argumentation peut permettre d'éviter des erreurs d'interprétation des positions énoncées.

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