Free Trade Agreement: EU x Mercosur

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1. EU x Mercosur FTA: An introduction

EU x Mercosur – General Information

Group	MERCOSUR	
Members	4	28
Countries	Argentina, Brazil, Uruguay and Paraguay	Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Sweden, UK*
Population	293 M	514 M
GDP per Capita	USD 16.185	USD 46.881
Extra Block Exports	USD 275.935 M	USD 1.781.305 M
Extra Block Imports	USD 219.521 M	USD 1.809.540 M

EU is Mercosur's 2nd biggest trade partner, and Mercosur is EU's 8th biggest trade partner.

42,1 B USD exports to EU; 34,7 B USD imports into Mercosur; 7,3 B USD superavit.

Source: World Bank, Mercosur and Eurostat webpages.

EU x Mercosur FTA – Time Line

- After 20 years of negotiation, the Free Trade Agreement between the Europe Union and Mercosur has been closed on June, 28, 2019.
- This agreement has its origins back in 1995, with the agreement of Madrid on cooperation, followed by the agreement of Rio to start negotiations in 1999, with 3 rounds of negotiation: Round 1: 2000-2004; Round 2: 2010-2012, Round 3: 2016-2019.
- The agreement does not produce immediate effect and must be ratified by the parts before it comes into force.
- The economic part of the agreement shall come into force provisionally after the European Parliament approval and the Mercosur countries ratification. The political part will depend on the ratification of the text by all State parties of the EU.
- In former FTAs, the EU has taken from 7 months to 3 years to formally sign the agreement.

1995	1999	2000-2004	2010-2012	2016-2019	2019	2019-2022	2023-2033
Madrid meetings	Rio meetings	Negotiations round 1	Negotiations round 2	Negotiations round 3	FTA closed on June 28th.	EU – 3 years to formally sign.	Full implementation of benefits

What will Mercosur gain with the Agreement?

It will be **easier for Mercosur to export to the EU**, as long as they respect the high standards of the EU. Access to the EU market will be more facilitated.

The Agreement will also help **integrate Mercosur industries** into the EU's highly innovative value chains and become more local players in the EU market.

More opportunities for Mercosur citizens to be able to provide their services in the EU.

Mercosur businesses may **sell more value-added products**, as opposed to raw materials, diversifying the economies.

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Opportunities versus Threats

- Opportunities for Export:
  - Better access of Mercosur companies in EU market
  - Possibility for selling more value added products versus raw materials
  - Mercosur companies might become more local players in the EU
  - AEO is facilitator to get goods easier into the EU market

- Opportunities for Imports:
  - Overall reduction of import costs, for products with similar and none similar industries
  - EU becomes a cheaper sourcing alternative
  - Increase of margins by the Mercosur importers
  - Investments in capital goods will become cheaper and is beneficial for the long term increase of production in Mercosur
  - Consumers gain easier access to certain high-end European products

- Threats for Imports
  - EU products become more competitive, can effect certain industries such as automotive, pharma, special chemicals, machinery and equipment
  - Multinationals might start to consolidate production plants on a transoceanic basis

EU x Mercosur FTA – Trade in Goods

Important to note that the tariff reductions / duty elimination for many goods will be implemented in **stages**, over a timescale of up to **15 years.**

EU

- **0 years** (80% of the products)
- **4 years** (coffee, cachaça)
- **7 years** (lemons)
- **10 years** (apples, orange juice concentrates)

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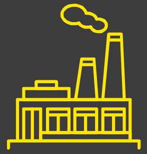
- **0 years** (vegetarian oils, 80% of metals)
- **4 years** (chemicals, textile)
- **8 years** (wines and champagne)
- **10 years** (milk products, auto parts, machines, shoes)
- **15 years** **(chocolate, cars)**

- The EU will eliminate duties on **92%** of goods (today it is 24%).
- Mercosur will fully liberalize **91%** of its imports from the EU over a transition period of up to 10 years for most products:



Industrial Sector

Agricultural Goods

Raw Materials

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EU x Mercosur FTA - Trade in Goods

Industrial Sector

Goods imported by Mercosur	Goods imported by European Union
91%	100%

Chemicals	Tariff reduction from 0 to 4 years
Machinery	Tariff reduction from 0 to 7 years
Medical equipment	Tariff reduction from 0 to 7 years
Auto parts	Tariff reduction from 7 to 10 years
Textiles	Tariff reduction from 0 to 4 years
Footwear	Tariff reduction from 7 to 10 years
Metals	80% of tariff elimination when the agreement comes into force. The remaining will occur from 4 to 10 years

Agricultural Goods

	Goods imported by Mercosur	Goods imported by European Union
Trade vol.	96%	82%
Tariff lines	94%	77%

EU will eliminate the tariffs on roasted and soluble coffee, avocados, lemons and limes, melons and watermelons, grapes, apples, fishes, vegetal oils, among others.

For other products, there is partial or full reduction through quotas, such as meat (beef, chicken and pork), sugar, ethanol, cachaça, rice, honey and corn. Quota volumes do increase in different installments

Mercosur will eliminate the tariffs on olive oil, whiskey, liquors and malt

For other products there is a partial reduction through quotas, such are cheese, milk powder, baby food, wines, champagnes, garlic, and chocolate

Raw Materials

The agreement will offer EU industries cheaper high-quality raw materials by reducing or eliminating duties that Mercosur currently imposes on exports to the EU of products such as soybean products;

The agreement prohibits import and export price requirements;

The import and export monopolies are also prohibited by the agreement

Challenges and Political Considerations

Import Challenges:

The increased competitiveness of EU products can effect certain Mercosur industries such as automotive, pharma, special chemicals, machinery and equipment.

Multinationals might start to consolidate production plants on a transoceanic basis.

Important Note:

Many EU suppliers do source in Asia, those goods will not benefit from the FTA, unless additional activities are performed in the EU.

Heavy focus on the Origin criteria, in order to avoid abuse of the agreement.

Political Considerations:

- The agreement represents a clear statement of intent for countries such as Brazil to become more open to foreign trade and less "protectionist".
- Local Tax reform and other domestic tax policies now come under the spotlight.
- Some opposition to the deal evident within the EU – for example Ireland and France meat producers.
- Mercosur keen to explore another significant deal with a "post-Brexit" UK

EU x Mercosur FTA - Main changes expected

Non-tariff barriers to trade in goods

Eliminating discriminatory tax treatment on imported goods

Trade in services and establishment in services manufacturing

Government procurement

Improving access to raw materials essential to the EU by lowering / removing export taxes, restrictions and monopolies

Smaller and Medium Sized Enterprises

2. Rules of Origin: Purpose and highlights

EU x Mercosur FTA – Rules of Origin

The Agreement provides a set of modern **rules of origin** that will facilitate trade flows between the EU and Mercosur.

They will allow exporters and importers on both sides to **benefit from the tariff reductions** under the agreement and are in line with EU practice in other recent FTAs.

Rules of Origin - Highlights

1. Modern Rules of Origin;
2. Not always simply Value Added (50 to 60%) or Tariff Shift;
3. More detailed rules of origin, in special on the most sensitive goods (PSR);
4. It is allowed the accumulated benefit of Origin and Drawback;
5. The use of Zona Franca under the agreement is not clear yet, no restrictions expected.

3. Next steps: What should companies pay attention to?

Next Steps - Main topics to note

Tax classification and quality of goods description for customs purposes (import and export operations).

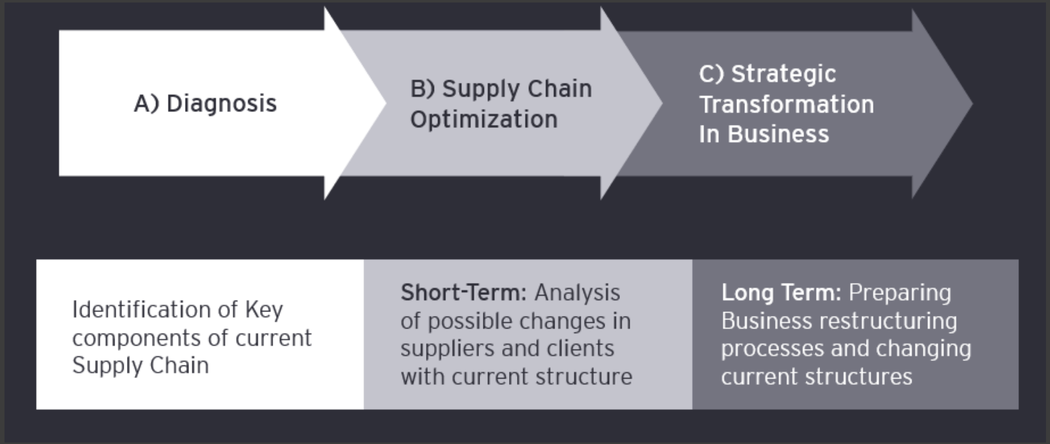
Traceability of the production process in order to comply with origin requirements.

Analysis of possible raw material suppliers in EU countries.

AEO Certificate and Customs Risk Management.

How to be Prepared for the Changes

- In the short-term it is important for companies with trade between these blocs to:
  - Perform Supply chain Impact assessments and modelling in order to understand the impact / opportunities
  - Strategic sourcing reviews.
  - Impact assessment related to new applicable origin rules, particularly relevant for manufacturers in Mercosur exporting to the EU.
  - Potential supply chain re-modelling based on the items above.



How to be Prepared for the Changes

A) Diagnosis	▸ With current structure, where are the most important suppliers and clients located? ▸ What is the current international trade among Mercosur and UE? ▸ How do customs barriers and tariff barriers impact profitability nowadays?
B) Supply Chain Optimization	▸ Are there alternative providers of raw materials/finished goods somewhere in the EU? ▸ How could the substitution of current suppliers for more efficient ones bring saving opportunities? ▸ What is the cost impact in local companies? ▸ Does the Multinational Group have suppliers in such countries? ▸ Would the FTA imply opportunities of sales to new EU markets? ▸ What are the main financial implications of Supply Chain changes? ▸ Will the suppliers need to adapt processes to follow the Rules of Origin defined by the FTA?

C) Strategic Transformation of Business	**New processes:** The Certificate of Origin issuing will have to be incorporated in companies' international trade departments.
	▸ Does the FTA create possibilities of redeployment of Functions, Risks and Assets within the Group?
	  ▸ From LRD to Full Fledge Distributors (or the other way round)
	  ▸ From Full Fledge manufacturers to Contract Manufacturers
	  ▸ From Contract Manufacturer to Distributor
	  ▸ Creation of regional supplier (in UE)

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Example of a possible case

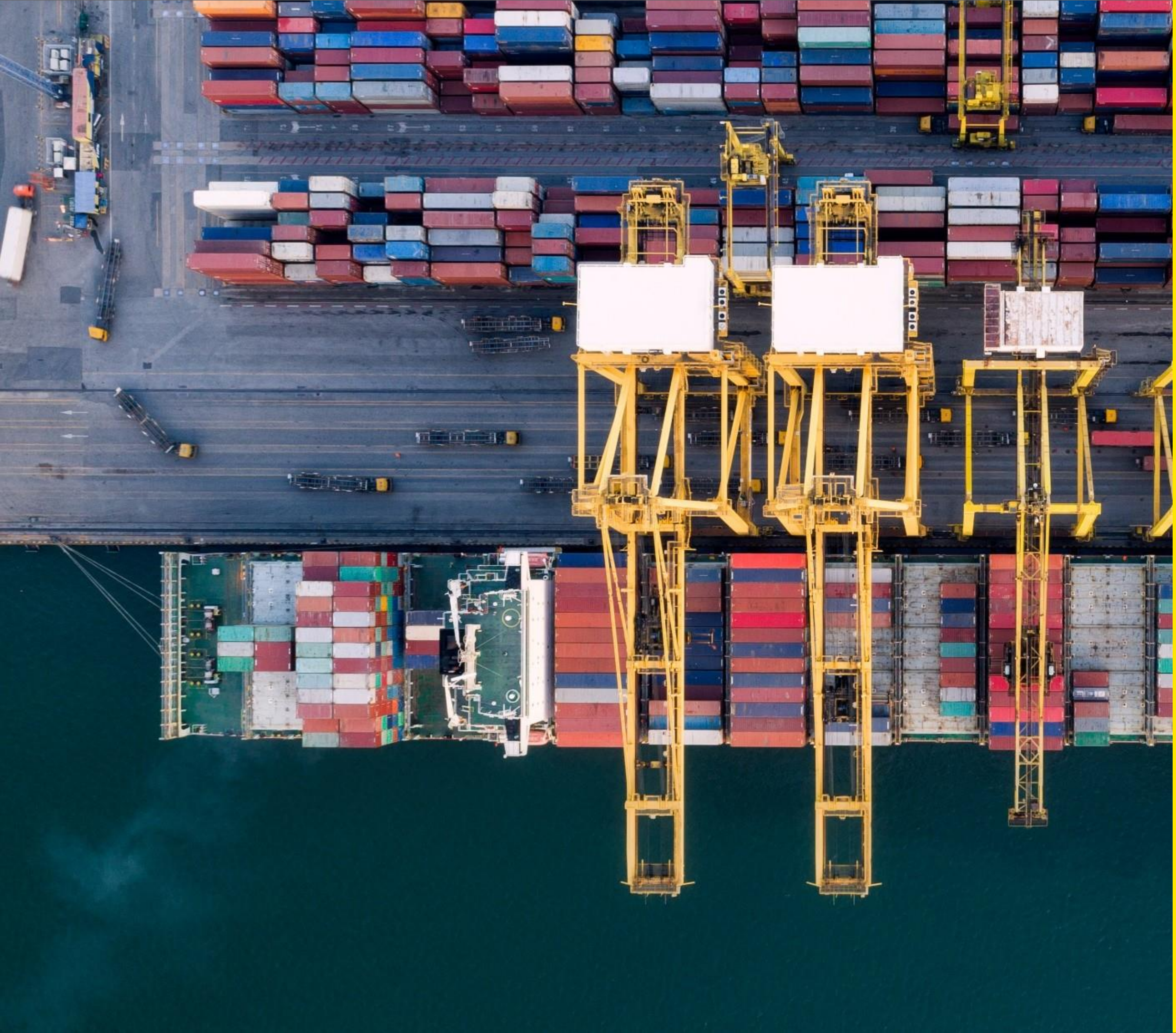
Manufacturer / Supplier → Sale of finished goods → Limited Risk Distributor → Resale in local market → Final Consumer

MERCOSUR

MERCOSUR

Before the Agreement	▸ Finished goods are imported with high tariffs when a Mercosur Distributor buys them from a UE supplier. High tariffs are then translated to cost basis and to final consumer prices (cost + mark up).
After the Agreement	▸ Finished goods will be imported with low/no tariffs when they come from the same supplier in UE.

- What would be the effect on prices of final products in Mercosur markets?
- Would these changes bring about extraordinary profitability levels for local distributors?
- How should such surplus be divided among the different parties involved?



Q&A