EU and Mercosur seal agreement following decades-long negotiations

Just in time for Christmas, it seems miracles do happen after all. A trade agreement between the EU and Mercosur has been finalised, potentially creating one of the largest free trade zones in the world; it covers over 700m people and 20% of global GDP. There are signs of resistance among EU members, however, and the ratification process could still fail

A trade deal between the two economic blocs would be welcome amid a global climate engulfed by a new era of protectionism, but we think the chances of success remain slim

Since 1999, the EU and Mercosur (comprising Argentina, Brazil, Paraguay, Uruguay, and since 2024, Bolivia) have been negotiating a trade agreement. While an agreement in principle was reached in 2019, EU members refused to ratify the deal.

Today at the Mercosur Summit in Uruguay, attended by EU Commission President Ursula von der Leyen, the agreement took a significant step closer to finally coming into effect, with both EU and Mercosur states signing the deal.

Trade agreement to slash tariffs, saving EU companies €4 billion annually

The trade agreement foresees the following (amongst other factors):

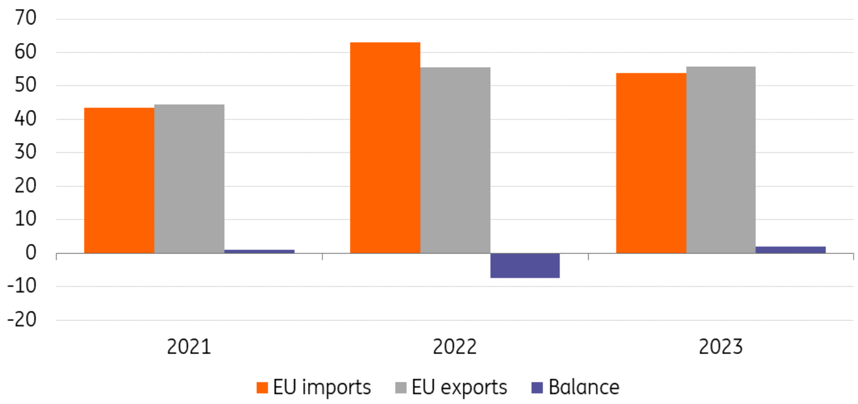
- **Tariff reductions**: The agreement will remove over 90% of tariffs on goods exchanged between the two blocs, saving EU companies around €4 billion worth of duties each year. For some products, duties will be phased out over longer periods to provide companies in Mercosur countries with a sufficient amount time to adapt.
- **Easier market access**: Elimination of non-tariff barriers, discriminatory tax treatments, and the facilitation of trade in services.
- **Sustainability**: Provisions to ensure that trade does not come at the expense of environmental and labour standards.

If approved by the EU member states and the EU parliament, this would create one of the largest free trade zones in the world. The EU and the five Mercosur states together make up 20.2% of global GDP, with the EU contributing the lions share with 17.4% (Brazil: 2.1%, Argentina: 0.6%, Uruguay: 0.1%, Paraguay and Bolivia: 0.04% each).

In terms of population, the trade deal would unite 730 million people (450 million in the EU), or about 8.9% of the global population. While goods trade between the two blocs is still relatively small, totalling €109.4bn in 2023, the EU is Mercosur's second-largest trade partner for goods, following China and ahead of the United States. Conversely, Mercosur ranks as the EU's tenth-largest trade partner for goods. When it comes to trade in services, the EU has exported €28.2bn to Mercosur, while Mercosur exported €12.3bn to the EU in 2022. The trade deal is expected to significantly boost goods trade between the two regions.

Trade in goods between the EU and Mercosur

(in € billions)



Source: European Commission

The pain and gain of some of the main sectors involved

But here's the catch, and the reason why the agreement hasn't been signed in five years – it faces significant opposition. France and Poland, amongst others, are openly opposing the trade deal. Meanwhile 11 countries – Germany, Spain, Portugal, Sweden, Denmark, Finland, Croatia, Estonia, Latvia, Luxembourg, and Czechia – recently called for the swift conclusion of the deal in a letter to the President of the Commission. Germany, for example, sees Mercosur as a key market for its auto exports. Currently, average car tariffs on imports into Brazil, for instance, stand at 35% compared to an import tariff of 10% in the EU.

Food and agri – mixed reactions

Food and agri products represent the biggest part of the EU's imports from Mercosur, with total a total import value of 23 billion euros in 2023 (42% of total imports). The agreement will facilitate trade growth due to a mix of larger import quotas as well as reduced and removed tariffs and duties on products like beef, poultry, sugar and soybeans. That's stirring discontent among EU beef, poultry, sugar beet and soybean farmers, given that their Mercosur counterparts can operate at lower costs.

Other companies in the food sector are more supportive. This is either because they can benefit from lower input costs, like confectionery and soft drinks manufacturers, or because the deal creates better market access for European cheese, beer, wine and spirits exporters.

For EU consumers, we would argue that any deflationary impact on food prices will be difficult to spot. Firstly, quotas will likely be expanded over multiple years to avoid market distortions. Secondly, quotas will be larger but they still represent only a small portion of total EU consumption. Thirdly, the costs of these products make up only a part of the final price that consumers pay. In the case of a premium steak bought in a restaurant, factors such as labour costs are also an important part of the equation.

Automotive – slashing the barrier could be positive for European exporters

A trade agreement between the EU and Mercosur countries could bring some light to the darkness for the struggling European car industry. Current tariffs of up to 18% on autoparts and even 35% on cars are obviously not very beneficial for export propositions. EU countries exported €1.1bn of passenger cars to Brazil, the bloc's largest market, in 2023 and Germany was responsible for almost 60% of this. Altogether – and including the largest category automotive parts – EU countries exported almost €5bn worth of vehicles and automotive parts to the Mercosur member states.

Including Bolivia, the Mercosur members produce just about as many cars as their domestic sales annually, but a significant chunk of this is exported to the rest of South America as the continent hardly has any other production sites outside of Brazil and Argentina. South America has a production deficit of about 30%, making it dependent on car imports. South American car markets therefore provide more growth opportunities than the sluggish European home markets.

Driven by high import tariffs, European manufacturers like the Volkswagen Group and Daimler Trucks have established their manufacturing sites on the continent. A reduction in tariffs could boost production in Europe, where occupancy rates are currently low.

Critical raw materials – a key element in the deal

While critical for the EU's economic future, raw materials like lithium are making less headlines in the coverage of the free trade agreement. That's surprising, given that a) the EU is very dependent on China for critical raw materials, b) countries like Argentina, Bolivia and Brazil hold large reserves of some of these critical raw materials and c) EU demand for these materials is expected to massively increase.

We've previously written about how demand for lithium batteries (which power electric vehicles and energy storage) is set to increase 12 times by 2030, while the bloc's demand for rare earth metals, used in wind turbines and EVs, is set to rise five to six times by 2030. It may be difficult to quantify the exact economic value of having better access to these materials through closer ties with Mercosur, but we believe this particular element carried a lot of strategic weight for the EU Comission when striking the deal – especially as diversification or sourcing and securing supply is currently top of mind.

More farmers' protests loom as EU-Mercosur agreement nears completion

The signing of the trade deal is expected to spark new protests from farmers – particularly those in France – who strongly oppose it. This response will mostly be borne out of a fear that the elimination of tariffs will lead to a substantial inflow of cheaper South American agricultural products, particularly beef, with products not meeting Europe's stringent environmental and food safety standards. French President Emmanuel Macron might even face stronger pressure at home, given that he was unable to stop this deal and that it looks unlikely he'd sign the Treaty in the current political situation in France.

In Poland, the Netherlands and Austria, farmers fear that the deal will lead to unfair competition, doesn't meet the EU's environmental ambitions, and contributes little to GDP for some member states. The expected GDP boost for the Netherlands is only 0.03% in 2035, compared to a GDP gain of 0.23% for Spain, for example.

The ratification process could fail again

If the trade agreement is signed in its current form, i.e., a 'mixed' agreement including both trade and non-trade measures, it would necessitate approval from the European Parliament as well as all national parliaments. It would also require ratification by all 27 EU member states. While the EU can negotiate trade agreements on behalf of its members with a qualified majority, any agreement involving shared competence between the EU and its member countries must be ratified by each member state. Remember that also the Canadian-European Trade Agreement (CETA) has not been ratified yet by all member states.

To avoid repetition of the CETA experience, the EU could therefore split the agreement into two parts: the pure trade agreement and the non-trade measure part. For the pure trade part, a qualified majority vote would be required instead of approval from all 27 members, meaning that at least 15 EU member states representing 65% of the EU population would need to approve. Consequently, at least four member states representing 35% of the EU population would be needed to block the deal. The same procedure had been in place for the tariffs against electric vehicles made in China.

A beacon of hope amid global protectionism

This agreement comes at a time when the world is facing increasing protectionism, with US President-elect Donald Trump returning to the White House. He has made no secret of his fondness for tariffs. However, protectionist tendencies are not solely limited to Trump.

This week, Beijing announced export bans on key minerals such as germanium and gallium in retaliation against US controls on semiconductor technology. Additionally, new tariffs worth $18bn on Chinese products will take effect in January 2025 and 2026. Elsewhere, the EU has also stepped up its protectionist measures against China this year – and Mercosur countries aren't holding back either. Brazil introduced import tariffs on electric vehicles (BEVs) of 10% at the start of the year, climbing to 18% in July and up to 35% in 2026.

A trade deal between these two economic blocs would be welcome amid a global climate engulfed by a new era of protectionism, and would be significant step towards ongoing trade liberalisation. However, the likelihood of success remains slim – and we're interested to see whether free trade supporters can prevail over the protectionists this time around.

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