Atradius
Managing risk, enabling trade

EU moving forward with free trade deals

Atradius Economic Research – July 2019

Summary

- The EU continues to buck the international protectionist trend, signing two historic trade agreements.
- The EU-Mercosur Association Agreement would create a market of 780 million consumers. It would slash tariffs for EU exporters, especially of machinery and autos, and offer substantial opportunities for Mercosur's agricultural sector.
- The EU-Vietnam Free Trade Agreement marks the EU's first FTA with a developing country in Asia. It integrates Vietnam more closely into the global economy and offers better market access for EU exporters of automotive, machinery and food products.

Two trade deals sealed

Squeezed between US protectionism and Chinese state-backed capitalism, the European Union is asserting itself as a torchbearer of the international trading system. As the US and China seized headlines during the G-20 conference with a temporary truce in bilateral retaliatory trade measures, the EU moved forward with two historic free trade agreements.

On June 28, the EU and Mercosur (Argentina, Brazil, Paraguay, and Uruguay) concluded a landmark trade deal after 20 years of negotiations – the first trade deal with the relatively closed South American trade bloc. Two days later, the EU-Vietnam Free Trade Agreement (EVFTA) was sealed, marking the first such trade deal with a developing Asian country.

The goals of both trade agreements are the same:
- To facilitate trade between the trade blocs by improving market access
- To create jobs and strengthen workers' rights
- To protect the environment and encourage corporates to act responsibly and sustainably
- To protect quality food and drink products from imitations (rules of origin).

Both agreements are expected to face uphill battles in their ratification processes. However, they set a strong example globally against the current trend of protectionist and unpredictable trade policies, and should offer expanded trade opportunities.

Improving market access is the key

As with any trade agreement, increasing market access is a key component of both the EVFTA and EU-Mercosur free-trade deals. Five key elements characterise both agreements.

1. **Elimination of import duties**. Tariffs on the majority of imports between the EU and Mercosur and the EU and Vietnam will be eliminated over time, increasing

competitiveness of goods exports in the respective destination markets.

2. **Easier compliance procedures and product standardisation**. Simplified customs procedures promote transparency and the use of international standards on products. Reducing non-tariff barriers reduces costs arising from complying with different technical regulations and standards.
3. **Support for small- and medium-sized enterprises (SMEs).** SMEs are disproportionately affected by red tape (such as customs, costly testing and certification requirements, and lack of transparency in product standards). Both agreements particularly promote market access for SMEs.
4. **Protection of labour rights and the environment.** Mercosur countries and Vietnam join the EU in showing commitment to effectively implementing the Paris Agreement on climate change and the International Labour Organisation's fundamental standards on labour rights. Both agreements include commitments to conservation and sustainable management of wildlife and biodiversity.
5. **Support for farmers and protection of regional specialties.** Geographical indications, including the ability to add new products to the protected list in the future, ensure quality and protection for food producers.

Mercosur opens its doors

The signing of the EU-Mercosur Association Agreement is the first significant trade deal signed by Mercosur since its establishment in 1991. This will help the relatively closed markets in South America, especially Brazil and Argentina, boost economic growth. At the same time, the EU will benefit from a first mover advantage, offering better market access than given to other countries.

EU-Mercosur trade relationship

Combined, the EU and Mercosur is a market of **780 million consumers** and accounts for about **25% of the world economy.**
More than **USD 50 billion** worth of goods flowed in both directions in 2018.
Mercosur is the EU's **tenth** largest export market. EU exports to Mercosur are primarily **machinery**, **chemicals and pharmaceutical products**, and **transport equipment**.
The EU is Mercosur's **second** largest export market (behind China). The main export products are **foodstuffs,** including beverages and tobacco, vegetable products, and meat.

The EU-Mercosur free-trade agreement is no done deal. The principle agreement still needs to be approved by the European Council and European Parliament, as well as by the national legislative bodies in the member countries of both blocs. The agreement faces strong opposition from EU farmers, particularly those in France. Moreover, there is still a risk that Argentina may opt out if President Macri loses the October election to the left-wing populist ticket of former President Kirchner.

Potential gains for EU industries

On top of the EU's first mover advantage, this association agreement marks the largest deal the EU has ever struck in terms of tariff reduction. Import tariffs on 91% of EU goods exports to Mercosur will be eliminated over time. The European Commission estimates that this will save more than EUR 4 billion on an annual basis – fourfold the savings estimated by the EU free-trade agreement with Japan. The sectors that particularly benefit are those where customs duties are currently high.

Mercosur to remove tariffs on key EU export sectors:

Sector	Current tariffs	
Automotive	Cars 35% Car parts 14% - 18%	0%
Machinery	14% - 20%	
Chemicals and pharmaceuticals	Chemicals 18% Pharmaceuticals 14%	
Textiles and clothing	Up to 35%	
Food and beverages	Up to 35% on products including chocolate, dairy, spirits and wine	

Finally, the pact will offer improved access to public tenders and maritime services. For the first time ever, Mercosur countries will open up their government procurement markets. They will also improve the transparency of tendering processes.

Potential gains for Mercosur industries

For the Mercosur countries, the agreement eliminates tariffs on 93% of exports to the EU and grants preferential treatment to the remaining 7%. Moreover, it signals that the South American bloc is finally ready to liberalise its markets after many years of protectionism. This is particularly relevant for Argentina and Brazil, which are among the most closed economies in the world. If ratified, the agreement will raise competitiveness, investments and productivity, thereby lifting potential economic growth in Mercosur's member-states.

Agriculture is the trade sector that will benefit most. Brussels agreed to reduce barriers on 82% of agricultural imports, although quotas will be enforced on some sensitive farm products like beef (99,000 tonnes per year max). Meat, fruit, orange juice, sugar, and ethanol in particular will gain improved market access. Better access to overseas markets is of major importance for Mercosur, due to the pivotal role the agricultural sector plays in the economies of all four member-states.

Vietnam solidifies its free-trade reputation

On 30 June 2019, the EU and Vietnam finally signed the free trade agreement already negotiated in December 2016. Once ratified by the legislative bodies of the EU and Vietnam, the FTA will eliminate 99% of all tariffs on both sides, reduce regulatory barriers and overlapping red tape, and increase the use of international standards by Vietnam. While promising, this agreement is also not a done deal as some European lawmakers are concerned about Vietnam's human rights record.

EU-Vietnam trade relationship

- Combined, the EU and Vietnam create a market of more than **600 million consumers** and account for more than **20% of the global economy**.
- The EU exported **USD 13 billion** worth of goods to Vietnam in 2018, while Vietnamese exports totalled **USD 45 billion**.
- Vietnam is the EU's 31st largest export market. EU exports to Vietnam are concentrated in high tech products, including **electrical machinery**, **vehicles**, and **pharmaceuticals**.
- The EU is Vietnams' **second** most important export market behind the US. Main export goods are **electronic products**, **textiles**, **coffee and rice**.

Potential gains for EU industries

Vietnam is one of Asia's fastest growing economies, regularly flagged by Atradius as one of the most promising export destinations. With 99% of tariffs being eliminated, several EU sectors will benefit from improved market access.

Vietnam to remove tariffs on key EU export sectors:

Sector	Current tariffs	
Automotive	Cars up to 78%	**0%**
Machinery	Up to 35%	
Chemicals and pharmaceuticals	Pharmaceuticals up to 8%	
Food and beverages	Dairy up to 20% Wine 50% Chocolates 30%	

European companies will also gain improved access to public tenders, including infrastructure projects (similar to the agreement with Mercosur). EU service providers will also get significantly better access to postal, environmental, financial, and maritime services. Furthermore, 169 traditional European food and drink products will be protected against imitation in the Vietnamese market.

Potential gains for Vietnamese industries

A major trade deal with the EU helps to boost Vietnam's competitiveness in its second-largest export market. On top of the many free-trade agreements that Vietnam has already signed, it underlines Vietnam's status as a stalwart of international trade and further integrates the country into the global economy.

With customs duties being nearly entirely eliminated, Vietnamese exports will be more competitive in the EU. Exporters active in the **food & beverage**, **textiles/footwear**, **furniture**, and **electronics/ICT** sectors will benefit most. Exporters of traditional Vietnamese products like local tea and coffee will also be protected in the EU. Additionally, modernising Vietnam's legal framework and improving food safety and quality standards will boost welfare and increase investment.

Long-term gains outweigh short-term pain

Reductions in tariff and non-tariff barriers and mutual commitment to sustainability and human rights offer significant opportunities for the EU, Mercosur, and Vietnam. However, there are also challenges ahead, especially for companies facing increased import competition. In Europe, concerns are highest in the agricultural sector, as cheaper imports from abroad may crowd out domestic products. In Vietnam and Mercosur, the concerns primarily lie in the manufacturing sectors, which will also face increased competition from high-quality EU imports. This holds especially true for Mercosur, which has a long history of protectionism. Therefore, those markets will reduce their tariffs over a longer time horizon in order to ease the transition for businesses.

While there may be some potentially painful adjustments, the long-term prospects of these trade pacts offer major opportunities. In Vietnam and Mercosur, increased competition will force the governments to implement regulatory and tax reforms. At the same time businesses will have to increase quality and productivity. Both will boost investment and international competitiveness. In the EU, on top of improved access to two large markets, consumers should benefit from lower prices for some goods. Additionally, increased competition spurs innovation, which could increase competitiveness and productivity of EU producers.

Greetje Frankena, principal economist
greetje.frankena@atradius.com
+31 20 553 2406

Dana Bodnar, economist
dana.bodnar@atradius.com
+31 20 553 3165

If you've found this economic update useful, why not visit our website www.atradius.com, where you'll find many more Atradius publications focusing on the global economy, including country reports, industry analysis, advice on credit management and essays on current business issues.

Connect with Atradius on social media

Disclaimer

Atradius N.V.
David Ricardostraat 1 – 1066 JS Amsterdam
Postbus 8982 – 1006 JD Amsterdam
The Netherlands
Phone: +31 20 553 9111

info@atradius.com
www.atradius.com