Comparative Analysis of Agricultural Policies of the Extended[1] MERCOSUR and the European Union

(Draft: 29 July 2008)

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[1] This comprises the MERCOSUR members and associate countries that make up the Agricultural Council of the South (CAS - Consejo Agropecuario del Sur), namely Argentina, Bolivia, Brazil, Chile, Paraguay and Uruguay.

This study corresponds to the **Final Report** *'Deliverable 8'* of the *'Work Package 3'* (WP3) component of the EUMERCOPOL Project (SSPE-CT-2005-006516) 'Agricultural Policies: Analysis of Competitiveness of MERCOSUR's Main Agro-foodstuffs Sectors, Comparison of Policies and Impact ex-ante EU-MERCOSUR Trade Liberalisation'.

This project is funded by the European Commission as part of its Sixth Frame Programme.

The opinions expressed in this study are the exclusive responsibility of the authors and may not agree with those of the organizations involved.

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EXECUTIVE SUMMARY

Bilateral trade negotiations between the European Union and MERCOSUR (Argentina, Brazil, Paraguay and Uruguay) began in 1995. After an initial phase of dialogue at the political level, in 2001 the two blocks commenced negotiations on the goods and services to be included in the trade liberalisation process. In this framework, a first list of sensitive products was drawn up, and agricultural products feature heavily on this list.

In this context, in order to understand the two blocs' negotiating positions it is vitally important to have a comparative analysis of their respective agricultural policies, since these policies are based on each side's agricultural policy objectives and the kinds of instruments used to pursue these objectives.

In this report we review different studies of the subject and undertake an analysis from two specific angles: (i) first, we cover agricultural policy in all its dimensions, with detailed consideration of trade aspects (market access and measures relating to exports), and with particular emphasis on internal policies to support agriculture; and second, we approach this question from the perspective of EU-MERCOSUR bilateral free trade negotiations so as to identify the policy measures most relevant to the negotiations. Our analysis in this study is based on information gathered by IICA, ECLAC and CIRAD, and also REDPA's[2] contributions, which have been systematized in a database developed at ECLAC.

The context of EU-MERCOSUR trade relations

In order to carry out this comparative analysis of policies, some of the outstanding characteristics of the relations between the two blocs must be taken into account:

- In the economic field the two regions are clearly asymmetrical. EU-25 has a total population of just under double that of the extended MERCOSUR, and generates 9.3 times the GDP and seven times more exports than the southern bloc. These figures go a long way towards explaining why EU-25's per capita GDP is more than five times greater than that of the extended MERCOSUR.

- This asymmetry, however, has not impeded the development of strong links between the two blocs. First, Europe is a major foreign investor in the extended MERCOSUR, particularly in Brazil and Bolivia, and in Chile, where EU investment accounts for more than one third of total foreign investment. Thus an association agreement between the two regions would not only improve conditions for European investors by providing greater legal security, it would also directly foster increased trade flows between MERCOSUR and the EU nations and give rise to increased profits for European firms located in MERCOSUR countries. Second, MERCOSUR's

[2] REDPA, the Regional Network for the Coordination of Agricultural Policies, is made up of the Agricultural Policy Directorates of the six countries in the extended MERCOSUR which are members of CAS.

agricultural exports account for more than 20% of Europe's total agricultural imports and generate a global trade balance very much in MERCOSUR's favour. Due to the fact that agricultural products loom so large in the bilateral relationship it is vital that they be adequately considered in the negotiations as otherwise MERCOSUR's trade balance may become negative in a framework of trade liberalisation, and thus the partner that is less developed economically would be negatively affected.

- It should be noted that, although EU-MERCOSUR trade links are strong at the present time, there is no preferential trade treatment between the two blocs with the exception of the Generalised System of Tariff Preferences (GSP) that is applied by the EU to the MERCOSUR countries, the GSP Plus applied in the case of Bolivia, and the mutual preferences established in the Economic Association Agreement between Chile and the EU.

Differences between the two blocs' agricultural policy objectives

The objectives of the EU and MERCOSUR agricultural policies can be clearly differentiated.

Although it is true that the goals of the EU's common agricultural policy have evolved over the last fifty years, a basic structural principle in community policy is still to defend European agriculture. In Europe, the initial objective was to increase production and productivity to cope with the food deficit in the 1950s and 60s, but this has gradually been replaced by multiple objectives such as adapting production to market needs, bringing agricultural policy instruments into line with World Trade Organization (WTO) requirements, environmental protection, land organization and ensuring the sanitary quality and safety of foodstuffs.

In MERCOSUR, over the last two or three decades, the countries' agricultural policies have focused on improving competitiveness so as to be able to enter international markets. These countries evolved very well with regard to the objectives of the 1970s and 80s when the state sector played a predominant and even overbearing role, and public entities were involved in storage, marketing, credit and providing subsidised services. In the mid and late 1980s the focus of agricultural and trade policies changed, there was widespread deregulation in the MERCOSUR economies, countries' markets were liberalised and import tariffs were drastically cut. All this meant a loss of protection for domestic markets. In recent years the trend has been to open up economies and insert into international markets, and this has increasingly involved policies to support the incorporation of small rural agricultural units into commercial chains, policies of rural development to support marginal and small farmers, and policies to combat rural poverty.

Differences between the two blocs' agricultural trade policies

As noted above, the Southern Cone countries have liberalised their economies and drastically decreased their levels of support for agriculture, while the EU policy, in total contrast, has been to promote generalised measures to support agriculture. This is reflected in policy instruments in the sphere of entry into markets, support for exports and internal support for the agricultural sector.

Access to markets

EU policies on access to markets differ from the MERCOSUR approach in that the Europeans make use of all available instruments for protection (tariff peaks, tariff escalation and tariff rate quotas (TRQ).

- The average tariff applied by the European Union on agricultural produce is almost double that applied by the extended MERCOSUR. While the EU applies an average tariff of 20.2% on agricultural produce from MERCOSUR (with the exception of Bolivia (12.2%) and Chile (16.0%), the MERCOSUR countries apply an average tariff of 12% on European agricultural produce (less in the cases of Bolivia (10%) due to GSP Plus, and also in the case of Chile (under 6%) due to its bilateral agreement with the EU).

- Even though European Union average tariffs are quite moderate, there are very high tariff peaks for some specific agricultural products that are considered sensitive by European producers. One example of this is sugar, for which the maximum tariff-rate quota applied in 2005 reached 245%, while certain meat products were taxed at 275%, flour at 222% and certain dairy products at 313%. In general, the MERCOSUR member countries do not apply these levels of tariff peaks to restrict trade. There are some relatively modest cases that do not exceed 22%, like some instances in the sugar and confectionary chapters (35% Paraguay), beverages (21.5%), tobacco (21.5%) and price bands that are in use in Chile.

- The European Union applies a broad system of tariff quotas. The chapters with the greatest number of tariff-rate quotas are meat, cereals, dairy products and sugar. For MERCOSUR agricultural products, contingency tariffs are a key instrument to gain access to the European market because the main South American agricultural exports are subject to tariff quotas when entering the EU market, and the level of this tariff quota protection is one of the most delicate points in the bilateral trade negotiations between the two blocs. It should be noted that tariff quotas are assigned to individual MERCOSUR countries and cannot be transferred from one country to another.

- The matter of European tariff quota protection measures applied to MERCOSUR agricultural produce is complex because it is closely linked to multilateral negotiations conducted under the umbrella of the WTO. It is necessary to distinguish between European tariff quotas specific to MERCOSUR and *erga omnes* tariff quotas that apply to all countries and for which MERCOSUR countries must compete with other WTO members.

Measures related to exports

The European Union has been exercising its right, which has been affirmed at the WTO, to subsidise exports by means of a mechanism called ‘export refunds’, whereby any European exporter receives a subsidy to compensate for the gap between the European price and the price prevailing on the world market.

These export refunds, which amounted to large sums in the 1990s (up to 12 thousand million euros at the beginning of the decade) have dropped sharply since that time. The progressive fall in European prices after the 1992, 1999 and 2003 common agricultural policy reforms has reduced refunds to such an extent that they came to just under 2.5 thousand million euros in 2006. Previously this system was applied to meat and cereals but today it is applied mainly to sugar and dairy products, and in 2005 these sectors accounted for 72% of total export subsidies (1,141 million euros for dairy products and 1,081 million for sugar).

In spite of this sizeable reduction in European subsidies, they are still onerous in comparison to the MERCOSUR system, which does not involve this kind of subsidy. On the contrary, some countries such as Argentina levy heavy taxes on agricultural exports and this has a negative effect on the international competitiveness of these products**.**

Domestic support

There is no doubt that domestic support is far greater in the EU than in MERCOSUR. According to OECD calculations, the estimated Producer Support Estimated (PSE) in Europe in the 2002-2004 period was 34%, but in the extended MERCOSUR it was under 5%.

Despite this, it must be stressed that this mechanism for domestic support through the Common Agricultural Policy (CAP), whereby producers were guaranteed high prices, has changed during the different reforms to the system of direct assistance for producers' incomes, a mechanism that supposedly causes less distortion to international prices. Until 2005 internal assistance was linked to production activity and was dealt with through the different common market organizations (COM). In 2005 most domestic support was transferred to the new Single Farm Payment (SFP), whereby each producer receives a single annual payment which is not linked to what is produced and which is reckoned in accordance with payments received during the reference period in prior years. In 2005, direct assistance for income, which came to 33.7 thousand million euros, accounted for 69% of the total CAP budget.

Likewise, the relative weight of the sums allocated to the second pillar (Rural Development) in the global CAP budget has increased every year since the 1990s. In 2001 the second pillar accounted for 10.3% of the CAP budget, in 2005 13.9%, and in 2006 15.4%. Measures for rural development are divided into three categories: (i) restructuring and fostering competitiveness, (ii) environmental protection and (iii) land organization.

In the extended MERCOSUR there is no common agricultural policy and support for the agricultural sector can be measured by public spending allocated to the sector, which varies considerably from one country to another within the bloc. In 2005 Chile spent the equivalent of 9.9% of agricultural GDP. It was the country with the highest public expenditure on agriculture, followed by Uruguay with 8% and then Bolivia with 4.8%, while Paraguay spent the least, 2.1%. It is worth noting how small a proportion of public spending goes on agriculture in countries like Argentina (3%) and Brazil (2.67%). A large part of this spending is aimed at fostering production, but this does not apply to Uruguay where social expenditure is the biggest budget item followed by expenditure on infrastructure, and expenditure on fostering production comes only third on the list.

Expenditure on support for research and development in the different countries in the MERCOSUR region is still insufficient. In relative terms, Chile is the country that allocates most to this area, 1.02% of agricultural GDP, followed by Bolivia, Brazil and Argentina. Uruguay comes last in the ranking with only 0.4% of sectorial GDP.

Tax pressure on the agricultural sector – measured as the total of taxes levied on agriculture divided by agricultural GDP – varies considerably across the countries in the MERCOSUR region. According to this indicator, and on the basis of the policy matrix as reported to REDPA, in 2005 Argentina would seem to be the country applying the greatest tax pressure at 23.30%, followed by Paraguay with 7.37%, Uruguay with 6.90% and Brazil with 2.76%. It would seem that Bolivian agricultural producers hardly pay any taxes at all, since the tax burden in that country, apparently, amounted to only 0.06%.

Key subjects in the bilateral negotiations

In the light of the contextual factors mentioned above, it is possible to identify the following key subjects in the EU-MERCOSUR bilateral negotiations:

- MERCOSUR is clearly on the offensive in the sphere of agriculture and it is promoting trade opening and market liberalisation in this sphere. The European Union, on the other hand, is maintaining a position that amounts to a defence of its own agricultural production, and it is providing internal support and applying mechanisms to control the volume of imported agricultural produce by maintaining tariff quotas.

- As a consequence of this, the key point for MERCOSUR in the negotiations is to obtain greater access to the European market for its agricultural products. But greater access is unlikely to be obtained through a reduction in the EU tariffs applied to products the Europeans consider sensitive but which are most important for MERCOSUR exports. Given that it is improbable that the EU will drop its tariff quota system, the way forward in the negotiations would have to be through an increase that is acceptable to MERCOSUR in the tariff quotas the EU assigns to imports of agricultural products from the region, and a consensus agreement on the tariffs to be applied in the trade quota.

- In addition, agricultural negotiations cannot be dealt with in isolation from the global framework of the negotiations, which also includes manufactured goods and services. It is obvious that the EU will not substantially improve its 2004 agricultural offer unless there is an improvement on the part of MERCOSUR in connection with the offer about measures governing manufactured goods and services.

- It should also be borne in mind that Europe's support for its agriculture places EU producers in an advantageous competitive position in international markets (although to a lesser extent now due to the policy of 'decoupling') in comparison to their MERCOSUR counterparts, which have no such support and are in fact labouring under a considerable tax burden on the sector. This complicates still further the trade negotiations between the EU and MERCOSUR, and its impact extends far beyond bilateral agreements. The subject of internal assistance cannot possibly be solved at the bilateral level, and will thus depend on developments at the multilateral level of the WTO.

- In a similar way, granting greater tariff quota latitude for MERCOSUR countries is closely linked to the multilateral negotiations in which the EU grants *erga omnes* tariff quota advantages that are open to all countries on a competitive basis. The question is whether the tariff quota advantages the EU grants MERCOSUR are to be a part of the *erga omnes* global tariff quota advantages which have already been established at the WTO, or whether they will be additional to these.

1. INTRODUCTION

Bilateral trade negotiations between the European Union and MERCOSUR started in 1995. After a first phase of dialogue at the political level, in 2001 the two blocs initiated negotiations on the goods and services to be included in the process of liberalisation, and a first list of sensitive products was drawn up. The central theme of the negotiations in the sphere of agriculture is access to the European market for MERCOSUR exports.

In their latest offer (October 2004), the EU based their proposal on a system of tariff contingency measures for sensitive products. The advantage of this system is that it will be possible to keep quantitative control of imports from MERCOSUR, and this is important to the Europeans as they fear there might be a dramatic increase in these imports if protection is exercised by means of tariffs alone. This 2004 European offer has been rejected by MERCOSUR, and negotiations have stagnated since then.

In this context, a comparative analysis of the two blocs' agricultural policies is very relevant as it will determine each side's objectives and the kinds of instruments used to pursue them. The most important element is obviously trade policy, but due attention must also be paid to other agricultural policy instruments.

In this study we carry out a comparative analysis of the trade and agricultural policies of the European Union and MERCOSUR, from the perspective of bilateral free trade negotiations. This analysis is based on information compiled and systematised in a database developed by ECLAC within the framework of the EuMercopol Project, with input from ECLAC itself, from IICA, and from other partners in the project and the Regional Network for the Coordination of Agricultural Policies (REDPA - Red Regional de Coordinación de Políticas Agropecuarias), which is made up by the Directors of Agricultural Policy of the extended MERCOSUR countries, which in turn make up the Agricultural Council of the South (CAS - Consejo Agropecuario del Sur).

In this study we refer to other studies on the subject[3], which often concentrate on instruments of trade policy, and we develop factors that are specific to domestic support for agricultural policy. We also take advantage of recent studies compiling and making comparative analyses of agricultural policies, carried out by IICA and REDPA.

In drafting this report we have sought a synthesis, stressing each policy's outstanding characteristics and relating them to the objectives pursued. So as not to distract the reader's attention with too many figures, much of the quantitative information has been placed in the annexes.

[3] Among the different studies on the subject of policies connected to the agricultural sector, the following deserve mention: OECD annual reports, studies coordinated by ICONE Brazil and studies carried out by the 'Chaire Mersosur de Sciences Pau'. One characteristic all these studies have in common is that they always stress aspects of trade policy but do not say much about other measures, especially those in the realm of domestic support.

This study is organised in six chapters. Chapters 2 and 3 are a brief summary of the general framework of economic and agricultural policy and the role of the agricultural sector in the European Union and MERCOSUR. They also make reference to aspects of the macroeconomic context that affect the agricultural sector. Chapter 3 sets out the objectives of EU and MERCOSUR policies, so as to put these policies in perspective and understand the coherence of different measures: we analyse them as converging elements in a strategy to achieve the above-mentioned objectives.

In Chapter 4 there is a detailed comparative analysis of different trade policies and policies by sector that affect agriculture. In the first part, policies governing access to markets are analysed, and in the second, policies governing support for agriculture. The instruments implemented by each bloc are described by section, and the chapter concludes with observations in which their points of convergence and divergence are examined.

Finally, in Chapter 5 we present a summary of the offers that have been proposed for access to markets by the EU and MERCOSUR in the course of the bilateral negotiations, and in Chapter 6 we present our conclusions.

2. THE MACROECONOMIC CONTEXT AND CONTEXT BY SECTOR OF THE EXTENDED MERCOSUR AND THE EUROPEAN UNION

2.1 Economic Dimension

The extended MERCOSUR[4] enjoys enormous relative importance in Latin America and the Caribbean. It has a consumer market of 264.5 million inhabitants and a Gross Domestic Product (GDP) equivalent to 57% of the total for Latin America and the Caribbean. Its exports amount to one third of the total for the region.

Nevertheless, in economic terms MERCOSUR and the EU are very asymmetrical. EU-25 has just under double the total population and an economically active population (EAP) that is 3.1 times greater than that of the extended MERCOSUR, but its GDP is 9.3 times greater than that of the southern bloc. These economic indicators go a long way towards explaining why the EU-25's per capita GDP is more than five times that of the extended MERCOSUR.

CHART 1
EXTENDED MERCOSUR-EU: MAIN ECONOMIC INDICATORS 2005-6

Countries	Population (thousands) 2005	EAP (thousands) 2005	Total surface area (million hectares)	GDP (thousand million USD) 2006 at corrrent prices	Per capita GDP (USD) 2006 at current prices	Exports (thousand million USD) 2006
Argentina	38,971	17,366	278.0	214.3	5,498	53.0
Brazil	190,128	94,421	851.5	1,067.8	5,616	156.5
Bolivia	9,627	4,164	109.8	11.2	1,160	4.7
Chile	16,436	6,968	75.7	145.8	8,873	66.2
Paraguay	6,009	2,487	40.7	9.0	1,501	5.3
Uruguay	3,324	1,594	17.6	19.3	5,809	5.8
TOTAL MERCOSUR	264,495	126,980	1,371.3	1,467.4	5,547	193.3
European Union EU-25	459,500	390,000	383.2	13,629.4	29,484	1,348.2

Source: For the MERCOSUR countries, ECLAC database and 2007 Economic Report on Latin America and the Caribbean. For the European Union, EUROSTAT database and EUROPE IN FIGURES – EUROSTAT Yearbook 2006-07.

Another important factor is that Brazil has great economic weight in the extended MERCOSUR. This country alone accounts for 72% of the bloc's population, 62% of its area, 73% of its GDP and 81% of its exports. This is completely unlike the situation in the EU, where Germany, the most populous country and the one with the highest GDP, accounts for only 18% of EU-25's population and 19% of its GDP.

[4] For the purposes of this study, 'the extended MERCOSUR' is defined as the bloc consisting of the four founding members (Argentina, Brazil, Paraguay and Uruguay) plus Chile and Bolivia as associate countries.

However, Europe's agricultural production is relatively concentrated, since the top three agricultural countries (France, Spain and Italy) account for 54% of European agricultural GDP.

The dynamics of growth in the Latin American and Caribbean countries have been quite favourable over the last four years: in 2007 GDP grew by 8.6% in Argentina, 3.8% in Bolivia, 5.3% in Brazil and Chile, 5.5% in Paraguay and 7.5% in Uruguay. Over the same period, economic growth in the EU was lower at only 2.6% in 2007 following 2.8% in 2006 and only 1.6% in 2005.

As regards the prospects for the immediate future, according to an IMF report published in April 2008[5], it is estimated that the growth rate of the world economy will drop to 3.5% in 2008 and 2009. Nevertheless, as long as the world's main emerging economies (especially China and India) keep on growing with the same dynamism they have exhibited up to now, the extended MERCOSUR countries will continue to benefit from high prices for the commodities they export (copper, soya beans, cereals, and to a lesser extent meat and dairy products), although it must be borne in mind that these profits will be severely reduced (or possibly even cancelled out) by an increase in agricultural production costs (energy, agrochemicals, transportation, etc.) and distortions caused by speculative factors behind the increase in foodstuff prices.

It is clear from the above that the EU-MERCOSUR Economic Association Agreement cannot sidestep the question of the asymmetry between the economies of the two blocs. This aspect has become an inevitable feature of all third generation economic agreements, and it is now an established fact that economically more powerful blocs or countries have to make greater concessions to weaker trading partners.

2.2. The Share of Agriculture in the Economy

The two blocs are very asymmetrical in the economic dimension, and they are also asymmetrical when it comes to agriculture. EU-25 has an agricultural area of 167 million hectares, which is equivalent to one third of MERCOSUR's, but European production systems are far more intensive and in 2005 this sector generated an agricultural GDP of 202 thousand million US dollars, which was approximately three times the figure for MERCOSUR. Similarly, in 2005 European agricultural exports came to 91 thousand million US dollars, which was five times greater than MERCOSUR's.

The picture changes considerably when we consider agriculture's contribution to the overall economy of each bloc. Agriculture is an important sector in the economies of the MERCOSUR economies, and although its relative weight is gradually diminishing it is greater than the weight of agriculture in the EU economies, according to all the indicators shown in Chart 2.

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5 International Monetary Fund: Economic Perspectives in the Americas, April 2008. Economic and Financial Studies.

- On average, agriculture's contribution to GDP is 5.1% in the extended MERCOSUR as against only 1.2% in Europe.

- Agriculture's contribution to exports is 9.5% in the extended MERCOSUR as against 6.1% in Europe.

- Agriculture's share of the extended MERCOSUR's economically active population is 16.3%, in contrast to only 4.7% in Europe.

These economic indicators for Europe must be variegated because they do not show the agricultural sector's political weight in public debate and decision-making at the political level, which is important in some countries like France, Spain, Italy and Greece. In these countries, the agriculture lobby has far greater influence, both with their own governments and with the European Community in Brussels, than is immediately apparent just from considering these indicators.

<u>Differences among countries</u>

Behind these averages there are big differences between different countries in the same bloc, not only in MERCOSUR but also in the EU.

- In the case of MERCOSUR, there are considerable differences between the agricultural GDP / total GDP ratios in different countries. This indicator ranges from 3.9% in Chile to 20.7% in Paraguay. Similarly, the European average is 1.2% but some countries are in very different situations: 0.4 to 0.5% in the Northern countries (Sweden, Finland, Great Britain), 0.7 to 0.8% in Germany and Belgium, 1.5 to 2.5% in the Mediterranean countries (France, Spain and Italy), and over 5% for some East European countries (Romania, Bulgaria).

- There are also considerable differences in the percentage of the active population involved in agriculture. In Argentina and Uruguay it is under 5%, but it is 12% in Chile, 19% in Brazil, and over 30% in Bolivia and Paraguay. In the European Union the average is 4.7%, but values are far higher in the new member countries. The average is only 3.7% in EU-15, but more than 10% in the Baltic countries, 15% in Poland, and as high as 30% in Romania.

- The average size of farms in EU-25 is 16.0 hectares, but farms are much larger in Western Europe (in EU-15 the average size of 21.4 hectares) than in the ten new member countries, where average farm size is only 4.5 hectares.

CHART 2
EXTENDED MERCOSUR-EU: INDICATORS OF THE IMPORTANCE OF AGRICULTURE IN THE ECONOMY. 2005

	Argentina	**Bolivia**	**Brazil**	**Chile**	**Paraguay**	**Uruguay**	**MERCOSUR**	**EU-25**
Agricultural GDP (thousand million USD)	16.5	1.2	48.2	5.6	1.9	1.8	**65.9**	**201.8**

Agricultural GDP / total GDP	7.7 %	11.0 %	4.5 %	3.9 %	20.7 %	9.2 %	**5.1 %**	**1.2 %**
Agriculture exports (thousand million USD)	7.7	0.16	12.9	5.5	0.8	0.7	**18.4**	**91.1**
Agriculture exports / total exports	15.6 %	4.2 %	4.0 %	9.4 %	15.7 %	15.6 %	**9.5 %**	**6.1%**
Economically active population in agriculture (million)	0.14	1.3	17.6	0.9	0.8	0.01	**20.8**	**9.5**
Ag, population / total population	0.8 %	32.3 %	18.6%	12.5%	31.1 %	4.6 %	**16.3 %**	**4.7 %**
Agricultural area (million hectares)	129.3	37.8	263.6	15.2	24.3	14.9	**485.2**	**166.8**
Ag. area / total area	47.3 %	34.8 %	31.2%	20.4%	61.1 %	85.4 %	**35.7 %**	**43.5 %**

Source: a) Agricultural GDP and total GDP; Agricultural and total exports; EAP; agricultural and total surface areas: Economic Report for Latin America and Caribbean, ECLAC; b) Agricultural EAP: Household Surveys in the different countries.

Another important factor is the behaviour of international prices for the exportable production of the countries in the extended MERCOSUR. Argentina, Brazil, Uruguay and Paraguay, and to a lesser extent Bolivia, have benefited over the last two or three years from the evolution of favourable international prices for soya beans, cereals, beef and dairy produce. In Chile, however, the situation is rather different because prices for most for-export fruit have been falling. In Europe, the rise in agricultural prices has had very different impacts depending on the product under consideration; in general, cereal producers have benefited far more than cattle farmers or fruit and vegetable producers.

We saw above that average agricultural productivity is far greater in Europe than in the Southern Cone of South America, and also that in economic and social terms, and therefore in terms of political stability as well, agricultural production is far more important in the extended MERCOSUR than in the EU.

2.3. EU-MERCOSUR Trade Flows

The balance of trade between the two blocs is structurally favourable to MERCOSUR, as can be seen in Chart 3.

- With exports worth 30.7 thousand million euros and imports totalling only 20.7 thousand million euros, in 2005 MERCOSUR enjoyed a favourable balance of trade with the EU, and the surplus came to 10 thousand million euros.

- This is entirely due to agricultural products, to the fact that trade flows in this sector are completely out of balance. In 2005, EU-25's agricultural imports from MERCOSUR amounted to over 14 thousand million euros while exports amounted to only 699 million euros.

- The non-agricultural balance of trade is in Europe's favour: the difference is slightly over 3 thousand million euros.

- All this makes agriculture strategically important in the two bloc's trade relations. Agricultural products make up almost half of MERCOSUR exports to the European Union, and without them the current favourable balance of trade would become negative.

CHART 3
MERCOSUR-EU: TRADE EXCHANGE, 2005
(million euros)

	Agricultural products	All products
EU imports from MERCOSUR	14,027	30,718
EU exports to MERCOSUR	699	20,676
EU trade balance	- 13,328	- 10,042

Source: European Economic Commission (Eurostat and General Directorate of Agriculture and Rural Development).

EU-25's agricultural imports from MERCOSUR are concentrated in relatively few products, as can be seen in Chart 4. Animal feed, which is considered as by-products and waste products from foodstuff industries, accounts for almost one third of these imports, while oleaginous seeds and fruit (mainly soya bean) account for another 18%. The other main MERCOSUR products entering the European market are meat (11.5%), coffee (9%) and fruit (7.7%).

CHART 4
EU-25: BREAKDOWN OF AGRICULTURAL IMPORTS FROM MERCOSUR, 2005

	Value of imports in million euros	Relative weight
Animal feed (code 23)	4,238	30.2 %
Oleaginous seeds and fruit (12)	2,503	17.8 %
Meat (02)	1,617	11.5 %
Coffee and other plant stimulants (09)	1,261	9.0 %
Fruit (08)	1,078	7.7 %
Total of agricultural imports	14,027	100 %

Source: European Commission (Eurostat and General Directorate of Agriculture and Rural Development).

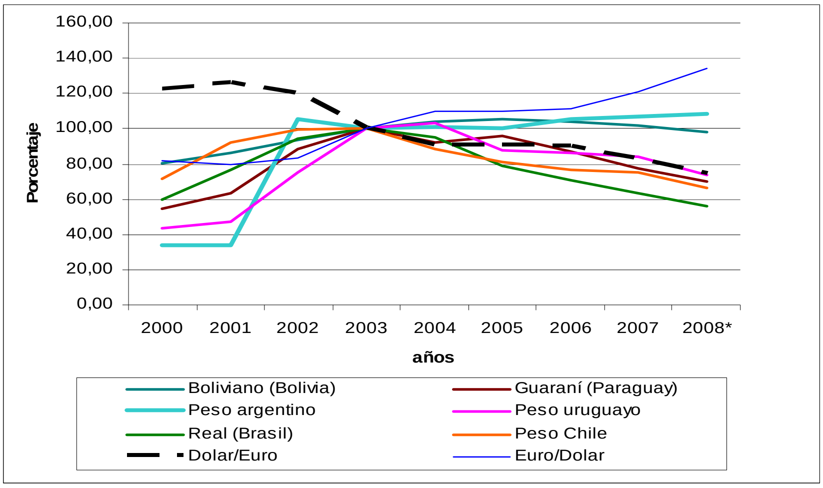
This structure of European imports does not reflect MERCOSUR's agro-export potential as it does not include the main products where the latter enjoys comparative advantages in the world market. The small proportion of meat in MERCOSUR exports to Europe, and the near-total absence of cereals, dairy products and sugar, are a direct consequence of EU policies to defend its markets against Latin American produce.

2.4. Other Factors in the Economic Context: Exchange Rates and Foreign Direct Investment

Exchange Rates

There is no doubt that exchange rates have great influence on any country's export competitiveness. With this in mind, it is important to note that the euro and the currencies of several MERCOSUR countries have evolved in a similar way with respect to the US dollar, as can be seen in Figure 1. The price of the dollar against local currencies increased up to 2003 in almost every country, but since then it has dropped systematically except in Argentina.

FIGURE 1
EXTENDED MERCOSUR-EU: EVOLUTION OF THE EXCHANGE RATE (2003=100)



Source: Countries' Central Banks.
* The datum for 2008 is an average value between January and April of that year.

TEXT
porcentaje = percentage
años = years
Peso argentino = Peso Argentina
Real (Brasil) = Real Brazil
Dolar/Euro = Dollar/Euro
Peso uruguayo = Peso Uruguay
Euro/Dolar = Euro/Dollar

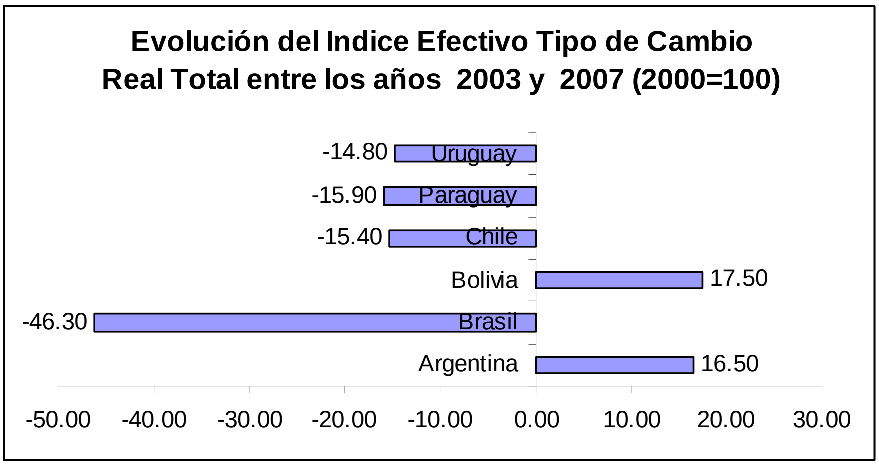
The steady appreciation of other national currencies against the US dollar over the last few years has negatively affected the production of export goods: imports have become cheaper and unemployment rates in export sectors have risen. Unemployment has also increased in activities producing goods for domestic consumption that have been replaced by imports.

In all the extended MERCOSUR countries, the exchange rate is subject to market forces and fluctuates, although occasionally the different countries' central banks intervene and buy or sell foreign exchange to avoid extreme variations. This kind of intervention has become increasing common recently as a consequence of the strengthening of local currencies against the US dollar in all the MERCOSUR countries, but it has not been sufficient to reverse the trend. The one exception is Argentina, where unlike in the rest of the region, the central bank has intervened to avoid increases in the value of the US dollar due to excessive demand, as happened in May, 2008.

To sum up, the behaviour of exchange rates indicates that although the strengthening of the euro against the US dollar apparently made MERCOSUR exports more competitive, this greater competitiveness has been completely offset or significantly reduced because the currencies of the MERCOSUR countries have also grown stronger against the US dollar, with the single exception of Argentina, and the prices of the imported inputs that the extended MERCOSUR's agricultural production and trade heavily depend on have also risen.

The situation in terms of actual effective exchange rates is shown in the figure below. It can be seen that, with the exception of Argentina and Bolivia, the currencies of the rest of the MERCOSUR countries have been steadily getting more expensive in terms of the US dollar. The country that has been affected most is Brazil, which has slid back by no less than 43.6%, followed by Chile, Paraguay and Uruguay.

FIGURE 2



Source: Prepared by César Morales on the basis of information in the ECLAC Preliminary Balance of Latin American and Caribbean Economies, 2007. The total real effective exchange rate is calculated by weighting the real bilateral exchange rates of each trade partner by that partner's share of trade (exports plus imports) in the country's total trade. The real extra-regional effective exchange rate index does not include trade with other countries in South America and the Caribbean.

TEXT
Evolución del Indice... = Evolution of Effective Exchange Rate between 2003 and 2007 (2000 = 100)
Brasil = Brazil

Accumulated foreign direct investment in MERCOSUR

Foreign direct investment flows are actually a form of external savings and one of the main sources of private investment funding. Thus this form of investment contributes to economic growth, technology transfer, increased productivity and development.

In the extended MERCOSUR, the figures for accumulated FDI (foreign direct investment) from 2000 to 2005 vary considerably from one country to another. For instance, Brazil received almost 147 thousand million US dollars, but in Uruguay no foreign investments are reported for that period. FDI in agriculture is minimal and amounts to only 0.8% of total FDI in Brazil.

There is no doubt that free trade agreements and agreements protecting foreign investment enhance the ability of countries to attract foreign investment, because they offer a greater degree of stability and legal security in economic relations between countries.

The European Union is one of the main investors in the region. In Chile and Brazil the EU provides almost 50% of total FDI, in Bolivia it provides 35% and in Paraguay and Argentina the EU share of FDI is about 10% of the total.

CHART 5
ENTRY FLOW OF FOREIGN DIRECT INVESTMENT (FDI) IN MERCOSUR ACCUMULATED 2002-2005
(*thousand million US dollars*)

	Argentina	Bolivia	Brazil	Chile	Paraguay	Uruguay
Total FDI flows entering country	115.1	4.5	146.9	22.5	0.2	0.0
FDI flows from the EU	11.9	1.3	68.3	10.8	0.03	0
Share of EU in total FDI flows (%)	10 %	35 %	47 %	48 %	12 %	n/a
EU enterprises with mergers and acquisitions in the agriculture, foodstuffs, beverages and tobacco sectors in MERCOSUR (Value of transaction in million USD)	Quilmes industr. SA (36.5), Salvia Netherland (4.9), British American Tobacco (0.92)	n/a	Inbev (2.984), Tereos (47.7)	Cermaq ASA (23.0)	n/a	n/a
Restriction rating in the FDI*	0.125 (manufacture); 0.145 (total)	no data	0.100 (manufacture) 0.195 (total)	0.025 (manufacture); 0.107 (total)	no data	no data

Sources: ECLAC, based on central banks for FDI flows and on Bloomberg for mergers and acquisitions; OECD for FDI Restrictiveness Index.

***** The index ranges from 1 to 0. The closer to zero, the more open the economy receiving the FDI. The indicator measures discriminatory treatment of foreign enterprises before and after the arrival of capital. For further information see OECD (2006), "OECD's FDI Regulatory Restrictiveness Index: Revision and Extension to more Economies", OECD Working Papers on International Investment, 2006/4, OECD Publishing.

<u>Outgoing investment flows</u>

The major flows of outgoing investment from Brazil and Argentina are directly related to the larger size of these economies as compared to the other countries in the region. In the case of Chile, however, outgoing investment can be attributed to this country’s policy of global insertion, while in the case of Uruguay, a small economy, it would seem to be related to this country’s role as a regional financial centre.

CHART 6
OUTGOING FLOWS OF INTRA-REGIONAL* FOREIGN DIRECT INVESTMENT, 2000-2005.
(*million US dollars*)

	Argentina	Bolivia	Brazil	Chile	Paraguay	Uruguay
Total outgoing FDI flows	1,244.0	3.0	1,212.0	993.0	11.0	1,480.0
Outgoing FDI flows to MERCOSUR countries	958.0	2.0	459.0	379.0	10.0	1,308.0
MERCOSUR share as destination of FDI (%)	77.0%	74.3%	37.9%	38.2%	97.7%	88.4%

Source: ECLAC
*Flows of outgoing foreign direct investment made by extended MERCOSUR countries in other extended MERCOSUR countries.

Outgoing investment flows from the extended MERCOSUR countries go mainly to other countries in the region. In Paraguay this intra-regional flow amounts to 97.7%, in Uruguay 88.4%, in Argentina 77% and in Bolivia 74.3%.

An analysis of foreign investment shows that an EU-MERCOSUR bilateral agreement will also benefit European enterprises located in the extended MERCOSUR countries, particularly those in Brazil, Bolivia and Chile. EU investments amount to more than one third of total foreign investment in Brazil and almost half the foreign investment in Bolivia and Chile.

3. GENERAL OBJECTIVES OF EXTENDED MERCOSUR AND EUROPEAN UNION AGRICULTURAL POLICY

3.1. European Union: Common Agricultural Policy (CAP)

Unlike the extended MERCOSUR, the European Union does have a Common Agricultural Policy (CAP). Since its inception in the early 1960s the CAP has undergone many important changes which can be interpreted in the light of the progressive evolution of its objectives. These have been gradually modified over the years to cater to changes in both the internal context (rises in the extent of coverage of the community market, increases in budget costs) and the external context (multilateral trade negotiations, the evolution of world markets).

The initial CAP: 1962-1992

The CAP came into being in the early 1960s when the different European countries were undergoing severe food shortages. For this reason, the main goal of the first version of the CAP was to increase productivity and production so as to be able to supply the internal market and reduce this shortfall as much as possible. The objectives of the first CAP were as follows: i) to promote an equitable quality of life for the rural population, ii) to stabilise markets, iii) to guarantee supplies, and iv) to supply consumers at reasonable prices.

The first measure adopted in pursuit of these objectives was the introduction of guaranteed prices. These were often far higher than international market prices so they provided a great incentive for production in many areas. These measures were supplemented with high import tariffs to protect European production.

Different reforms as of 1992

The goal of eliminating shortages was attained for many products, and during the 1980s surpluses of different products such as cereals, milk and meat, began to accumulate. These surpluses have given rise to two kinds of problems: first, inside the EU there was a sharp rise in the cost of the CAP (storage costs and also refunds to sell surpluses on the world market), and second, outside the EU the appearance of subsidised exports tended to distort these products' competitiveness in world trade.

In 1992, in response to this new context, the European Union introduced its first important reform to the CAP, with far-reaching changes to policy objectives. The initial target of increasing production was set aside, and fresh objectives were set:

- To contain the increases in production and public spending.

- To maintain the competitiveness of European agriculture by closing the gap between domestic (European) and world prices.

For the first time, rural development objectives were added to the market-oriented objectives:

- To reduce inequality in the distribution of assistance.
- To guide agriculture towards a model that does more to foster environmental protection and land organization.

There were subsequent reforms in 1999 and 2003 that helped strengthen the 1992 orientation. The previous strict agricultural policy was replaced by a rural development policy in which two core elements were clearly identified as ‘pillars’.

The first and more classical pillar was market support, and the second was to promote rural development with financial instruments and funding lines designed specifically for this purpose. The stated objectives of the 2003 reform were as follows:

- To align production to market needs.
- To make CAP instruments compatible with WTO requirements.
- To take consumers’ and people’s wishes into account regarding care of the environment, the production of amenities, sanitary quality, animal welfare and the balanced development of rural areas.

The reformulation of objectives embodied in the different reforms brought about a gradual decrease in the prices guaranteed to producers, and a portion of the subsidies corresponding to price differentials were changed into direct income assistance. A consequence of this was that export subsidies decreased, due to the double effect of decreasing surpluses and a drop in the price gap between European and world market prices. Along the same lines, new conditions for granting these new kinds of direct assistance were introduced such as production standards promoting care for the environment, sanitary standards and animal welfare regulations, as an expression of concern about the environment and rural development.

As a consequence of the different reforms in the CAP, it gradually lost the healthy approval on the part of the general public it had enjoyed in the early years. In the 1960s and 70s there was a consensus among the member countries and public opinion was favourable to the social objectives inherent in the CAP. The instruments that were implemented were clearly designed to attain objectives set for the CAP. The successive reforms that were introduced to respond to internal pressure (to limit rising budget cost) and external pressure (to conform to WTO requirements) caused the instruments to be changed to such an extent that they no longer corresponded to any clearly identified vision for the future of society. As a consequence the early public approval of the CAP has waned somewhat, and today it is heavily criticised by a public that does not understand the rationale of direct income assistance that a relatively small number of large producers have won for themselves.

3.2. Agricultural Policies in the Extended MERCOSUR

Towards the end of 1980 a new economic model was introduced in Latin America (with the exception of a few countries, such as Chile, which had initiated this process during the previous decade), and as a result some public policies were reformulated.

Up to that time the state had played a dominant and even overbearing role in agriculture with public enterprises involved in the storage and marketing of agricultural produce, providing credit for the sector, supplying services, and there were trade restrictions, price bands and subsidies for producers, multiple exchange rates, restrictions on the ownership of land, etc. When a more market-oriented economic model supervened the state started to withdraw from agriculture as part of its overall strategy. One of the factors that encouraged this trend was the opinion of certain analysts that the previous bias in favour of urban areas would be rectified with the application of sectorially neutral policies.

In the 1990s and the early years of the new century, there were far-reaching changes in the nature of agricultural policies and agro-food systems, partly in response to increasing economic globalisation, changes in political and economic forces, technological progress and a greater emphasis on the sanitary quality of foodstuffs and protection of the environment.

It gradually became harder to use the traditional instruments for analysis and traditional policies to incorporate the variables needed to examine subjects such as negotiations at the World Trade Organisation (WTO), and also to combine rules governing entry into markets, domestic support, export subsidies, non-tariff barriers, rules of origin and sanitary and phytosanitary regulations with general WTO regulations, and as of the 1990s a second generation of reforms were introduced. This involved the application of new economy measures in institutions and greater consideration for the effects of globalisation, in what has come to be called '*getting institutions right*'.[6]

Even though these reforms were enacted throughout the MERCOSUR region, this has not led to the implementation of a common agricultural policy in the extended MERCOSUR countries in spite of the fact that, as of 2003, there has been significant progress in the institutions involved in terms of coordinating agricultural policies, with the creation of the Agricultural Council for the South (CAS - Consejo Agropecuario del Sur) as a regional forum for the Ministers of Agriculture from the four original MERCOSUR countries plus Chile and Bolivia.

At the first meeting of the CAS (Brasilia, May 2002), regional coordination networks were set up as technical bodies to furnish support at the political level. These networks included the six countries' top technical authorities on agricultural policy and negotiation, sanitary matters and agricultural technology.

[6] Taken from Mario Cimoli, Martina Sirven, Carlo Ferraro, João Carlos Ferraz, Nicolo Gligo, Martin Hilbert, Wilson Peres, Analiza Primi and Giovanni Stumpo (2007). Cinco piezas de política de desarrollo productivo. Desarrollo Productivo Series. Santiago de Chile: ECLAC.

These networks are the Regional Network for the Coordination of Agricultural Policy (REDPA), the Informal Group for Agricultural Negotiation (GINA Sur) and the Permanent Veterinary Committee (CVP), which were set up along with the CAS, and also the Regional Committee on Plant Health for the Southern Cone **(**COSAVE) and the Cooperative Program for the Agro-alimentary and Agro-industrial Technological Development of the Southern Cone (PROCISUR), which has been in existence for 25 years.

There are two further entities that serve as regional interlocutors with the ministerial forum in the academic environment and the private sector, namely the Forum of Agronomy Faculties of MERCOSUR, Bolivia and Chile, and the regional agricultural private sector forum, which includes the Federation of Rural Associations of MERCOSUR, Bolivia and Chile (FARM) as the main regional organization of large agricultural producers.

In this context, one of the major objectives of the extended MERCOSUR countries' agricultural policy over the last two decades has been to promote adequate penetration in the international market of their different agricultural products, in harmony with the macro policies that are geared to the same objective at the global level. In the last few years some other very important policies have been added to those mentioned above as a result of political change in the region. These include policies to incorporate small farmers into commercial groupings (particularly in Brazil and Chile) and policies to combat poverty in rural areas.

3.3. Some Comparative Reflections

In order to analyse the objectives the two blocs are pursuing in their agricultural policies, it must be borne in mind that CAP dates from the 1960s when there was a foodstuffs shortfall in Europe, while the member countries of the present day extended MERCOSUR, particularly Argentina, Brazil and Uruguay, have traditionally been foodstuff exporters.

As a result, the objectives of the EU Common Agricultural Policy (CAP) have always been to defend and protect European agricultural production, with an overall vision of foodstuff self-sufficiency and security. This has been maintained even when criteria limiting increases in production and incorporating care of the environment gradually came into play after the 1992 CAP reform process.

The MERCOSUR has no common policy for agriculture, but there has been a powerful move in all the countries in the bloc towards external opening and increased insertion into international markets. In this context, these countries have formulated and applied policies to strengthen competitiveness and have sought improved conditions of access to third markets through bilateral and multilateral trade agreements.

These different objectives must be taken into account in the negotiation of bilateral trade agreements, especially as the prevailing international regulations and the dynamics of globalisation are geared to facilitating international penetration.

Furthermore, in pursuit of these objectives, the Southern Cone countries have greatly liberalised access to their own markets and, in contrast to the EU, they do not subsidise their agriculture. Likewise, it is obvious that European subsidy and support measures have placed EU agriculture in a better position to compete in international markets as it is more competitive than MERCOSUR agriculture, which not only does not receive such support but is labouring under a considerable tax burden.

4. COMPARATIVE ANALYSIS OF TRADE AND AGRICULTURAL POLICIES

The European Union countries and the MERCOSUR countries both comply with WTO rules as regards market access. Moreover, the countries in both blocs grant preferential access conditions to countries with which they have bilateral or bloc trade agreements. Details of the main agreements that the EU and MERCOSUR had in force in 2007 are given in Annexes 2 and 3. It can be seen from this that the extended MERCOSUR countries have been very dynamic in the sphere of signing trade agreements.

Chile is the extended MERCOSUR country with the highest number of trade agreements. As at 2007 it had 19 agreements in force involving 54 countries. Most of the agreements signed by the other countries in the region are basically part of the MERCOSUR integration process or that of the Andean Community of Nations, within the framework of the Latin American Integration Association (ALADI)[7].

The main European trade agreements have been made with non-EU countries in Europe and with the 78 ACP (Africa, Caribbean and Pacific) countries. As for Latin America, the EU has only signed agreements with Mexico and Chile, but negotiations in this field are in progress with Central America, the Andean Community and MERCOSUR.

From the above it is apparent that MERCOSUR is focusing on a policy of international insertion for its economies and agriculture that is rather more aggressive and open than the European strategy, which has geared its agreements to markets that have traditionally been dependent or protected.

We present below a comparative analysis of this chapter, ordered in accordance with the nomenclature of the WTO agricultural agreement. In the first section we deal with measures related to market access, in the second we deal with export subsidies and taxes, and in the third we focus on domestic support for agriculture.

4.1. Market Access Policies

4.1.1. Tariffs

a) <u>General Framework</u>

[7] The member countries of ALADI are Mexico, Cuba, Venezuela, Colombia, Ecuador, Peru, Bolivia, Brazil, Uruguay, Paraguay, Argentina and Chile.

The European Union grants a unilateral preference scheme called the Generalised System of Preferences (GSP) to nations not in the category of industrialised countries. The GSP was completely overhauled on 1 July 2005. There are three components to this new system:

- A general regime.

- A special, more favourable, regime called GSP Plus for countries complying with specific requirements in terms of sustainable development and good governance.

- A specific regime for less developed countries, called ‘Everything Except Weapons’, which involves exemption from all tariffs and quotas.

The European Union applies the basic GSP regime to MERCOSUR countries. This consists basically of preferential access for goods on a list established by the EU and classified as sensitive or non-sensitive. Non-sensitive products enter the European market with no tariffs, while sensitive products may enter the market paying a tariff that is below the Most Favoured Nation level.[8] This gives MERCOSUR exports a degree of preferential access compared to other industrialised countries’ exports to Europe, but it does not grant MERCOSUR greater preferential treatment than that accorded to other developing countries.

In MERCOSUR, a common external tariff (CET) has been in force since 2005, and today European Union goods do not enjoy preferential access to any MERCOSUR countries except Chile and Bolivia, which are associate members and apply a lower tariff level than the MECOSUR common external tariff.

It should be borne in mind that, under the current arrangements, the MERCOSUR countries enjoy preferential treatment that goes one way because they benefit from the EU GSP regime, but there is no form of tariff preference for products from the European Union entering MERCOSUR. This situation is due to the fact that, up to the present time, no EU-MERCOSUR preferential trade agreement has been signed, beyond the unilateral scheme the EU applies to imports from less developed countries.

b) Average Tariffs

At present the European Union uses three different types of tariff in the agricultural sector: *ad valorem*, specific, and mixed. In this study we will use data from the MacMaps database, which gives the *ad valorem* equivalents of specific and mixed tariffs, and this enables us to make a more exact comparison of the EU and MERCOSUR positions.

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[8] For further details of the GSP scheme and the lists of products and tariffs applied under this regime, see Rule 980/2005 of the European Community.
http://eur-lex.europa.eu/LexUriServ/LexUriServe.do?uri=OJ:L:2005:169:0001:0043:ES:PDF

The tariff applied by the European Union for practically all agricultural products is the same as the tariff established at the WTO. On average, the EU tariff is just under 20% for agricultural products. When we include in the calculation tariff preferences granted to countries with which the EU has some bilateral agreement, this average drops to 14.7%.

CHART 7
EXTENDED MERCOSUR-EU: SIMPLE AVERAGE OF PREFERENTIAL TARIFFS (PT) AND MOST FAVOURED NATION (MFN) TARIFFS, 2004

	Importing or informing country													
	Argentina		**Bolivia**		**Brazil**		**Chile**		**Paraguay**		**Uruguay**		**EU-25**	
	PT	**NFN**	**PT**	**MFN**	**PT**	**MFN**	**PT**	**MFN**	**PT**	**MFN**	**PT**	**MFN**	**PT**	**MFN**
Total agricultural products	11.6	12.3	9.6	10.0	11.7	12.4	5.4	6.1	11.6	12.1	11.7	12.4	14.7	19.8
By trade partners														
MERCOSUR	0.0	12.0	3.9	10.0	0.0	12.1	0.4	6.1	0.2	12.0	0.1	12.0	20.2	20.7
EU-25	11.5	11.5	10.0	10.0	11.6	11.6	6.1	6.1	11.5	11.5	11.6	11.6		
Bolivia	5.3	11.7			3.4	11.6	2.4	6.0	9.8	11.6	8.7	12.0	12.2	16.7
Chile	8.7	12.2	7.8	10.0	8.9	12.5			11.2	12.2	10.4	12.2	16.0	20.4
By sub-sectors (Agricultural sector chapter)														
Meat (02)	10.7	11.6	9.6	10.0	10.9	11.6	6.9	7.7	10.9	11.6	10.7	11.6	40.9	46.4
Dairy (04)	14.8	15.7	9.6	10.0	17.2	18.1	5.5	6.0	15.0	15.7	14.8	15.7	64.4	70.6
Vegetables (07)	9.4	9.8	9.8	10.0	9.1	9.7	5.4	6.0	9.4	9.9	9.4	9.8	8.9	16.2
Fruit (08)	10.8	11.4	9.6	10.0	11.1	11.8	5.4	6.0	10.7	11.3	10.8	11.4	3.2	6.6
Cereals (10)	6.7	7.2	9.4	10.0	6.9	7.5	5.4	6.0	7.2	7.7	6.3	6.8	45.6	49.4
Sugar and confectionary (17)	18.7	19.5	9.8	10.0	17.4	18.3	5.6	6.0	20.7	21.3	19.0	19.9	63.7	66.1
Beverages (22)	19.9	21.2	9.6	10.0	20.5	21.7	5.4	6.0	19.4	20.3	19.9	21.1	5.1	7.1
Tobacco (24)	17.1	18.5	9.5	10.0	17.6	18.6	5.3	6.0	17.3	18.1	16.4	17.5	11.0	30.8

Source: MacMaps.

It can be seen that the EU applies an average tariff of 20.2% on MERCOSUR agricultural produce. In the case of Bolivia the rate is 12.2%, and 16.0% for Chile. These two countries enjoy special treatment under the GSP Plus scheme because they have signed economic association agreements with the EU.

Unlike the EU, the extended MERCOSUR countries apply tariffs that are below the level established at the WTO, and this gives them a ‘breathing space’ or margin in how they handle their tariff policy. On average, the MERCOSUR countries apply a tariff of just over 12% on agricultural produce, but Bolivia applies 10%. Until 2005 Chile applied a lower tariff, a flat rate of 6% that was slightly changed by the price bands applied for wheat and sugar. However, even this level has been decreasing and must eventually reach zero because of the Chile-EU bilateral agreement.

It can be seen from the above that the European Union level of tariff protection for agricultural products is considerably higher (almost double) than the average protection applied by the extended MERCOSUR. This protection differential is much higher for some important products such as meat, dairy produce, cereals and sugar.

In addition to this, the EU applies specific and mixed tariffs to most products, which makes for higher levels of protection than the *ad valorem* tariffs applied by MERCOSUR because specific or mixed tariffs increase as a percentage of the entry price whenever prices go down.

c) Tariff Peaks

Average tariffs in the European Union are fairly moderate, but the bloc applies very high 'tariff peaks' for some specific agricultural products that are considered sensitive by European producers. For example, in the case of sugar the maximum tariff applied in 2005 was 244.7%, for meat it was 275.4%, for flour 222.4% and for dairy products 313% (a breakdown by sector of the tariff peaks applied by the EU is given in Annex 6).

The European Union applies lower tariff peaks to produce from Chile and Bolivia than those applied to the rest of the MERCOSUR countries. In the case of Chile this is because of the Chile-EU Economic Association Agreement, and for Bolivia it is because that country enjoys the benefits of GSP Plus.

In general the MERCOSUR countries do not apply high tariff peaks to restrict trade. Those that are in force are relatively moderate, they do not exceed 22% for certain items in the sugar and confectionary chapters (35% in the case of Paraguay), beverages (21.5%) and tobacco (21.5%). For further details see Annex 5.

To sum up, the extended MERCOSUR's tariff protection is not only lower than the EU system, it also has a more homogeneous structure that does not involve such high tariff peaks. In the EU, these tariff peaks can be in the range of 200% to 500% (see Annex 6), and they affect products like sugar, meats, cereals and dairy products that are important for MERCOSUR exports. This situation makes for difficulties in the process of negotiating an association agreement.

It seems clear that the whole question of high EU tariff peaks is of fundamental importance in the inter-bloc bilateral agreement negotiations, and that the solution may well be in the area of adequate flexibility in the values of the quotas the EU grants MERCOSUR.

d) Tariff escalation

Tariff escalation is the practice of levying higher customs duties on partially finished products than on raw materials, and even higher rates for finished products. This practice can provide significant protection for finished products, and the extent of this protection depends on the proportion of added value in the final product.

In general, the European Union applies higher tariffs to processed (intermediate and final) agricultural products, and in some cases these levels can be twice the rate for primary products. One exception is meat: this is mainly consumed in the form of fresh or frozen products, and a higher tariff is levied on the primary phase so as to protect European producers. An average of 45.9% is levied on meat as a primary product, whereas an average of 30.1% is levied on final meat products (for further details see Annex 8).

In the MERCOSUR, the tariffs on intermediate or final agricultural products that are imported from the European Union are higher than those levied on primary products. However, this tariff escalation is far lower than that applied by the EU to

MERCOSUR exports (for further details see Annex 7). Chile and Bolivia have no tariff escalation and they apply a flat rate of 6% and 10% respectively.

This seems to indicate that for an EU-MERCOSUR bilateral agreement to be successful, there must be greater flexibility on the part of the Europeans in the sphere of lowering tariffs on processed and intermediate products, and that the rates will have to fall towards base tariff levels.

e) Variable tariffs and special regimes

Since GATT 94 became effective, the European Union has been applying the entry price system on fresh agricultural products. This system coves 15 products (tomatoes, cucumbers, Italian pumpkins, cherries, apricots, lemons, nectarines, plums, apples, pears, grapes, artichokes, clementines, mandarins and oranges) which are exported to European Union countries.

The entry price system consists of fixing a minimum import price (called the minimum entry price) for every batch of a particular product regardless of its country of origin. If the import value drops below the minimum entry price, the importer will have to pay an extra tax which is known as an equivalent tariff. This extra duty is additional to the normal import tax. When batches imported by the European Union drop below the 92% minimum import price (88% in the case of pears and apples for a certain period), the maximum equivalent customs duty is levied.

In the extended MERCOSUR, Argentina levies an additional tax on sugar and sugar products in line with the provisions of Decree 797/1992. In 2005 this amounted to a cost of 47.5 US dollars per ton. Chile has a system of price bands for wheat, wheat flour and sugar. This system is in the process of change to comply with a WTO ruling about this area. Since 2005 Chile has taken measures that apply to products with price bands, and these include tariff quotas,[9] safeguards and anti-dumping measures. The other extended MERCOSUR countries have no variable or additional tariff system.

In the extended MERCOSUR the situation of special import regimes to support agriculture is as follows. In Bolivia, in accordance with Supreme Decree 27,971, imports of inputs and capital goods are exempt from tariffs. Brazil has a zero percent tariff rate for imports under heading 3105, heading 3102 (ammonium sulphate and urea) and heading 3103 (simple and triple super phosphate). Heading 3808 has variable tariffs ranging from zero to 14%. Chile also has a special regime for imports of capital goods consisting of fiscal credits at 4% interest for imports of new fixed assets. Uruguay has a zero percent tariff for imports of capital asset inputs.

It is clear that the extended MERCOSUR countries only make use of variable tariffs in very few cases, whereas in the EU this kind of protection is a traditional mechanism in agricultural trade policy to restrict market access. Although the EU has

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[9] In the case of Chile, in late 2003 a duty-free quota of 15,000 tons of sugar, distributed as follows: 12,000 metric tons annually from Bolivia, and 1,500 each from Costa Rica and El Salvador. These quotas were done away with in 2005. However, that same year they were re-established, with the following distribution: Bolivia 6,000 metric tons, Costa Rica and El Salvador 1,500 metric tons each, and 6,000 from any origin. If there was any excess requirement, authorisation was granted to import from any origin.

been gradually adjusting its variable tariffs in accordance with WTO rules, they are still in place for products that loom large among MERCOSUR agricultural exports, and are therefore a subject that has to be tackled in bilateral negotiations. The experience of removing this kind of tariff in other bilateral negotiations may well be a useful reference.

4.1.2. Tariff Rate Quotas (TRQ)

a) European Union and MERCOSUR Global Tariff Quotas

The European Union applies a broad system of tariff quotas. The chapters with the highest number of tariff quotas are meat, cereals, dairy products and sugar. For MERCOSUR agricultural products, tariff quotas are a key instrument for access to the European market because the main South American agricultural exports entering the EU market are subject to quotas, and the level of these quotas is one of the most delicate points in bilateral trade negotiations.

The following is a summary by chapter of the total amounts of EU quotas established at the WTO, and an indication of the extent to which they were actually used in 2004. In some chapters, the amount given as the quota actually used is higher than the quota allowed. This is because the EU deals in managed trade and the consolidated quotas function as the minimum level allowed for imports enjoying tariff preferences. However, the European countries can increase the amount of the quota in accordance with actual demand each year, which in effect is what they do. In the European Union approximately 61% of the total tariff quota established is made use of.

CHART 8
EU: TARIFF QUOTAS ESTABLISHED AT THE WTO,
TOTAL QUOTA ACTUALLY USED AND PERCENTAGE OF USE, 2004

Chapter	Description	TRQ permitted (Tm)	TRQ used (Tm)	Percentage of utilisation
01	Live animals	8,837	191,444	2,166.4%
02	Meat	852,318	296,413	34.8%
04	Dairy products	309,640	373,637	120.7%
06	Plants and flowers	25,493	37,544	147.3%
07	Vegetables	2,953,298	6,564,698	222.3%
08	Fruit	5,971,241	3,595,633	60.2%
09	Coffee, tea and spices	528	206	39.0%
10	Cereals	8,208,392	735,294	9.0%
11	Products of the milling industry	44,816	20,002	44.6%
15	Fats and oils	20,815	5,106	24.5%
16	Meat preparations	9,285	12,406	133.6%
17	Sugar and confectionery	3,674,116	1,659,302	45.2%
18	Cocoa and preparations	28	2,500	8,928.6%
19	Cereal preparations	5,199	3,401	65.4%
20	Fruit and vegetable preparations	354,173	264,274	74.6%
22	Miscellaneous foodstuff preparations	20,446	85,000	415.7%
23	By-products and waste	877,293	597,799	68.1%

TOTAL	23,335,918	14,444,659	61.9%

Source: MacMaps. Note that this chart does not include EU imports effected outside the quota, and the data cover imports effected with tariffs in-quota.

b) Specific EU quotas currently used by MERCOSUR and tariff rate quotas

The subject of European quotas for MERCOSUR products is complex, because it is closely linked to the multilateral negotiations taking place in the framework of the WTO. At the present time there are two kinds of quotas in the European Union that MERCOSUR countries can gain access to:

i) Those designated *erga omnes*, i.e. not specific to any particular country. The MERCOSUR countries have to compete with other WTO member-countries to gain access to these.
ii) Quotas specifically for MERCOSUR.

The following is a breakdown of products from MERCOSUR countries that currently enter the European Union under tariff quotas:

- Beef

There are several quotas that depend on the quality of the beef and the country benefiting. Two are specific to MERCOSUR: one for 49,300 tons of high quality beef (the Hilton quota) and the other for 38,500 tons of frozen beef. There are other specific quotas such as those reserved for the ACP area (Africa, Caribbean and Pacific), and an *erga omnes* quota of 53,000 tons.

CHART 9
EU: AMOUNTS OF EUROPEAN BEEF QUOTAS FOR MERCOSUR

	Hilton quota ™	Frozen meat quota ™
Argentina	38,000	6,000
Brazil	5,000	28,100
Uruguay	6,300	4,400
Total MERCOSUR	**49,300**	**38,500**

Source: European Commission.

Is should be noted that the MERCOSUR quotas are specific to each country and cannot be transferred from one to another. The tariffs applied in and over the quotas are fairly complex because they combine specific and *ad valorem* tariffs. In all cases these tariffs are heavy, and they severely limit access to the European market for products that are over the quota.

CHART 10
EU: TARIFFS IN AND OVER THE QUOTA FOR BEEF

Products	In-quota tariff	Over quota
Fresh or refrigerated boned	20%	12.8% + 3034 €/ton
Fresh or refrigerated in channels		12.8% + 1768 €/ton
Frozen boned		12.8% + 2211 €/ton
Frozen in channels		12.8% + 1768 €/ton

Source: Export Helpdesk, European Commission.

- <u>Pork</u>

European quotas for pork are small. The European Union grants a 72,600 ton *erga omnes* quota, and maintains a specific 11,000 ton quota for MERCOSUR. These volumes are low indeed in comparison to the 1.6 million tons imported by Europe in 2006.

The tariffs applied are combined, as in the case of beef, one part being specific and the other *ad valorem.*

CHART 11
EU: TARIFFS IN AND OVER THE QUOTA FOR PORK

	Specific tariffs		***Ad valorem***	
	In-quota tariff	Over quota	In-quota tariff	Over quota
In channels	268€/ton	536€/ton	17.1%	34.3%
Fresh or refrigerated pork cuts	233€ to 434€/ton	778€ to 869€/ton	22.5 to 30.8%	45.1 to 61.7%
Shoulder and cuts	0%	467€ to 869€/ton	0%	27.9 to 40.4%
Shoulder and boned ham	250€/ton	869€/ton	10.8%	40.4%

Source: Export Helpdesk, European Commission

- Chicken

The quotas for chicken granted by the European Union are also very limited. Of a total of 26,400 tons, some 7,100 are earmarked for Brazil. In addition, tariffs are high, even within the quota, as can be seen from the chart below:

CHART 12
EU: TARIFFS IN AND OVER THE QUOTA FOR CHICKEN

Products	In-quota tariff	Over-quota tariff
Frozen boned chicken cuts	795 €/ton	1024 €/ton
Fresh or refrigerated boned chicken cuts	512 €/ton	1024 €/ton

Source: Export Helpdesk, European Commission.

Brazil has enormous export capacity (2.1 million tons in 2004), and this is out of all proportion to the quota level. Of course, Brazil fills its quota completely and also exports over it, and so 90% of Brazil's chicken exports to the European market are subject to the over-quota tariff[10].

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[10] JANK, M. (coord.) 2004. Fast tracking a 'feasible' EU-Mercosur Agreement: Scenarios for Untying the Agriculture Knot.

- Cereals

Most of the European quotas in this sector are *erga omnes*, i.e. open to all WTO member countries. The United States and Canada have specific quotas (572,000 tons of medium and low-quality wheat for the U.S., and 38,000 tons for Canada), but MERCOSUR enjoys no such quotas.

CHART 13
EU-VOLUMES AND TARIFFS IN AND OVER QUOTAS FOR CEREALS

Product	Amount of quota	In-quota tariff	Over-quota tariff
Maize	2.5 million tons *erga omnes*	45.2%	84.9%
High quality wheat	300,000 tons *erga omnes*	0%	75.1%
Medium and low quality wheat	610,000 tons for USA and Canada 2.37 million *erga omnes*	12 €/T	95 €/T

Source: Export Heldesk, European Commission.

- Sugar and Ethanol

The EU has a sugar quota of 1.8 million tons earmarked for countries in the ACP area, but MERCOSUR countries do not have access to this, and the question of establishing such a quota is not on the agenda in the negotiations for the Association Agreement. Nor does MERCOSUR currently have a European quota for ethanol. However, the 2004 European proposal includes a 1 million ton quota, which is of great interest to Brazil.

- Dairy Products

At present the EU grants no quota for dairy products from MERCOSUR, whose share in European imports of these products is only 0.1%. The 2004 European proposal includes quotas of 3,000 tons for powdered milk, 5,000 tons for butter and 20,000 tons for cheese.

c) <u>Some comparative observations on quotas</u>

While the EU uses the concept of ‘managed trade’ as a key feature of its trade policy, particularly in the sphere of agriculture, the extended MERCOSUR countries do not apply this concept except in the quite exceptional case of some of the bloc’s member countries in the context of intraregional trade. For this reason, the MERCOSUR countries have not established tariff quotas at the WTO, and the quotas that are in force today in their trade are only those negotiated within the framework of bilateral preferential agreements, particularly intraregional agreements within the framework of ALADI.

Considering the importance the EU attaches to quotas, and that its tariffs, tariff peaks and tariff escalations are so high, it would seem clear that quotas should be included in any bilateral agreement. The question is whether the quotas granted by the EU to MERCOSUR are to be a part of the global quotas already established or negotiated at the WTO, or whether they are to be additional to these. There is no doubt that MERCOSUR would rather have quotas that are additional to global quotas and would also rather be able to choose to use part of the global quotas in a framework of free competition. As this seems unlikely, the bloc's main aim will be to obtain guaranteed adequate and high bilateral quotas in either of the two schemes: within the WTO or additional to the WTO.

4.1.3. Rules of Origin

The rules governing the origin of goods are a set of regulations established at the national level. They allow enterprises in countries with which some sort of tariff preference system is in place to know under what conditions their products may enter the other country while enjoying this tariff preference, i.e. rules governing origin make it possible to identify where the goods are from, not in terms of where they were shipped from but in terms of where they were actually produced.

In this context, the European Union has a system known as the Pan-European system, which is very complex and basically consists of different rules of origin for each tariff heading. The European Union has gradually established these different rules over time in the context of its various trade agreements.

This system is difficult to change in the framework of a trade agreement, because what the European Union wants is to maintain a standard set of rules of origin by product for all countries with which it makes trade agreements.

To find out what particular rule of origin a given product must comply with, a check must be made with the corresponding tariff heading as there is no general rule that applies to all agricultural products, for example.

An important element of flexibility in the European system is that a less advanced country can request a temporary exception to the EU rules of origin to allow its own industry to develop.

In extended MERCOSUR countries, the most common criteria in rules of origin are as follows:

- Products must be totally obtained or made in MERCOSUR

- The regional content of goods must be at least 60%, i.e. the value of intermediate products **not** of MERCOSUR origin must not be over 40% of the value of the finished product.

In addition, in trade agreements signed by the extended MERCOSUR, other criteria are taken into account, such as those covered by the De Minimis rules, the absorption principle and exceptions by process, as well as other items detailed in Annex 9. Likewise accumulation, be it bilateral or diagonal and worldwide, is allowed.

Everything indicates that if an EU-MERCOSUR agreement were reached, the different criteria already used by both regions in trade agreements signed up to that time would be incorporated. The precedent of the EU-CHILE agreement might be used as a basis for the general criteria to be adopted.

4.1.4. Non-Tariff Measures

a) Antidumping measures, the application of general safeguard and compensatory measures.

Between 1995 and 2007 the European Union reported six cases of the application of antidumping measures on agricultural imports, and the MERCOSUR countries reported having applied such measures in ten cases, seven of which were in Brazil.

According to information from the WTO, of the total number of cases of antidumping measures applied against exporters of agricultural products in that period, two affected exports from the EU and 14 exports from extended MERCOSUR countries, mostly from Argentina and Chile.

Similarly, the extended MERCOSUR countries reported 10 cases in which general safeguard measures were applied against agricultural products in that period, and there were three instances when they themselves (as exporters of agricultural products) were subject to safeguard measures applied by other countries. The European Union applied general safeguards against the import of agricultural products only once during the period, and other countries took measures against EU exports in nine instances.

CHART 14
EXTENDED MERCOSUR-EU: CASES IN WHICH ANTIDUMPING MEASURES, GENERAL SAFEGUARD MEASURES AND COMPENSATORY RIGHTS WERE APPLIED AGAINST AGRICULTURAL AND AGROINDUSTRIAL PRODUCTS (A) 1995-2007

	Antidumping measures		Safeguard measures		Compensatory measures	
Country	Reporting country	Exporting country	Reporting country	Exporting country	Reporting country	Exporting country
Argentina	1	5	4	3	13	25
Brazil	7	3	5	0	15	23
Chile	2	5	no report	no report	7	no report
Paraguay	0	0	no report	no report	no report	no report
Uruguay	0	1	no report	no report	no report	no report
Extended MERCOSUR	10	14	9	3	35	3
European Union	*6*	*2*	1	9	1	0

Source: WTO. Includes measures applied in sections I to IV in the nomenclature of WTO reports, i.e.: I. Live animals and animal products; II. Vegetable products; III. Animal or vegetable fats and oils; derived products; manufactured food fats; animal or vegetable wax, and IV: Products from the food industry; beverages, alcoholic liquids and vinegar; tobacco and manufactured tobacco substitutes.

In some specific cases countries in the extended MERCOSUR have applied antidumping measures. In late 2006 Chile imposed a 16.2% provisional antidumping surcharge on imports of wheat flour from Argentina, classified under tariff code 1101.0000 in the National Customs Tariffs. This was changed in 2007, and a new provisional antidumping surcharge of 33.1% was established.

In 2005 Argentina applied antidumping measures against imports of wheat gluten and peach syrup from the EU, and Brazil levied antidumping surcharges for ammonium nitrate, glysophate, powdered milk, garlic, preserved mushrooms, jute sacks and peaches in syrup. In this case the imports in question were mostly from Asian countries and the European Union. Uruguay has also used this measure, against edible oil from Argentina.

Between 1995 and 2007, the European Union applied special agricultural safeguards against more than 50 products. Measures applied as a result of the fall in prices affected exports to the EU of some chicken and beef preparations and also sugar. The measures based on the increase in import volumes particularly affected exports of fruit to the EU (oranges, citrus fruit, apples, pears, plums) and vegetables (tomatoes, cucumbers, pumpkins).

The MERCOSUR countries did not use this instrument for protection, mainly because most of them had not included it on their lists of commitments in the Final Agreement of the Uruguay Round, which was an indispensable condition to be able to make use of these measures.

In February 2005, Chile imposed a 17% *ad valorem* extra tariff duty on wheat flour (heading 1101.0000 of the National Customs Tariffs) as a definitive safeguard measure. Excluded from this was wheat flour with a c.i.f. price of over USD 0.3/net kilo that satisfied specified quality characteristics. Imports of this product from Mexico, Canada and Peru were also exempt because of prevailing trade agreements with these countries. Developing countries that were WTO members with an individual market share of less than 3% were also exempt. In October 2005 a change was introduced whereby the extra duty was not levied on imports of wheat flour up to 1,944 tons, but quantities above this amount were liable to the new charge.

In Argentina, a safeguard measure was applied against preserved peaches, with an extra duty of USD 0.50 /kilo net, but this was later reduced to USD 0.40/kilo net. Excluded from this measure were products from MERCOSUR countries and South Africa. The value of imports affected by the measure is reckoned to be over one million US dollars.

In general the use of antidumping measures does not seem to be an obstacle to the development of trade between the EU and MERCOSUR in the framework of an agreement between the two blocs, even though the instrument is available and has been used by both.

b) <u>Sanitary and Phytosanitary Measures</u>

In recent years consumers have somewhat lost confidence in foodstuff safety as a result of some food-related health crises. To confront this problem, the European Union is applying a global strategy aimed at re-establishing public confidence in foodstuffs 'from the farm to the table', based on a combination of foodstuff, zoosanitary and phytosanitary standards that are applicable to EU-produced and also to imported foodstuffs.

This strategy rests on three pillars:

- Legislation on foodstuffs and feed.
- Solid scientific advice to base decisions upon.
- Effective application and controls.

Imports of products of vegetable origin must comply with certain general conditions and specific requirements that have been established to avoid risks to public health, to preserve the vegetables and to protect consumers. Vegetable products must comply with standards governing foodstuff safety, phytosanitary aspects, labelling and quality.

These standards are set down in community directives and rules. The former define objectives but leave each country free to choose how to comply with them in their national legislation. The rules are obligatory in full, and automatically become effective in all countries on the date established.[11]

In the case of products of animal origin, the matter of traceability of foodstuffs, feed, animals for the production of food and any other substance added to food must be established throughout all the stages of production, transformation and distribution. That is to say, every enterprise must be able to identify not only its suppliers but also the entities it has supplied. In the European context, the objective of the rules is to take 'one step back and one step forwards'.

The extended MERCOSUR countries have stated that they apply only the measures necessary to preserve the country's sanitary status and that there are no common sets of rules for the region. They do, however, have two mechanisms for regional coordination, both of which depend on the CAS forum of Ministers of Agriculture:

- The Permanent Veterinary Committee (CVP - Comité Veterinario Permanente), which is made up of the National Directors of Animal Health of the six CAS countries, and which is recognised by the World Organization for Animal Health (OIE) and the regional animal health reference body.

[11] In the following hyperlinks in the EU website, information is available on established sanitary and phytosanitary matters:

- Phytosanitary protection: http://ec.europa.eu/food/plant/index_en.htm
- Food safety: http://ec.europa.eu/food/food/index_en.htm
- Summary of legislations: http://europa.eu.scadplus/leg/es/s80000.htm.

- The Committee for Plant Heath for the Southern Cone (COSAVE), made up of the National Directors of Vegetable Health of the six CAS countries, with regional legal status to dictate sanitary standards in this area.

The six countries attach great importance to strengthening sanitary services and preserving and improving the region's sanitary status, and coordinated efforts are made to eradicate, control and/or prevent (depending on the situation in each country) fruit fly, foot and mouth disease, bird flu, cotton blight, bovine spongiform encephalopathy (BSE), citrus canker, soya bean blight and other plagues and pests.

All the MERCOSUR countries have been implementing and improving their traceability systems, particularly in the case of cattle, and making joint efforts to progress towards a regional traceability system.

d) Technical and Labelling Standards

Rules regarding the labelling, presentation and advertising of foodstuffs sold in the EU are laid down in Directive 2000/13/CE. This Directive covers wrapped, packaged and tinned foodstuff for delivery without further transformation to the final consumer, restaurants, hospitals and other similar entities.

The aim is that the labelling, presentation and advertising of foodstuffs should not to lead consumers into errors as regards the product's characteristics or effects.

Foodstuff labels must include mandatory information such as sales denomination, list of ingredients (it is not necessary to indicate the ingredients for some products including fresh fruit and vegetables), the product's expiry date and its storage and preservation conditions. This essential information must be on the original wrapping or an attached label. When wrapped, packaged or tinned foodstuffs are sold in phases prior to sale to the final consumer, or are to be delivered for subsequent preparation, the information may be given just in the commercial documentation, so long as the sale denomination, minimum expiry date and data about the manufacturer or enterprise responsible for wrapping, packaging or canning appears on the external wrapping, packaging or tin can containing the foodstuff in question.

In the EU there are also foodstuff quality stamps that indicate quality characteristics that exceed the basic health and safety requirements. These quality characteristics are known as differentiating quality emblems, and there are voluntary control systems to guarantee that a foodstuff does actually possess one or more of these characteristics.

These systems usually consist of an independent entity (usually called a certifying body) verifying and checking that the product actually possesses the value attributes shown. The visible sign that the product has been checked is a quality indication stamp, symbol or logotype on the label. Three kinds of quality stamps are in use: Denomination of Origin and Protected Geographic Indication; Guaranteed Traditional Specialty; and Organic Production.

In 1991 the European Union established rules governing ecological agricultural production and how this is shown for agricultural products, and in 1999 the ecological breeding of animals was included. These rules establish a standard basis for being classified as *organic*, and give the consumer a guarantee that the product qualifies for this denomination.

The standards employed for ecological agriculture and breeding require an accredited public certifying body or a private control body that is recognised in each member state to check that a product actually has been produced under conditions that comply with the European Union requirements in question.

In the extended MERCOSUR the main certification instruments are basically certification of origin, certification of quality, sanitary certification and, in the case of Brazil, certification as an organic product.

In Argentina labelling policies are regulated by Law 18,284, which establishes labelling requirements for foodstuffs. The aim is to provide consumers with the clearest and most relevant information possible about the food to be consumed.

In Bolivia, the National Identification of Ecological Products stamp certifies the quality of the product and guarantees it. In Brazil the policy is that all foodstuffs sold in the market, no matter what their origin, must be suitably labelled.

Paraguay has a set of rules covering the wrapping, packaging or tin can, and the marking of fruit and vegetables. For genetically modified organisms, which are not forbidden in that country, all marking and labelling requirements must be complied with. Lastly, in Uruguay the rules established by MERCOSUR are in force.

d) <u>Some comparative observations about tariff measures</u>

The European systems of labelling, quality, sanitary control and traceability are stricter than the world average and those used in MERCOSUR, and these instruments are a factor that may restrict MERCOSUR exports to the EU or at least reduce their margins of competitiveness. This is because compliance with European standards would mean that production and sales costs for MERCOSUR agricultural exporters would increase, even though these enterprises are already taking measures to align their export systems with the standards in question.

One way of tackling this difficulty in bilateral negotiation is through joint investment, whereby European investors could contribute to solving this problem. Another is through bilateral EU-MERCOSUR cooperation on these points, thus extending what has already been initiated in the EU regional cooperation project with MERCOSUR in the field of agricultural product safety.

4.2 Subsidies and taxes on exports

European community subsidies are granted at the community level, i.e. the payments come from the community budget as well as from the member states. In

MERCOSUR, on the other hand, this kind of subsidy is supposed to be defined, financed and applied by each country individually, but in fact no subsidies are being paid at the present time.

4.2.1. Taxes on exports

In the EU member countries, no taxes of any kind are levied on exports.

Among MERCOSUR countries, Argentina recently increased taxes on exports. As a general rule a 5% rate is applied in the case of industrialised products, 10% on non-industrialised items and 20% on cereals and oilseed and their derived products.

Bolivia, Chile and Paraguay do not apply any form of tax on exports. In Brazil, on the other hand, there is an export tax on furs and hides, and Uruguay taxes exported unprocessed cattle and sheep hides at 5%.

4.2.2. Export Subsidies

a) Subsidies established at the WTO

In the framework of the final agreement reached in the Uruguay Round, countries established their export subsidies and made a commitment to reduce associated budgetary outlay by 36% (developed countries) or 24% (developing countries) until the end of the reform period (2000/2001).

This means a reduction of almost 5 thousand million US dollars on the part of the EU, which made a commitment not to exceed 8,500 million US dollars per annum in export subsidies as of 2001. These subsidies, however, are concentrated in products that are important to MERCOSUR such as beef, cereals and dairy products.

In addition, should the Doha Round close successfully, the commitment already made in current negotiations would be established, and export subsidies would be completely eliminated by 2013. This deadline was proposed by the EU itself.

In the MERCOSUR, only Brazil and Uruguay (the latter almost symbolically) established export subsidies in the Uruguay Round, and only for tiny amounts compared to EU subsidy levels.

CHART 15
EXTENDED MERCOSUR-EU: COMMITMENTS TO REDUCE EXPORT SUBSIDIES ESTABLISHED AT THE WTO, 1995

Country	Base (mill USD)	Final (mill USD)	Reduction %	Composition of products covered by subsidies

European Union	13,274	8,496	36	Beef 19%, wheat 17%, butter 13%, secondary cereals 13%, other dairy products 10%
Brazil	96	73	24	Sugar 56%, fruit, green vegetables and vegetables 23%
Uruguay	2	1	23	Rice 83%, butter 12%

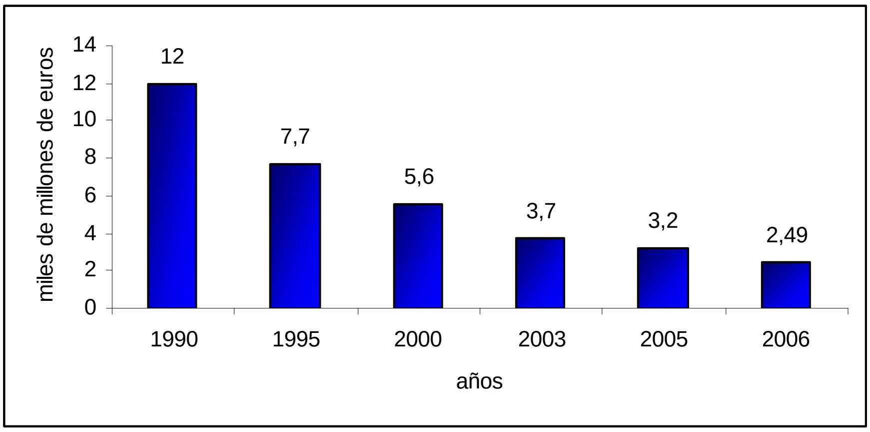
Source: ECLAC

b) Subsidies applied to exports

The EU has been exercising its right, which was established at the WTO, to subsidise exports through a mechanism called ‘refunds’, whereby any European exporter receives a subsidy to compensate for the gap between the European price and the price that could be obtained on the world market.

In the 1980s, when domestic European prices were far higher than international prices, refunds were high: they amounted to over 12 thousand million euros in the late 1980s. Progressive reductions in European prices after the 1992, 1999 and 2003 reforms have automatically reduced refunds. As can be seen in Figure 3, refunds fell from 12 thousand million euros in the early 1990s to under 2.5 thousand million euros in 2006.

FIGURE 3
EU: TOTAL VALUES OF EXPORT REFUNDS
1990-2006



Source: Aerostato

TEXT
miles de millones de euros = thousand million euros
años = years

The relative importance of the different kinds of products qualifying for refunds has changed over time in line with the evolution of domestic and international prices.

- Cereals were the product receiving the most export subsidies in the 1990s, but this was no longer the case at the end of that decade because domestic prices fell after the 1992 and 1999 reforms. In 2005, refunds for this product amounted to 131 million euros and accounted for 4% of total refunds.

- In recent years, dairy products and sugar accounted for 70% of total refunds. However, there has been a considerable fall in refunds for dairy products, from 1,495 million euros in 2004 to 725 million in 2006. In 2006, sugar became the most subsidised export product, with refunds of 1,117 million euros.

- Animal products account for only a small part of total refunds and the trend is for refunds in this sector to decrease. Refunds for beef dropped from 251 million euros in 2004 to 118 million in 2006. In the same period, refunds for chicken decreased from 88 to 61 million, and refunds for pork fell from 42 to 19 million euros.

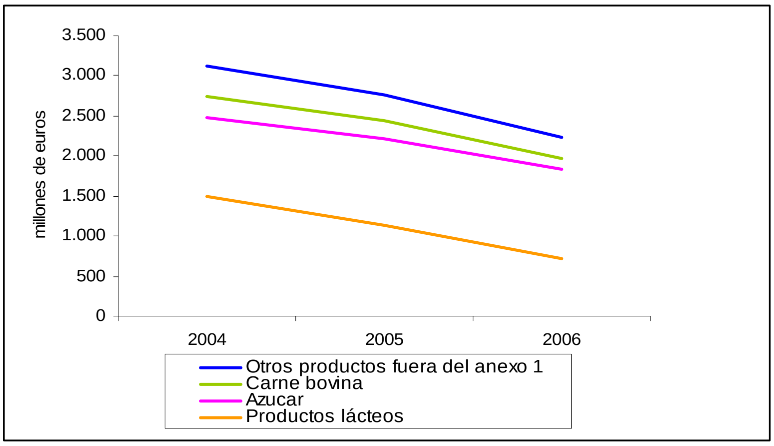
CHART 16
BREAKDOWN OF REFUNDS BY PRODUCT TYPE IN MILLIONS OF EUROS AND AS PERCENTAGES, 2004-2006

Type of product	2004		2005		2006	
	Amount	%	Amount	%	Amount	%
Dairy products	1,495	44 %	1,141	37 %	725	29 %
Sugar	988	29 %	1,081	35 %	1,117	45 %
Beef	251	7 %	212	7 %	118	5 %
Cereals (including rice)	95	3 %	131	4 %	129	5 %
Chicken	88	3 %	87	3 %	61	2 %
Fruit and vegetables	26	0.8 %	25	0.8 %	26	1 %
Pork	42	1.2 %	19	0.6 %	19	0.8 %
Wine	13	0.4 %	17	0.5 %	19	0.8 %
Other products not in Annex 1	380	11 %	335	11 %	274	11 %
TOTAL	3,384	100 %	3,052	100 %	2,494	100 %

Source: Notification to the WTO about subsidies and compensatory measures (**G/SCM/N/155/EEC**)

In June 2007, the EU decided to abolish refunds for dairy products and sugar and keep them only for cereals, beef and wine, which means a considerable additional reduction in refunds. It is expected that they will amount to less than one thousand million euros in 2008.

FIGURE 4
EU: AMOUNTS OF REFUNDS FOR MAIN PRODUCTS 2004-2006
(*million euros*)



Source: Notification to the WTO about subsidies and compensatory measures (G/SCM/N/155/EEC)

TEXT
millones de euros = million euros
Otros productos fuera del anexo 1 = Other products not in Annex 1
Carne bovina = Beef
Azúcar = Sugar
Productos lácteos = Dairy products

In MERCOSUR no subsidies are paid for export products, not even by Brazil or Uruguay, who stated, however, that they did have them and had established them at the Uruguay Round. In fact the situation is quite the reverse: not only are there no subsidies but Argentina actually levies taxes on exports instead of subsidising them (for almost all its agricultural exports), Brazil does this partially (for tobacco and hides) and Uruguay taxes exports of unprocessed hides. In all cases, this negatively affects the products' international competitiveness.

c) <u>Some comparative observations</u>

A comparative analysis of policies shows clear differences in how exports are treated. While Europeans support their exports through refunds, some MERCOSUR countries restrict theirs with taxes. This dramatic difference between the two blocs still exists, despite the progressive drop in European refunds. This situation does not affect bilateral trade relations (agricultural exports from the EU to MERCOSUR have always been very limited, even though in the past refunds were high) as much as it affects the competitiveness of European and of MERCOSUR exports in third markets.

The best chance for a solution to this problem would be a successful outcome at the Doha Round, and compliance with the commitments made at the WTO ministerial meeting in Hong Kong to abolish all export subsidies by 2013.

d) <u>Institutionality and export promotion policies in the extended MERCOSUR</u>

In all the MERCOSUR countries there are public sector special programmes and organisations that operate in close contact with the private sector to promote the development of exports. These specialised organisations do not constitute subsidies.

These institutions include Fundación Exportar in Argentina, a mixed body with public and private sector participation, which assists the entrepreneurial community in their efforts to sell their products effectively at the international level, the aim being to gain access for their exports and to widen and diversify their offer.

In Bolivia two of the organizations that help promote exports and attract investment are the Bolivian Institute for Foreign Trade (IBCE - Instituto Boliviano de Comercio Exterior) and the BOLIVIA Promotion Centre (CEPROBOL - Centro de Promoción BOLIVIA), which is the operational branch of the Ministry of Foreign Relations and Cults, geared to promoting exports and attracting investment. Their objectives are:

a) To contribute to improving the business climate and the country's image.
b) To increase and diversify the flow of international trade, with an emphasis on exports with added value.
c) To foster and attract investment in production and service sectors.
d) To generate strategic alliances and favour the internationalisation of the productive and entrepreneurial sector.

In Brazil, the Agency for the Promotion of Exports and Investment (APEX) is an autonomous institute under the auspices of the Ministry of Development, Industry and Foreign Trade. It was set up in early 2003 with specialised management from SEBRE (the Brazilian Service for Assistance to Micro and Small Enterprises), and its goal is to stimulate Brazilian exports. In addition, there are three important public programmes: a) the 'Estado Exportador' ('Exporting State') which works on improving the competitiveness of Brazilian states that export less than 100 million dollars per annum; b) the promotion of micro, small and medium enterprise exports to Japan through training in selected sectors, a programme supported by JICA (the Japan International Cooperation Agency); and c) the Export Portal, which offers a communication channel for suggestions, queries and consultations.

In Chile, the Ministry of Foreign Relations has a specialised institute called PROCHILE, which helps the entrepreneurial sector to take advantage of opportunities stemming from trade agreements, promotes public and private sector cooperation and improves the positioning of the country's image in other markets. This organization has a network of offices throughout Chile and the main world markets.

In Paraguay, there is the ProParaguay Institute (the General Directorate for the Promotion of Exports and Investment in Paraguay), which comes under the auspices of the Ministry of Foreign Relations. This body was set up in October 1991, and its goals are to promote the export of non-traditional Paraguayan products and foster national and foreign investment that contributes to the country's economic development. ProParaguay has three directorates to carry out its functions and services: Export Promotion, Investment Promotion, and Trade Information. In addition, the Ministry of Industry and Trade has set up a special programme called 'Ventanilla Única' which centralises all the necessary information about bureaucratic procedures for exporting. Besides this, the Investment and Export Network (REDIEX - Red de Inversiones y Exportaciones) coordinates related private and public efforts.

In Uruguay there are four organisations involved in export promotion. Two are public bodies devoted to the general promotion of exports, and the other two are more specifically responsible for promotion by sector. The four organisations are:

a. *Uruguay XXI*, the Institute for the Promotion of Investment and Exports of Goods and Services, whose goal is to position Uruguay in the new context of the international economy.
b. *The Directorate of Trade Programming* (DPC - Dirección de Programación Comercial), which is an organ of the Ministry of Foreign Relations and organises all kinds of trade fairs and trade information required by enterprises in order to gain access to international markets.
c. *The Farm Retraining and Development Programme* (Programa de Reconversión y Desarrollo de la Granja), which is responsible for promoting farm sub-sector exports by enhancing enterprises' competitiveness and increasing the value of farm production.
d. *The National Institute for Viticulture* (INAVI - Instituto Nacional de Vitivinicultura) which collaborates in the improvement of winemaking enterprises through the technological redevelopment of raw material.

4.3. Domestic Assistance for Agriculture

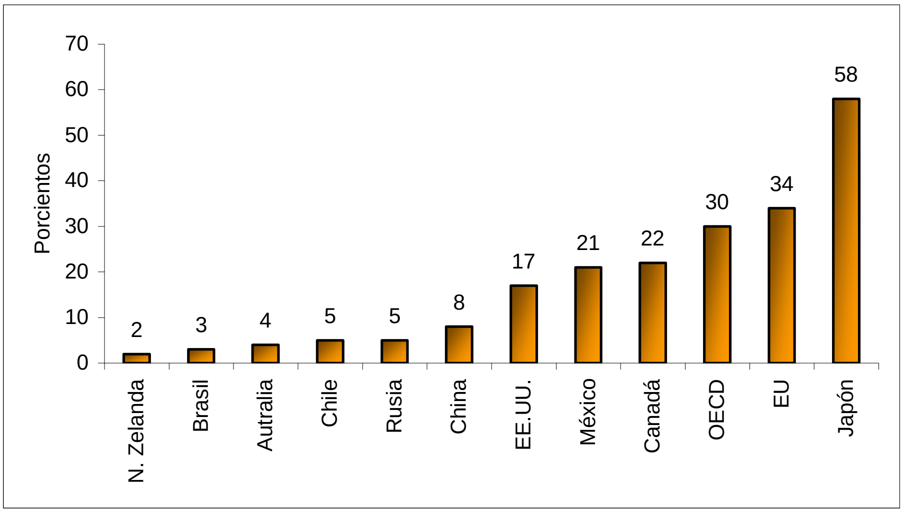
Domestic assistance for agriculture is no longer an instrument for governments' discretionary policies. Since the time when its direct or indirect influence on trade and international prices was recognised internationally, this kind of assistance has become part of analysed policies and is declared and negotiated in the framework of the World Trade Organisation. As a result, analysis and the effort to reach agreement on the possible effects on agriculture have become part of all international trade negotiations.

4.3.1. Global levels of support for agriculture

OECD's Producer Support Estimate (PSE) for 2002-2004 shows that in Europe more than one third of agricultural producers' incomes comes from outside support (from the state and from consumers), whereas in the extended MERCOSUR this kind of support amounts to less than 5% of income. In other words, European agricultural producers receive ten times more support than do farmers in the MERCOSUR countries for which this calculation has been made.

In fact, estimates for Brazil (2002-2004 average) and Chile (2003-2005) show that these two countries' support for production is substantially less than that implemented in the rest of the OECD countries and in the European Union. When we bear in mind that Brazil and Chile are the countries in the region with the greatest public spending on agriculture, it is clear from the above that there is considerable asymmetry between government support for agriculture in the EU on the one hand and MERCOSUR on the other.

FIGURE 5
ESTIMATED SUPPORT FOR PRODUCERS AS A PERCENTAGE OF GROSS INCOME AT THE FARM LEVEL. 2002-2004 AVERAGE*



Source: OECD Review of Agricultural Policies. Brazil and Chile, 2005 and 2008 respectively**.**

*With the exception of Chile, whose average covers 2003-2005.

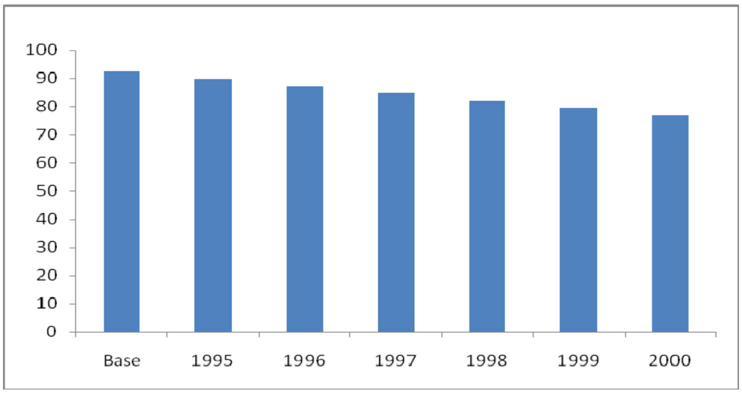
TEXT
Porcientos = Percentages
N. Zelanda = N. Zealand
Brasil = Brazil
Autralia = Australia
Rusia = Russia
EEUU = USA
México = Mexico
Canadá = Canada
Japón = Japan

4.3.2. The European Union

Domestic support for European agriculture is included in the Common Agricultural Policy, as are export subsidies. The figures below for the European Union include both kinds of support.

The global budget of the CAP is programmed in six-year periods, and effective execution of these budgets varies very little with respect to what was programmed initially. In 1999 the budget for 2000-2006 was decided, and the budget for 2007-2013 was decided in 2006.

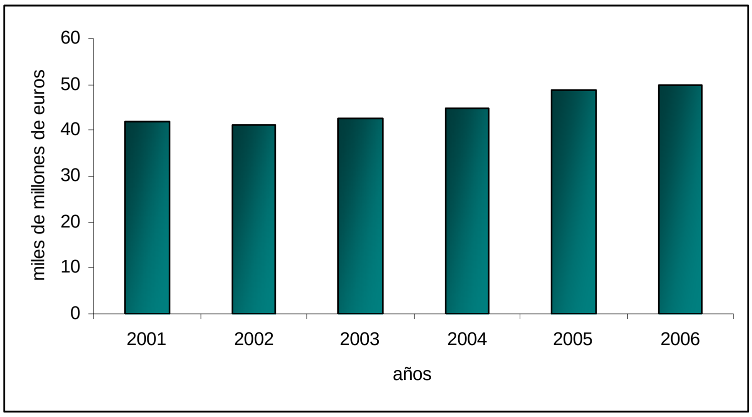
FIGURE 6
EU: COMMITMENTS TO REDUCE DOMESTIC SUPPORT 1995-2000
(thousand million US dollars)



Source: European Economic Commission

The annual budget for the CAP rose from 42.1 thousand million euros in 2001 to 49.9 thousand million in 2006 (see Figure 7). This 18.5% increase over five years was due mainly to the incorporation of ten new member countries into the EU on 1 April 2004, and the corresponding increase in population from 389 million inhabitants (EU-15) to 463 million (EU-25), a 19% rise. Taking this perimetric change into account, the CAP budget per capita has remained constant in recent years.

FIGURE 7
EU: CAP GLOBAL ANNUAL BUDGET, 2001-2006
(thousand million euros)

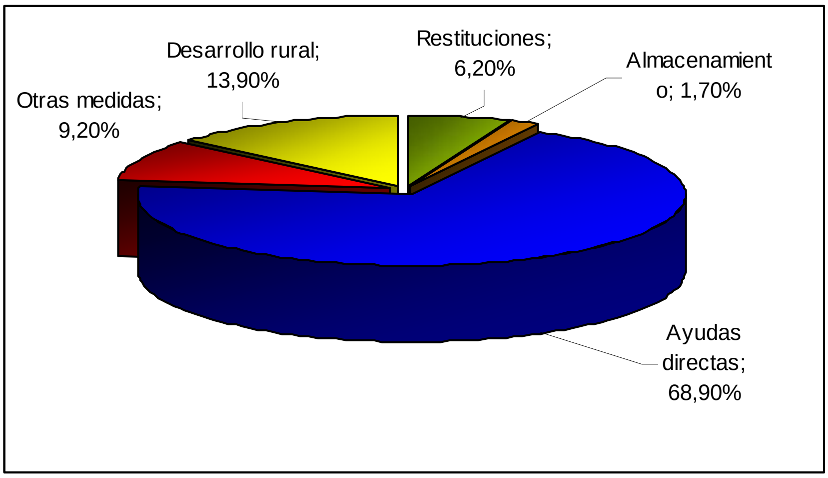


Source: European Economic Commission, Staff Working Document, 2005 financial year.

TEXT
miles de millones de euros = thousand million euros
años = years

The CAP budget can be broken down into two parts. The larger, which is called the first pillar, covers intervention in markets and accounts for 86% of the total, and the second pillar covers rural development expenditure and accounts for the remaining 14%.

FIGURE 8
EU: BREAKDOWN OF BUDGET BY TYPE OF MEASURES, 2005



Source: EU Commission Staff Working Document, 2005 financial year.

TEXT
Otras medidas = Other measures 9.20%
Desarrollo rural = Rural development 13.90%
Restituciones = Refunds 6.20%
Almacenamiento = Storage 1.70%
Ayudas directas = Direct support 68.90%

First CAP pillar

In 2005, assistance under the first pillar amounted to 42.1 thousand million euros, equivalent to 86% of the total CAP budget. It is worth noting that with 3.05 thousand million euros in refunds, export subsidies amounted to 6.2% of the CAP budget.

The most important mechanism in the first pillar is direct assistance for producers' incomes, which in 2005 came to 33.7 thousand million euros. This assistance has been increasing progressively, in line with decreases in guaranteed prices. Until 2005 this assistance was linked to production activity and was administered by different Common Market Organisations (COM). In 2005 most assistance was transferred to the new Single Payment Scheme (SPS) whereby every producer receives a single annual payment that is not linked to what is produced, and is reckoned on the basis of payments received during the reference period of previous years.

The main goal of the single payment, besides becoming a green box type of assistance, is to guarantee producers a more stable income. They can decide what they want to produce as they know that the amount they receive will be the same regardless of what they produce, which allows them to adapt to demand.

Besides the single payment, agricultural producers can benefit from other special assistance schemes for certain crops (protein crops, rice, cotton, tobacco, olives and leguminous grains). The change in the mechanism for the distribution of direct assistance did not affect volumes. Direct assistance for 2006, the first year the new mechanism was applied, amounted to 34.05 thousand million euros, as against 33.7 thousand million the previous year. Direct assistance makes an important contribution to European producers' incomes: in 2005 it accounted for 54% of their total income.

The right to the single annual payment is linked to the requirement that producers manage their operations in a sustainable manner. To benefit from the single payment scheme or other direct payments, it is not necessary for producers to actually produce, but they must comply with conditioning standards on a twofold basis: (i) good agricultural and environmental conditions and (ii) legal management requirements. Non-compliance with these conditions can lead to the reduction or complete discontinuation of direct payments.

Direct assistance has come in for criticism in the EU itself, and one of the most important complaints is that the distribution of this assistance is rather unequal among the EU member states and among European producers:

- At the country level: 5% of the member-countries receive 75% of direct assistance (France 22%, Germany 15%, Italy 13%, Great Britain 12% and Spain 11%).

- Ten percent of farms receive more than 20,000 euros each and thus receive 56% of total direct assistance. On the other hand, 60% of farms receive less than 5,000 euros each, and thus enjoy only 10% of the assistance.

Storage

Over the last 15 years, CAP expenditure on storage has followed the same downward trend as refunds, and for the same reasons. High prices in the 1990s provided an incentive for production and this gave rise to a sizeable surplus which not only needed refunds to be able to sell in the world market but also required storage facilities. Guaranteed prices have gradually decreased and been changed into direct assistance, which has greatly reduced surpluses and thus storage costs. This expenditure, which accounted for 10% of the global CAP budget in the early 1990s, dropped to 2.5% of the CAP budget in 2001 and to 1.7% (equivalent to 850 million euros) in 2005.

<u>The Second CAP Pillar: Rural Development</u>.

In 2005, rural development measures came to 6.82 thousand million euros, which was 13.9% of the global CAP budget. It should be noted that the amount of funds spent on this second pillar is growing at a faster rate than the total CAP budget. Thus, the relative weight of rural development in the CAP has been increasing every year since the 1990s. This second pillar accounted for 10.3 % of the CAP budget in 2001, 13.9% in 2005, and 15.4% in 2006.

There are 22 specific measures that member countries can include in their national rural development programmes. These measures are organised into three broad categories:

- Category 1: Measures for restructuring and for fostering competitiveness. These include support for young people to set themselves up, for pensions for the elderly, for soil improvement, for development and improvements to facilities, and for marketing high quality products. In 2005, measures in this category accounted for 52% of the total funds of the second pillar.

- Category 2: Environmental management. This includes measures to protect the environment, reforestation, and support for disadvantaged areas. In 2005, measures in this category accounted for 38% of second pillar funds.

- Category 3. Measures for land organization. These include projects to develop villages and hamlets, services for the rural population, and fostering rural tourism. In 2005, measures in this category accounted for 10% of second pillar funds.

CHART 17
EU: BREAKDOWN OF CAP BUDGET BY PRODUCT, 2005

	Amounts in million euros	Relative weight
Vegetable production	29,134	68.0 %
Cereals and other herbaceous crops	17,836	41.6 %
Olive oil	2,297	5.4 %
Fruit and vegetables	1,814	4.2 %
Sugar	1,770	4.1 %
Direct horizontal assistance	1,388	3.2 %
Winemaking sector	1,228	2.9 %
Tobacco	929	2.2 %
Cotton and textile plants	913	2.2 %
Food support programmes	223	0.5 %
Other vegetable products	737	1.7 %
Animal production	13,684	32.0 %
Beef	7,888	18.4 %
Milk and dairy products	3,804	8.9 %
Sheep and goat meat	1,794	4.2 %
Pork, eggs and poultry, beekeeping and others	197	0.5 %
TOTAL	42,818	100 %

Source: European Economic Commission.

The above chart shows all funds allocated to each product category, whatever the expenditure mechanism may be, so it includes refunds (export subsidies) where applicable. Note that the weight of different mechanisms varies greatly according to the product in question.

- In the case of cereals and other herbaceous crops, most of the 17,836 million euros are for direct payments. Refunds account for only 131 million of this total, and expenditure on storage accounts for another 444 million. Assistance for olive oil is granted only as a direct payment.

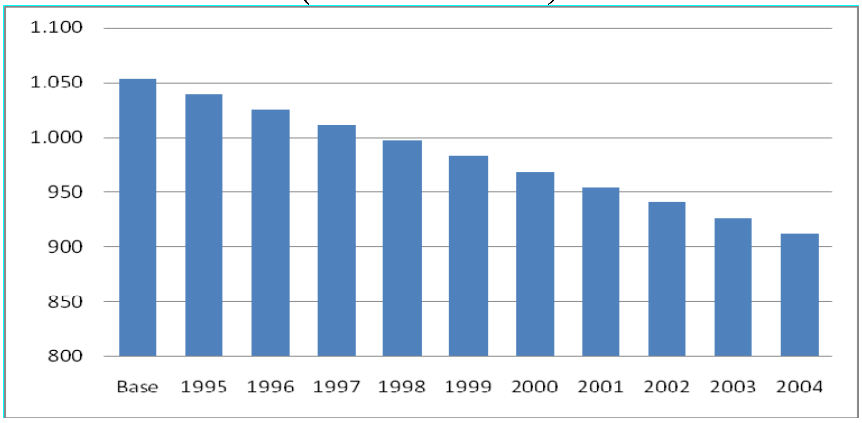
- In the case of sugar, the situation is quite the reverse. Of the 1,770 million euros allocated to this product, the larger share (1,080 million) goes on refunds, and a further 232 million is for storage costs. The policy of paying the producer high prices is basically financed by the consumer, and these funds do not come out of the CAP budget.

4.3.3. The Extended MERCOSUR

In the extended MERCOSUR, the only country that has made a commitment to reduce domestic assistance for agriculture is Brazil. As part of the so called 'amber box' programmes, expenditure in this area was gradually reduced from 1,050 million US dollars to just under 900 million over the 1995-2004 period

The lack of a common agricultural policy somewhat hampers a comparison between the EU and MERCOSUR agricultural policies. Nevertheless, one form of measurement that can facilitate a comparison is to consider the relation between public expenditure in the agricultural sector (for which there are some figures for the extended MERCOSUR) and sectorial GDP.

FIGURE 9
BRAZIL: COMMITMENTS TO REDUCE DOMESTIC SUPPORT, 1995-2004
(million US dollars)



Source: OECD

As can be seen in Chart 18, these costs fluctuate a lot between countries in the region. In 2005, expenditure of this kind in Chile was equivalent to 9.9% of agricultural GDP, and this made Chile the country with the highest public agricultural expenditure as a proportion of sectorial GDP. Next on the list came Uruguay with 8%, Bolivia with 4.8%, and the country with the lowest rate was Paraguay with 2.1%. Note that in some countries the proportion of agricultural public spending is very low (3% in Argentina and 2.67% in Brazil), which no doubt reflects the fact that the sector is very competitive. However, it should be born in mind that the Chart does not take into account assistance at the province or state level in Argentina and Brazil.

CHART 18
EXTENDED MERCOSUR: PUBLIC AGRICULTURAL SPENDING, 2005
(million US dollars)

Agricultural public expenditure policy	Argentina	Bolivia	Brazil	Chile	Paraguay	Uruguay
1. Public expenditure on promoting production	378.02	54.84	892.36	372.90	12.49	34.88
a. Horizontal production promotion	*228.83*	*27.49*	*339.22*	*181.00*	*9.87*	*21.28*
b. Localised production promotion	*149.19*	*27.35*	*553.14*	*191.90*	*2.62*	*13.60*

2. Infrastructure	75.35	8.48	637.02	*no data*	10.52	94.57
a. Agriculture infrastructure works	*67.00*	*8.48*	*637.02*	*no data*	*10.52*	*94.57*
b. Energy	*8.35*	*no data*	*no data*	*no data*		
3. Rural social spending	22.53	*no data*	71.50	282.90	8.25	125.76
4. Total expenditure on agriculture	475.90	63.32	1600.88	655.80	31.26	255.21
Agricultural expenditure / GDP (%)*	3.00	4.80	2.67	9.92	2.12	8

Source: REDPA, Policy Matrix, 2005.

In most of these countries a large portion of this expenditure goes to foster production, but in Uruguay social expenditure is the most important item followed by expenditure on facilities, and expenditure allocated to fostering production is in third place.

Chart 18 and Annexes 22, 23 and 24, give a more detailed picture of the agricultural policy instruments this expenditure is allocated to.

It can be seen in Annex 23 that most of the productive units in Argentina, Brazil, Chile and Uruguay are less than 50 hectares in size, and there are processes of concentration of land in all these countries. Nevertheless, Argentina and Uruguay have a more balanced distribution of land, while in Chile and Brazil there is a high degree of concentration with a very low percentage of proprietors owning the larger areas, and a large number of smallholders. In Bolivia the situation is different: small productive units predominate on the high plateau while in the east of the country most holdings are medium-sized and large.

According to the information available, most holdings are in the hands of their proprietors. However, in Chile the proportion of leased land is greater than in the other countries, and in Argentina and Uruguay a higher proportion of farmers are tenants, especially in the production of crops like soya beans.

As for land reform, in all these countries the institutional system is involved in the process of the allocation or distribution of land. Brazil seems to have the clearest policy in this respect, but the subject has become more important in all the countries' sectorial policies. Brazil is the only member of the extended MERCOSUR to take positive steps in this direction and to be operating an active process of land redistribution.

In Annex 24 it can be seen that all the countries have policies to manage water and forestry. That is to say, they all have legislation in force governing the use of biofuels, with the exception of Chile which is in the process of implementing a policy of this kind. Argentina, Chile and Uruguay have animal welfare standards, and in Brazil the application of a policy of this type is currently under debate.

In Chile the main areas of agricultural public spending are, in order of the amounts involved, irrigation, productivity improvement and the development of capabilities, rural development, soil recovery, training and extension. Considerable resources are also devoted to social expenditure and fostering production.

As to financial instruments, it can be seen in Annex 22 that Argentina makes use of the warrants systems for rice, oils, apples, olives, hides, oats and rice husks, and futures markets are in operation for soya beans, maize, sunflowers and wheat. Brazil also makes use of the warrants system and other credit instruments for sugar, cotton, sugarcane rum and alcohol. Chile has developed agricultural insurance for maize, wheat, wine in bulk, rice and raps.

All the MERCOSUR countries have implemented policies aimed at improving producers' competitiveness so as to promote favourable insertion in world markets. For this reason technology policies implemented by government institutions follow this path, but the countries in the region are still allocating insufficient investment to research and development.

Chile allocates relatively high amounts to this kind of policy, 1.02% of agricultural GDP, followed by Bolivia, Brazil and Argentina. Uruguay is the country with the lowest relative rate of investment in agricultural research and development: only 0.4% of sectorial GDP.

Investments in R&D have enabled some countries to develop new varieties of high productivity plants adapted to local conditions, such as enhanced soya beans in Brazil, biotechnology programmes to improve soya, oilseed and some cereals in Argentina, improved competitiveness in the production of quality beef in Uruguay, and developments in wine in Chile.

4.3.4. EU export subsidies and domestic assistance for some export products important for MERCOSUR countries

The following are some examples of EU support mechanisms for some products that loom large in MERCOSUR agricultural exports, such as rice, dairy products, cereals and oilseed.

a) Rice

Current direct assistance for this product increased from 52 euros/ton to 177 euros/ton (converted into assistance according to area, taking into account national yield coefficients). Of this, 102 euros/ton will be part of the Single Payment Scheme and will be paid in accordance with traditional rights, within the present limit of guaranteed maximum area. Likewise, the intervention price mechanism is maintained but with a 50% reduction, and stands at 150 euros/ton. Intervention is applicable to 75,000 tons per annum.

The CAP reform established a number of conditions for this kind of assistance. For instance, to qualify for the Single Payment Scheme it is necessary to comply with standards for environmental protection, food safety, animal and vegetable health and animal welfare. In addition to this, there is a requirement that agricultural land be kept in good agronomic and environmental condition. Along the same lines, there are modulation conditions (reductions in direct payments in order not to go over budget), agricultural audits and possible sanctions when established limits for areas or maximum quantities are exceeded.

In the case of rice, there are also requirements about sowing deadlines, varieties, crop mix, payment terms, etc. The European Union grants the rice sector average annual assistance to the tune of 406 million euros, although during the last three commercialisation campaigns the sum for global measures increased steadily.

In addition, assistance is granted through exempt direct payments (compensatory payments per hectare for rice producers) of around 110 million euros per annum.

CHART 19
EU: DOMESTIC ASSISTANCE AND SUBSIDIES FOR RICE

Commercialisation campaign	Export subsidies (million euros)	Internal assistance (million euros)
2001-2002	30.3	112.8 (compensatory payment per HA*) 396.5 (GAM)
2002-2003	24.9	117.5 (compensatory payment per HA*) 405.6 (GAM)
2003-2004	No data	110.1 (compensatory payment per HA*) 420.7 (GAM)

Source: European Union notification to the WTO.
GAM: Global Assistance Measures: All assistance granted to specific products and assistance not earmarked for specific products that is not only subject to commitments to reduction but whose level has been established at the WTO. Thus assistance in excess of a given notified sum for each country is not allowed. A typical example of this kind of measure is that of maintaining price levels.
Exempt Direct Payments: Payments made in the framework of production-limiting programmes. Such payments are linked to a specific number of head of cattle.

The rice sector receives average export subsidies from the European Union amounting to about 25 million euros per annum. This distorts these firms' competitiveness and rebounds to the detriment of MERCOSUR rice exporting countries such as Uruguay.

b) Dairy Products

According to notifications to the WTO, the EU granted a total of 6,884.7 million Euros to the dairy product sector in 2003-2004, which is the latest period for which the WTO has received notification. The specific products that benefited include powdered skimmed milk, butter and milk. These assistance payments were classified as amber box internal assistance by specific product.

Of the above sum, only assistance that went to powdered skimmed milk and butter was included in the Global Assistance Measure (GAM). Assistance provided for milk was not included because it is a considered *de minimis.* In other words, if the outlay is less than 5% of the value of the total production of milk it can be disregarded, and thus it is possible to remain within the limits of outlay allowed. In the EU, this is the sector receiving the greatest domestic assistance payment.

Assistance for powdered skimmed milk and butter was granted to keep prices up, while assistance for milk was granted directly to support production in Finland.

Besides amber box assistance measures, the EU also grants assistance of the green box type, i.e. the kind of assistance that will not distort trade or do so only minimally, and which is allowed without limits to outlay. The green box assistance that the EU grants the dairy sector lies comes in the class considered as ‘domestic food assistance’, that is to say, assistance provided for the most needy sector of the population, and it takes the form of directly supplying food products to beneficiaries, providing beneficiaries with the means to buy food products at market prices, or subsidising prices.

The EU also grants a considerable number of export subsidies, mainly for cheese and powdered skimmed milk. In 2002-2003, the last period for which the WTO has been notified about export subsidies, the EU granted a total 1,027 million euros for dairy products, of which 26% was earmarked for cheese (267.7 million euros), 16% for powdered skimmed milk and 58% for other dairy products. In addition to this, the EU has reported that in 2002-2003, food assistance consisting of dairy products amounted to a total of 1,200 tons.

c) Cereals

In 2001-2002, subsidies granted by the EU to the cereal sector amounted to 112.8 million euros for the production of 3,922.4 million metric tons (the harvest qualifying for this subsidy started on 1 July, 2001). In addition to this, the EU provided food assistance in cereals amounting to 58.2 million metric tons.

For 2002-2003 (the latest period reported to the WTO) total expenditure on export subsidies amounted to 167 million euros, which means that a total of 6,259.3 thousand metric tons was subsidised. The EU also granted 86.5 thousand metric tons of cereals in food assistance.

In addition to this, according to European Union notifications to the WTO, in 2003-2004 (the last period covered), domestic assistance to maintain price levels was granted to barley producers (1,859.8 million euros), rye producers (243.2 million euros) and sorghum producers (8.8 million euros). This assistance was classified as amber box domestic assistance for specific products. The EU reported negative assistance for oats of -89.2 euros.

The European Union also granted blue box domestic assistance to secondary cereals by means of direct payments in the framework of programmes limiting production. These measures are exempt from reduction commitments as they are based on areas and fixed yields rather than on volume of production.

d) Oleaginous products and vegetable oils

With the 2003 CAP reforms, payments connected to production in the olive oil sector became direct income assistance. Thus 60% of payments linked to production were turned into new rights under the Single Payment Scheme for exploitation.

As is the case for other EU sectors, this new kind of assistance for producers in the sector depends on compliance with environmental and food safety standards, through the policy of ecological conditioning.

The EU has still not notified the WTO about levels of assistance for the seed and oil sector after the CAP reforms. However, the amounts of domestic assistance awarded to the olive oil sector for 2001/2002 to 2003/2004 are available. During the 2001/2002 period, assistance amounting to a total of 2,070 million euros was provided for the purpose of maintaining price levels, and in the 2002/2003 and 2003/2004 campaigns assistance amounted to 2,122 and 2,649 million euros respectively. This too was for programmes aimed at maintaining prices.

e) Some comparative observations about EU assistance and subsidies for specific products important for MERCOSUR.

The above outline sums up a very important question in the bilateral negotiations and is the reason for continued rejection on the part of agricultural producers in the extended MERCOSUR. These producers would have to compete with European agricultural producers under asymmetrical conditions in the framework of a bilateral free trade agreement and also in international markets, and this would even affect MERCOSUR’s own domestic markets. This is because still today (albeit to a far lesser extent than previously due to the policy of ‘decoupling’), European agricultural subsidies and assistance make European producers artificially more competitive than the unsubsidised agriculture in the MERCOSUR countries, which, to make matters worse, is even liable for export taxes.

It is not feasible to solve the question of internal assistance in bilateral negotiations. A solution will depend on the international environment at the WTO. Even export subsidies will require sophisticated mechanisms if they are to have any real effect in the framework of a bilateral agreement while preventing the triangulation of prices. However, the fact is that the question of domestic assistance and export subsidies is a factor in the negotiating climate, and may hamper progress. This suggests that it would be advantageous to search for flexible formulae to enable the EU to grant some concessions in order to somehow compensate for the disadvantages that MERCOSUR agriculture is burdened with.

5. EU-MERCOSUR NEGOTIATING PROPOSAL 2004

5.1. Tariff Reduction

a) European Proposal

In 2004 the European Union submitted a proposal for the reduction of tariffs on MERCOSUR agricultural exports. This involves five categories of reduction, which depend on how sensitive different products are for European producers.

1. *Category A:* Less sensitive products. For these the EU proposes the complete elimination of tariffs when the bilateral agreement is signed.

Seventy percent of European imports from MERCOSUR come in this category. Note that that 50% percent of these imports already enjoy free access to the European market.

2. *Category B:* Products for which the EU proposes to completely eliminate tariffs four years after the bilateral agreement is signed.

3. *Category C:* Products for which the EU proposes to completely eliminate tariffs seven years after the bilateral agreement is signed.

4. *Category D:* Products for which the EU proposes to completely eliminate tariffs ten years after the bilateral agreement is signed.

5. *Category E:* Highly sensitive products for which the EU does not propose any reduction in tariffs whatsoever. This category includes meat, sugar, wine, some fruit and vegetables, and the volumes involved amount to a very small percentage of current MERCOSUR exports to Europe because the access conditions for these products entering the European market are so adverse. Naturally, this small percentage is out of all proportion to these products' great export potential.

CHART 20
EU: PROPOSAL FOR TARIFF REDUCTIONS ACCORDING TO PRODUCT CATEGORY

	Year after signing											Number of tariff lines	Percentage of tariff lines	Average tariff applied	Percentage of exports to EU
	0	1	2	3	4	5	6	7	8	9	10				
Category A	100											4323	41.5	1.4	69.9
Category B	20	40	60	80	100							2182	20.9	4.5	6.7
Category C	12.5	25	37.5	50	62.5	75	88	100				2664	25.5	8.4	12.4
Category D	9	18	27	36	45	54	63	72	81	90	100	429	4.1	17	5
Category E	0	0	0	0	0	0	0	0	0	0	0	532	5.1	15.1	3.1

Source: European Commission.

b) The MERCOSUR Proposal

The first MERCOSUR offer covers 32.6% of MERCOSUR imports from the EU, and a notable feature of the offer is that MERCOSUR has announced its intention to reach a 100% reduction in taxes on trade and maintain *ad valorem tariffs* as its only tariff protection. In this proposal, MERCOSUR has excluded 68% of trade.

In the analysis of this offer the same categories for tax reduction as in the EU proposal are used.

CHART 21
THE MERCOSUR TARIFF OFFER TO THE EU:
MERCOSUR IMPORTS FROM THE EU – 1996-2000 AVERAGE
(million US dollars)

	A		B		C		D		E		TOT
Agriculture and fisheries	43	0.2%	17	0.1%	116	0.5%	5	0.0%	11	0.0%	193
Foodstuffs industry	0	0.0%	1	0.0%	37	0.2%	41	0.2%	13	0.1%	91
Minerals and fuels	176	0.8%	0	0.0%	7	0.0%	0	0.0%	0	0.0%	182
Chemicals, pharma., plastics	195	0.8%	997	4.3%	150	0.7%	552	2.4%	55	0.2%	1949
Paper, publications	57	0.2%	0	0.0%	1	0.0%	0	0.0%	0	0.0%	58
Stone, cement, ceramics, glass	0	0.0%	7	0.0%	26	0.1%	29	0.1%	12	0.1%	73
Metal and manufactures	5	0.0%	0	0.0%	3	0.0%	65	0.3%	6	0.0%	79
Machines, electric equipment	536	2.3%	80	0.3%	190	0.8%	2534	11.0%	37	0.2%	3376
Tractors, aircraft, ships	745	3.2%	0	0.0%	0	0.0%	38	0.2%	0	0.0%	783
Optical, photographic, surgical medical instruments and equipment, and furniture	143	0.6%	8	0.0%	13	0.1%	318	1.4%	50	0.2%	533
TOTAL OFFER	1900		1110		542		3580		166		7319
Share in EU imports	8%		5%		2%		16%		1%		32%

Source: European Economic Commission.

5.2. Tariff Quotas

a) European Proposal

The 2004 European 2004 proposal for tariff quotas covers all the sensitive agricultural products in the negotiations, namely meat (beef, pork, chicken), cereals (maize and wheat), dairy products (powdered milk, butter, cheese) and ethanol. It distinguishes two different steps: a first group of quotas granted when the bilateral agreement is signed, and additional tariff quotas after the WTO multilateral agreement stemming from the Doha Round has been signed, as a part of the *erga omnes* quota open to all countries earmarked for MERCOSUR.

CHART 22
EU: QUOTAS PROPOSED IN MERCOSUR-EU ECONOMIC ASSOCIATION AGREEMENT (EAA) NEGOTIATIONS
(metric tons) 2004

Products	Direct quotas "First step"	Additional quotas resulting from Doha Round "Second step"	TOTAL quota
Beef	60,000	40,000	100,000
Pork	6,000	5,000	11,000
Chicken	45,000	30,000	75,000
Maize	400,000	300,000	700,000
Low quality wheat	120,000	80,000	200,000
Ethanol	600,000	400,000	1,000,000
Milk and powdered milk	6,500	6,500	13,000
Cheese	10,000	10,000	20,000

Source: European Economic Commission

6. CONCLUSIONS

It is not possible to make a true comparative analysis of EU and MERCOSUR agricultural policies without taking the global context of the two blocs' trade relations into account.

In economic terms, there is clear asymmetry between the two regions. EU-25, with just under twice the population of MERCOSUR, generates a GDP that is 9.3 times greater, and its exports are seven times greater than the extended MERCOSUR's. This disparity goes some way towards explaining why EU-25 per capita GDP is five times greater than the extended MERCOSUR's.

This asymmetry does not prevent there being strong links between the two blocs. Europe is one of the main investors in the extended MERCOSUR, particularly in Brazil, Bolivia and Chile, where EU investments account for more than one third of total foreign investment. Thus, an Association Agreement between the two regions would not only improve conditions for European investors, it would also lead indirectly to increased flows of trade between the EU and MERCOSUR thanks to the greater legal security that the agreement would provide, and this would be reflected in more profits for European enterprises located in MERCOSUR countries. Besides this, MERCOSUR agricultural exports account for more than 20% of Europe's total agricultural imports. Agricultural products occupy a strategically important position between the two blocs because the global balance of trade, which is very much in MERCOSUR's favour, would be negative for the southern bloc if these products were not taken into account.

It should be noted that despite the strong links between the two blocs they do not give preferential trade treatment to each other except for GSP Plus, whereby Bolivia enjoys trade advantages in the EU, and the Economic Association Agreement between Chile and the European Union.

The agricultural policies of the European Union and MERCOSUR are clearly divergent.

In the first place, their objectives are different. Whereas, despite CAP reform, the main European objective is still to defend agriculture in the EU countries, the MERCOSUR countries have focused their policies on improving competitiveness in order to penetrate international markets, and in recent years they have placed greater emphasis on rural development policies to support marginal and small agricultural producers.

The two blocs can also be differentiated by their instruments they employ.

- The Southern Cone countries have liberalised their economies and have drastically cut support of agriculture, while the emphasis in the EU policy, in contrast, is on mechanisms for generalised direct assistance.

- When it comes to access to markets, the EU, unlike MERCOSUR, makes use of all available instruments for protection such as tariff peaks, tariff escalation and quotas. The European Union applies these kinds of instruments far more than does MERCOSUR, particularly for products that loom large in MERCOSUR exports.

- European export subsidies were high in the 1990s but were reduced sharply in the latest CAP reforms. Previously they were geared more to meat and cereals but now their greatest impact is on sugar and dairy products. In 2005 the latter two items accounted for 70% of total export subsidies. European subsidies have been cut considerably but they are still high in comparison to those of the MERCOSUR countries, and this difference is further exacerbated by the fact that MERCOSUR agriculture does not just lack subsidies but is burdened with export taxes.

Bearing these context-related elements in mind, we can easily identify two key points in future bilateral EU-MERCOSUR negotiations:

MERCOSUR is clearly on the offensive in the sphere of agriculture, and the EU position is merely defensive. Europe’s generalised support for agriculture gives European producers an artificial advantage over MERCOSUR producers in international markets since the latter have nowhere near the same levels of support and are heavily taxed.

Access to European markets is of vital importance to MERCOSUR, but today access to these markets is restricted by high barriers against imports, and the only flexibility in this scenario is provided by limited tariff quotas in the framework of managed trade.

Agricultural negotiation cannot be analysed independently of the framework of global negotiations, which also include manufactured goods and services. It is obvious that the European Union will not substantially improve its 2004 agricultural offer unless MERCOSUR reciprocates with concessions in the areas of manufactured goods and services.

The complexity of EU-MERCOSUR trade negotiations goes far beyond the bilateral relationship between the two blocs. It is not feasible to tackle the question of domestic support just on the bilateral level; progress will depend on developments in the multilateral arena of the WTO. Similarly, the possibility of the MERCOSUR countries obtaining larger tariff quotas is closely linked to the multinational negotiations through which the EU grants *erga omnes* quotas that are open to all countries on a competitive basis. The question is whether the quotas granted by the EU to MERCOSUR are to be a part of the global *erga omnes* quotas that have already been established or are on the agenda at the WTO, or whether they are to be additional to these.

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