Position paper

FTA MERCOSUR

Key issues for the mechanical engineering industry

- Resuming negotiations between the EU and MERCOSUR.
- Lifting customs tariffs of the MERCOSUR states on mechanical engineering products.
- Taxation of the import value without including customs duties in Brazil.
- Coherence of rules of origin with other EU free trade agreements.
- No misuse of technical requirements as market access barriers.

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Setting realistic targets, creating short-term growth stimuli

A. General

The German Engineering Association (VDMA) is the largest European association in the capital goods industry with over 3,150 German and international member companies. The sector employs over 1 million people (as at August 2015) in Germany and generated revenues of around €212 billion in 2014.

The capital goods industry has a large number of medium-sized companies. Around 87% of all VDMA members are small and medium-sized enterprises (SMEs) according to the EU definition with two-thirds employing fewer than 100 staff. The sector is not only heavily export-oriented with an average export ratio of 77% but is also extremely successful globally. One indication of this is that almost 60% of exports are sold outside of the EU. The sector's high level of innovation is reflected in the fact that VDMA member companies are currently global market leaders in 18 of 32 internationally comparable product areas in the mechanical engineering industry.

To ensure the mechanical engineering industry can continue to operate successfully Europe-wide, export markets have to be kept open or existing trade barriers to markets dismantled. Only in this way can sustainable growth be achieved and jobs maintained or created in Europe.

B. Introduction

The South American economic alliance MERCOSUR is one of the focus regions of the German and European mechanical engineering industry, not least owing to the major regional importance of Brazil as a market and investment location.

MERCOSUR is the third most important economic area for the European mechanical engineering industry and the fourth largest sales market for the German mechanical engineering sector. There is global competition for market access to the MERCOSUR states between European, Asian and US mechanical engineering companies. Resuming trade negotiations with the MERCOSUR states to lay the foundations for a subsequent, comprehensive trade agreement is therefore in European interests.

Expectations of an upturn in the region were raised after the 2008 financial crisis. Negotiations between the EU and the South American MERCOSUR internal market organization (Argentina, Brazil, Paraguay and Uruguay) broken off in 2004 were resumed in 2010. The new members – Bolivia and Venezuela – did not take part in the negotiations at their own request.

Owing to significantly intensified protectionism in Argentina since 2012, the negotiation process once again ground to a halt without the exchange of negotiation proposals. The cessation of the status of general EU preferences for Argentina and Brazil did not have a beneficial effect.

The political context has fundamentally changed since 2010. Brazil finds itself in a major economic and political crisis which could lead to the collapse of the government. The economic model of discretionary economic promotion through customs duties, taxes and funding programmes has not proven sustainable which means that Brazil urgently requires fresh impetus. New elections have brought about a change of government in Argentina. The new president Macri is again focussing on international cooperation by observing international agreements. Argentina has therefore undertaken an about-turn towards an open trade policy which may favour negotiations. Macri needs international success to secure the nation's financial stability. The EU should take advantage of this window of opportunity and provide the new Argentinean leadership as well as Brazil with specific incentives to open up their markets.

MERCOSUR is also faced with new competition within Latin America in the form of the 'Alianza del Pacífico'. This region, which is also striving for tariff dismantling, could overtake MERCOSUR as a new investment region. In contrast to 2010, China has pumped an enormous amount of credit into Latin America and is increasing its sales in Latin America in the mechanical engineering sector year on year.

MERCOSUR has an interest in not becoming further dependent upon China. It also urgently requires economic policy stimuli in the current economic crisis.

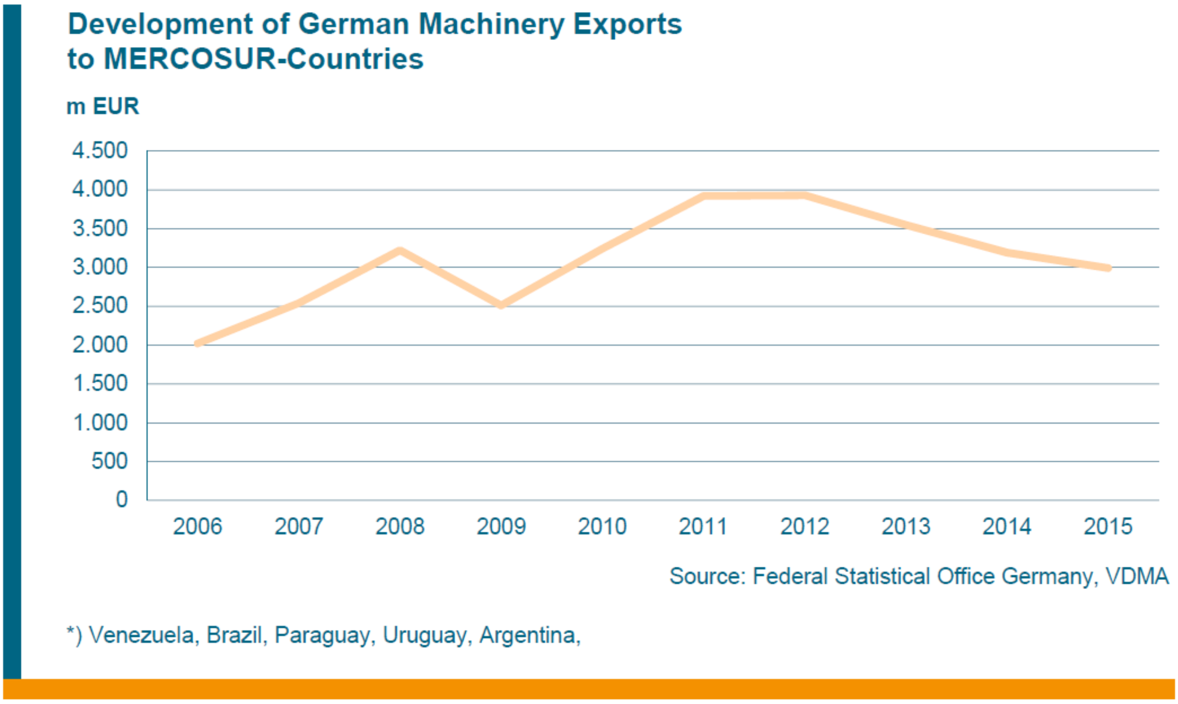
C. Importance of MERCOSUR to the German mechanical engineering industry

In 2015, Brazil imported German mechanical engineering goods worth just under € 2 billion. This represented a decline of over 15% in comparison to an export volume of € 2.5 billion in 2011. This trend looks set to continue in 2016 – based on the existing figures – albeit at a slower pace. Argentina, the second largest market within the MERCOSUR group, imported goods worth around € 545 million in 2015. Uruguay follows in third position with an import volume of just under € 177 million while Paraguay occupies fourth place with around € 25 million. The key MERCOSUR markets differ greatly in terms of their importance as sales markets for German mechanical engineering firms. The fall in exports in recent years has cancelled out the 2010 to 2012 growth rates.

German Exports to MERCOSUR-Countries*

Total Exports of Goods		Machinery exports		
Year	m EUR	m EUR	Share in Total Exports (in percent)	Changes to previous year (in percent)
2006	8.114	2.020	24,9	
2007	9.538	2.543	26,7	25,9
2008	11.739	3.222	27,4	26,7
2009	9.510	2.510	26,4	-22,1
2010	13.843	3.241	23,4	29,1
2011	14.943	3.920	26,2	21,0
2012	15.823	3.930	24,8	0,3
2013	15.468	3.547	22,9	-9,7
2014	14.098	3.193	22,6	-10,0
2015	13.670	2.992	21,9	-6,3

Source: Federal Statistical Office Germany, VDMA



D. Customs

The joint customs tariffs of MERCOSUR provide for a 14% tariff rate for most mechanical engineering products (lower to duty free for some goods and up to 20% higher for others). These are amongst the highest tariff rates in global comparisons. The Brazilian system of duty suspension, on one hand, and high domestic taxes – which are added to the export value subject to duty – on the other, mean huge distortion of market access.

VDMA's Roland Berger Brazil study in 2014 showed that the rise in costs had an impact on the entire value-creation chain in the mechanical engineering industry. Tariff dismantling would ultimately also strengthen the position of local manufacturers as there would be greater competition in components.

With regard to Argentina it remains to be seen how the import quotas prohibited by the WTO will be abolished.

In VDMA's view, the FTA negotiations must aim to achieve the complete dismantling of tariffs without exception. However, such dismantling does not have to take place immediately (which would obviously be the best outcome from our perspective) and graduated dismantling over a period of three to a maximum of five years could be negotiated for certain products.

E. Rules of origin

Rules of origin is an extremely important issue for our member companies. The rules of origin should be in line with those of other EU free trade agreements (e.g. with South Korea) to reduce bureaucracy for the companies and to create viable rules for them. It is essential that the areas of industry currently affected by this issue are involved in the negotiations.

F. Customs procedures/internal taxes

In particular in Brazil, internal duties and taxes (IPI, ICMS, PIS, COFINS) result in an import charge of around 60% of the CIF value. This was also confirmed by VDMA's Roland Berger Brazil study in 2014. Dismantling external tariffs would be a first important step towards improving market access.

G. Non-tariff trade barriers, technical trade barriers

Technical regulations in Brazil hamper market access. The 'Norma Reguladora 12' regulation on machinery safety, which was reformed in 2010, has made the situation significantly worse owing to its complexity. Due to the NR 12's lack of clarity in terms of interpretation and additional safety requirements, technology transfer in the form of state-of-the-art and inherently safe machinery in particular – which is currently so important to Brazil – is being adversely affected to a significant extent.

In addition, there is the trend in Argentina, which primarily emerged in 2015, of deploying technical provisions for market foreclosure. New technical regulations (such as for electrical equipment), that are difficult for importers to meet, are being made mandatory in individual machine categories where there is great import competition. A further shift in this direction would almost certainly cancel out possible success over tariff trade barriers.

H. Public procurement

Modernization and a policy of openness are urgently required with regard to public procurement and invitations to tender, particularly in Brazil. The recent Petrobras corruption scandal illustrates this. The priority is reducing the local-content provisions on which the invitation-to-tender system has been based to date.

I. Summary

The development of MERCOSUR into a uniform economic area would be beneficial with regard to direct investment.

A free trade agreement should in particular also allow non-tariff trade restrictions (such as technical regulations on machinery safety) to be addressed. They represent a trade-restricting problem for exporting to Brazil but also for local mechanical engineering companies.

VDMA firmly believes that the challenges of MERCOSUR can only be overcome through interaction between local and foreign technologies. A stable framework for all key members – which concerns customs as well as taxes and funding programmes – is also an important factor.

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