



Mercosur-SACU FTA: Strengthening Relations across the South Atlantic

South-South cooperation (SSC) presents developing countries with several opportunities in terms of trade, which include reducing dependency on the markets of developed countries, climbing value chains and strengthening their influence in the multilateral trading system. The regional trading arrangement (RTA) between the Mercado Común del Sur (Mercosur) and the Southern African Customs Union (SACU) is one of several initiatives that can be seen as part of this development.

Mercosur and SACU signed a preferential trade agreement (PTA) at the end of 2004, as a first step toward the creation of a free trade area (FTA). However, the PTA is limited in scope and its impact on trade flows and economic benefits is likely to be minimal. Although the impact of a future Mercosur-SACU FTA would be greater, there is still a risk that political economy reasons in particular could stand in the way of reaping benefits.

Even if direct economic benefits through increased trade would not materialise to any great extent, closer ties between Mercosur and SACU would arguably bring indirect benefits, for instance, through gathering momentum in the India-Brazil-South Africa (IBSA) Dialogue Forum as well as its contribution to strengthen SSC.

Introduction

Mercosur and SACU are key players in Latin America and Africa, respectively. Mercosur is a customs union comprising Argentina, Brazil, Paraguay and Uruguay (with Bolivia, Chile, Colombia, Ecuador, Peru and Venezuela as associate members) that came into existence on December 31, 1994, following the Treaty of Asunción signed in 1991. SACU – which is composed of Botswana, Lesotho, Namibia, South Africa and Swaziland – dates back to 1910 and as such it is the world's oldest customs union.

Although trade between the two trading blocs has picked up pace somewhat in recent years, it remains at a low level. In a bid to boost trade flows as well as to strengthen economic cooperation, Mercosur and SACU, therefore, signed a PTA at the end of 2004. This PTA is seen as the first step toward the creation of an FTA between the two groups. This paper addresses the background, implications and future challenges of the Mercosur-SACU initiative.

Mercosur-SACU Trade Relations

In December 2000, South Africa and Mercosur signed a 'Framework Agreement' with the objective of forming an FTA. The Agreement was partly the result of a growing South African interest in the newly formed trading bloc across the South Atlantic. This is not surprising, as Mercosur had emerged as one of the largest integrated markets in the world. Yet at the time of signing, the South American trading bloc only constituted 1.5 percent of South Africa's total trade.

Trade between South Africa and Mercosur had more than doubled by 2004 and now accounts for 2.1 percent of the former's total trade. It should be noted here that recent trade data on SACU is scarce, but because South Africa is such a dominant power in SACU – accounting for roughly nine-tenths of the

group's combined population and GDP – its trade flows will frequently be used as a proxy for the whole group in what follows.

Mercosur's trade with South Africa, conversely, made up around 0.8 percent of the bloc's total intra regional trade – a figure that had also risen in the past few years.

In 2004, total trade between South Africa and Mercosur amounted to US\$1.83bn. South African exports totalled US\$304.2mn, whereas its imports from Mercosur stood at US\$1.52bn. Mercosur, therefore, enjoyed a sizeable trade surplus. Interestingly, as shown in figure 1, South African

Table 1: Mercosur: Selected data, 2004

Indicators/ countries	Mercosur	Argentina	Brazil	Paraguay	Uruguay
Population (mn)	226.1	38.2	178.7	5.8	3.4
Gross Domestic Product (US\$bn)	775.7	151.5	604.0	7.1	13.1
GDP per Capita (US\$)	3,431	3,966	3,380	1,224	3,853
Annual Average GDP Growth 1994-2004 (%)		0.3	2.1	1.0	-0.1
Main Exports	Mineral fuels and oils, agricultural products	Soya beans	Food products	Soya beans	Animal products
Main Imports	Machinery, electrical machinery, mineral fuels and oils	Motor vehicles and parts	Crude petroleum oils	Computers, office machines and parts	Crude petroleum oils

Sources: World Bank, WTO, International Trade Centre (ITC) and BrazilTradeNet.
Note: Only Mercosur's exports and imports are extra-regional.

Table 2: SACU: Selected Data, 2004

Indicators/ countries	SACU	Botswana	Lesotho	Namibia	South Africa	Swaziland
Population (mn)	52.2	1.7	1.8	2.0	45.6	1.1
Gross Domestic Product (US\$bn)	230.8	8.7	1.4	5.5	212.8	2.4
GDP per Capita (US\$)	4,421	5,118	778	2,750	4,667	2,182
Annual Average GDP Growth 1994- 2004 (%)		5.7	2.6	3.3	2.9	2.9
Main Exports	Metals, minerals, cars	Diamonds	Apparel	Fish products	Metals, minerals, cars	Sugar, sugar- based flavourings
Main Imports	Crude petroleum oils	Vehicles	Knitted and crocheted plus cotton fabrics	Petroleum oils, not crude	Crude petroleum oils	Petroleum oils, not crude

Sources: World Bank, WTO and ITC.
Note: Only SACU's exports and imports are extra-regional.

exports to Mercosur remained fairly static between 2000 and 2004, whereas imports surged by more than US\$1bn during the same period. In fact, this trend reflects Brazil's total extra-regional trade in recent years, mainly attributed to weak domestic demand *vis-à-vis* the growing overseas demand overseas for many of its exports.

As would be expected, the main trading partners in Mercosur-SACU trade are South Africa and Brazil. Some two-thirds of South Africa's trade with Mercosur is transacted with Brazil alone. Virtually all trade with SACU from Mercosur's viewpoint is done with South Africa. For example, in some cases the Mercosur countries did not even report any exports to or imports from one of the other SACU members in 2004.

South Africa's main exports to Mercosur are iron and steel products; mineral products, including coal; organic chemicals; miscellaneous chemical products; and paper and paperboard products. The main imported items include: vehicles and their components; chemicals; residues and waste from food industries; animal or vegetable fats and oils; meat and edible meat offal; and machinery. South Africa generally exports primary products, whereas Mercosur's exports are typically higher value-added products (Simon Roberts, "Reflections on Approaching an FTA Negotiation with Mercosur: A Review of Key Issues", The South African Institute of International Affairs (SAIIA), Trade Policy Report No. 6, November 2004, Carol Molate & Dirk Ernst van Seventer, "Bilateral Trade Between Brazil and South Africa", TIPS Focus on Data Series, December 2003).

Political Economy behind RTAs

The prospect of expanding trade between the two regions is one of the reasons for SACU and Mercosur to engage in an RTA. There are other reasons as well, however, that would have prompted them to strengthen their ties. Countries around the world have in the past decade been in a rush to negotiate and form RTAs and the Mercosur-SACU initiative can, somewhat cynically, be seen as simply yet another manifestation of this trend.

However, a factor behind the surge in new RTAs has been the lack of progress of multilateral trade talks as well as, from developing countries' point of view, the disappointment with the benefits from the multilateral trading system. Hence, instead of seeking greater market access on the multilateral level, countries have looked for it on the regional level.

Regarding the preceding issue, what happened at the World Trade Organisation (WTO) Ministerial at Cancún in 2003 and the emergence of the G-20 as a powerful voice in the multilateral trade forum are contributive developments. In this context, with South Africa and all the Mercosur members – notably Brazil – part of the G-20, strengthening the ties between them in an RTA could also lead to a stronger G-20.

A further reason for SACU and Mercosur seeking closer relations with one another is to strengthen SSC. More importantly, in strengthening their economic relations, developing countries are looking to, *inter alia*, reduce their dependence on the markets of developed countries, and endeavour to diversify their own economies. The Mercosur-SACU initiative can be seen as a part of this effort. In addition, as will be seen below, it can be seen as contributing to the development of the IBSA process.

PTA and its Evolution

On December 16, 2004, Mercosur and SACU signed a PTA between them. The agreement was based on the South Africa-Mercosur Framework Agreement of 2000 and was seen as 'a first step towards the creation of a free trade area' (Art. 2). The negotiations leading up to the PTA had not been without difficulties, and only a year before the deal was struck, Hilton Zunckel, senior researcher at the University of Stellenbosch-based *Trade Law Centre of Southern Africa (TRALAC)*, rhetorically asked if it was 'going the way of the rain forest?' (TRALAC, 2 December 2003, <http://www.tralac.org/scripts/content.php?id=2271>).

Several factors played a role in delaying the negotiations. First, there were domestic reasons. In Mercosur, the Argentinean and Brazilian economies were struggling, with the former defaulting on its debts at the end of 2001. SACU, meanwhile, was in the middle of renegotiating a new customs union agreement. Second, both trading blocs prioritised other bilateral trade negotiations over a Mercosur-SACU agreement. Mercosur was (still is) engaged in talks *inter alia*, with the European Union (EU) over an FTA, with the US and other countries in the Americas over a FTA of the Americas (FTAA) and with Latin American countries over closer economic relations. SACU, on the other hand, was negotiating FTAs with the US and the European Free Trade Association (EFTA).

Table 3: South Africa: Trade with Mercosur and the Rest of the World (RoW), 2004 (US\$mn)

	Exports	Imports	Total
Mercosur	304.2	1,521.7	1,825.9
- Brazil	238.5	973.5	1,212.0
- Argentina	59.3	531.7	591.0
- Uruguay	5.0	13.8	18.8
- Paraguay	1.4	2.7	4.1
RoW	39,256.2	46,493.9	85,750.1

Source: UN Comtrade Database

Finally, as pointed out by Lyal White of the *South African Institute of International Affairs (SAIIA)*, the Mercosur-SACU initiative is, in many ways, a political initiative between economic rivals and there was a lack of business and civil society involvement in the PTA negotiations (“SACU-Mercosur: Long Process, Little Progress”, presentation at workshop on Mercosur-South Africa in Rio de Janeiro, 17-18 February 2003, http://fp.chasque.net:8081/redmerco/english/2003/sacu_presentations/Pres_Lyal.ppt).

Notwithstanding these impediments, the leaders of the two trading blocs were able to sign the PTA in December 2004. The agreement establishes fixed preference margins between the parties on a limited number of products, the specifics of which are laid out in the first two Annexes. Annex I contains the preferences granted by Mercosur to SACU. In all, it features 958 product categories, such as organic chemicals (492 product categories), electrical machinery and equipment (74) and pharmaceutical products (59). SACU’s offer list to Mercosur is found in Annex II and contains 951 product categories, of which the major ones are electrical machinery and equipment (159 products), boilers, machinery and mechanical appliances (132) and plastics (95).

The Mercosur-SACU PTA also contains three other Annexes: rules of origin (RoO), safeguards and dispute settlement. In general, the PTA refers various trade policy measures – national treatment, antidumping and technical barriers to trade (TBTs) etc. – to the relevant articles of the WTO agreements. It also establishes a Joint Administration Committee (JAC) that shall meet at least once in a year and ‘ensure the proper functioning and implementation’ of the PTA and ‘recommend further steps to create’ an FTA (Art. 27).

Possible Impact and Outcomes

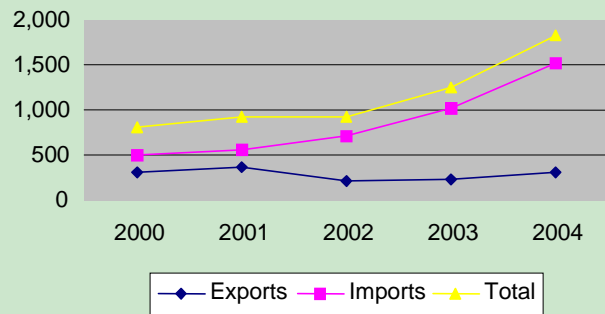
As a recent agreement, the Mercosur-SACU PTA has not yet shown any visible impact. Nevertheless, based on the two trading blocs’ offer lists and the trade structure, possible effects of the PTA can still be discerned.

The commodity most apparent when looking at South Africa’s export flow with Mercosur and seeing how it corresponds with the latter’s offer list is organic chemicals. It makes up of little more than half of the products to which Mercosur has granted preferential access, and in 2004, it was South Africa’s third largest exported product category to the South American trading bloc. Since South Africa was not among Mercosur’s major import partners of organic chemicals, there may be scope for the former to expand its market share. There are, however, also reasons to believe that the impact would be limited. Although many of the preference margins granted are 100 percent, the initial tariff levels generally stand at two percent only.

Moreover, organic chemicals also make up more than half (250 products) of Mercosur’s offer list to India in the PTA they signed in early 2004. In contrast to South Africa, India is one of Mercosur’s main import partners of organic chemicals. Although the two lists do not always feature the same products and the preference margins granted to SACU are on the whole greater than the concessions offered to India, the impact of the preferences on trade flows will (in both SACU’s and India’s case) be limited.

Analysing SACU’s offer list to Mercosur and how it corresponds with the latter’s exports to South Africa yields a somewhat different conclusion. None of the Mercosur countries are among SACU’s top ten import partners in electrical machinery and equipment or boilers, machinery and mechanical appliances. One study calculates the unweighted averages of tariffs on these two product categories to be 6.1 percent and 2.7 percent, respectively. (Rashad Cassim, “*Reflections on South Africa First Wave of Reforms*”, 50th Anniversary Conference

Figure 1: South Africa: Trade with Mercosur, 2000-2004 (US\$mn)



Source: UN Comtrade Database

Reviewing the First Decade of Development and Democracy in South Africa, 21-22 October 2004). This indicates that there exists a potential for Mercosur countries to increase their market shares in these two products categories.

In the final analysis, however, the impact of the PTA on trade flows between Mercosur and SACU is likely to be modest simply because it was never supposed to be anything but limited and serve as a first step towards an FTA. The real challenge and potential *vis-à-vis* significant impact in economic relations, therefore, lies before the two trading blocs.

Towards an FTA: Potential and Constraints

From SACU’s perspective, the sheer market size of Mercosur (a population more than four times its own) offers an opportunity for SACU to exploit niches there in a future FTA. As for specific goods, two studies seek to assess South African products that have export growth potential *vis-à-vis* Brazil through, *inter alia*, identifying under-traded goods. The main commodities found to have such potential include: aluminium and articles thereof; various chemical products and synthetic yarns; motor vehicles and components; synthetic fibres; and various machinery products, including electrical machinery (Simon Roberts, pp. 10-11; Matthew Stern & Christopher Stevens, “*FTAs with India and Brazil: An Initial Analysis*”, TIPS Working Paper No. 10, 2000).

Based on figures from 1998, Stern and Stevens also try to identify under-traded goods with export growth potential from Brazil to South Africa. They find agricultural products (including sugar and tobacco); vehicles and parts; wood furniture; semi-finished base metals (iron and steel); and leather footwear to be the main goods in this respect. According to the International Trade Centre (ITC), agriculture and hunting commodities as well as metal and metal products have an untapped export potential *vis-à-vis* South Africa (www.intracen.org/menus/countries.htm).

Notwithstanding the potential of increased trade in the above-mentioned products, on balance, the overall impact of a Mercosur-SACU FTA would be limited. To begin with, Mercosur and South Africa produce many common products, e.g. motor vehicles and components, electrical and electronic equipment, and agricultural products (Roberts S). This indicates that little exchange might take place, but more importantly it implies that businesses on both sides of the Atlantic will be defensive. Such protectionism is naturally more likely to go with the less competitive party, which in the case of Mercosur and SACU generally appears to be the latter. Disregarding protectionist pressures, Stern and Stevens find that the likely impact on trade between Mercosur and SACU even in the case of full liberalisation would still be modest. The main reason for a low increase in trade, they argue, is that the growth would be primarily based on trade diversion rather than trade creation.

Other constraints include the existence of non-tariff barriers (NTBs), especially in Mercosur (Roberts S). Thus, even with tariffs eliminated, NTBs, like complex regulations and cumbersome customs procedures, could offset many of the preferences accrued. Another constraint is the possibility of an FTA covering only goods and not including other areas such as services or investment. Indeed, the Mercosur-SACU PTA does not contain a single mention of either services or investment. Moreover, if included, negotiations on services and investment would arguably prove to be a more arduous exercise than those on goods.

Finally, some of the obstacles that prolonged the negotiations for a PTA would prove to be stumbling blocks in the negotiations for an FTA as well. The Doha round, albeit bogged down, is still ongoing, as are regional negotiations involving Mercosur and SACU with other trading partners, including the EU and the US. Not only do these multilateral and regional negotiations divert attention from talks on a Mercosur-SACU FTA, but they also strain resources. Another potential problem is that the negotiations are between two trading blocs, not between two countries. Differences, therefore, need to be resolved not only between Mercosur and SACU, but also among the various parties within each of the two groups.

In addition, there remains the risk that the FTA negotiations would be settled too much at the political level with a continued lack of input from businesses and the civil society, as is discussed next.

Stakeholders' involvement

The importance of sizeable participation of different stakeholders in the negotiations of any trade agreement cannot be understated. Yet there was a lack of involvement of businesses and civil society organisations (CSOs) in the PTA negotiations. In 2003, South Africa's chief trade negotiator, Xavier Carim, is reported to have complained about the indifference of the private sector in his country thus: "[T]he South African business community shows interest in free trade issues only when a full FTA is being negotiated ... [which] has slowed up the progress in talks with Mercosur." (Mining Weekly and Business Report, "Mercosur-SACU trade agreement needs more input from business", 1 December 2003)

The comment suggests that the interest of the private sector will gain momentum now that the PTA is in place. However, there is also some cause for concern that this will not be the case. As indicated above, Mercosur and South African businesses compete with each other in many product categories and, therefore, a high risk of loud protectionist voices could be heard on both sides of the Atlantic. In addition, because the businesses' main markets are situated in East Asia, North America and Europe, they are likely to be more concerned about getting involved in trade agreements with parties in those regions. This tendency is also reinforced by the relative lack of familiarity Mercosur and SACU stakeholders have with their respective regions.

The Bigger Picture

Since the Mercosur-SACU initiative does not take place in a vacuum, it is important to view it in the broader context of the trading system as a whole. At the multilateral level, the

Mercosur-SACU Framework Agreement makes clear the intention to conform to the WTO principles. Nonetheless, a PTA by definition detracts from the non-discrimination values endorsed in the multilateral system and also diverts attention from multilateral trade negotiations.

At the regional level, the Mercosur-SACU RTA is only one of hundreds of bilateral or plurilateral trade, investment and economic partnership agreements being formed around the world. As has already been pointed out, Mercosur's and SACU's other RTA engagements would divert attention and strain resources.

But the impact will not be one-sided; Mercosur-SACU relations also affect RTAs. One of the reasons for Mercosur and SACU to engage in a RTA is to strengthen SSC. In addition to being important players in their respective regions – Latin America and Africa – they have strong external relations with other developing countries as well. A key issue is convergence and whether South-South RTAs can be made compatible with one another rather than contribute to the 'spaghetti bowl' effect of a complexity of rules and regulations. Greater SSC, moreover, will also have an impact on the dynamics of the multilateral trading system, for instance, by virtue of South Africa and the Mercosur members all being part of the G-20.

The IBSA initiative needs to be highlighted in this context. The Foreign Ministers of India, Brazil and South Africa launched the IBSA Dialogue Forum in June 2003 as a means to support political consultation and co-ordination, to strengthen cooperation in sectoral areas and to improve economic relations. Since then, the Mercosur-SACU PTA has been signed, as has a PTA between Mercosur and India. India and SACU are currently negotiating a PTA, with a view to complete the talks by the end of 2006. Bilaterally, therefore, India, Brazil and South Africa are interconnected in RTAs. Moreover, at a trilateral meeting in March 2005, the three countries mooted the idea of forming a trade alliance between India, Mercosur and SACU.

Conclusion

The Mercosur-SACU PTA is too recent to display any visible effects on trade flows between the two trading blocs. Still, based on their offer lists, current flows and competitive advantages, it seems unlikely that the impact of the agreement will be substantial. On the other hand, it was never supposed to be much more than a limited agreement, with fixed preference margins on a certain number of products.

Going forward, an FTA has the potential of having a greater impact on their trade flows. This depends, however, on the scope of such an agreement: how deep tariffs would be cut, what goods would be excluded, if services and investment would be included and so on. In addition, major challenges need to be overcome during the negotiations, including protectionist voices within the constituencies, diverting attention to other trade talks and getting the involvement – and support – of businesses and CSOs.

But whether or not an FTA would have any direct effects on Mercosur-SACU trade flows, the initiative could nevertheless prove beneficial through forging of closer ties between two key developing country groups, which in turn could provide momentum to the IBSA process as well as contribute to strengthen SSC.

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