



Universidade do Minho
Escola de Direito

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**The trading relationship between the EU
and Mercosur: The mediatory role of Brazil**

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and Mercosur: The mediatory role of Brazil**

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1. É AUTORIZADA A REPRODUÇÃO INTEGRAL DESTE RELATÓRIO APENAS PARA EFEITOS DE INVESTIGAÇÃO, MEDIANTE DECLARAÇÃO ESCRITA, QUE A TAL SE COMPROMETA.

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The responsibility for any errors or inadequacies that may remain in this work is entirely mine.

Abstract

The global multilateralism has been the option for the expansion of trade and economic investments. The objectives of free trade exceeded the traditional notion of trade in goods liberalization to include contemporary topics such as services, investment and intellectual property and to be consistent with the rules established by the World Trade Organization (WTO).

The interest of developing countries to implement inter-regional trade agreements with developed countries is one way to ensure necessary political and economic reforms and attracting more foreign direct investment.

In this context, economic and world order can be characterized by the coexistence of regionalism and multilateralism.

In general, preferential trade agreements have taken on increased importance since the failure of the Doha Round and consequently have proliferated in recent years. These agreements are an exception to the principle of the most favorable nation, laid down and regulated by the WTO.

The negotiations on market access among the largest and most influential regions of Europe and Latin America can vary since mutual political influence to economic returns. Thus, the negotiations emerged on a trade preferential agreement between the European Union and Mercosur in 2000 to the present day. These negotiations have already suffered many forward and backward steps, and is expected its conclusion in the near future.

The future of political and economic relations and cooperation between the EU and Mercosur will depend on the final results of the negotiations already ongoing. Therefore, the interests at stake must be expressed in all their diversity and fully considered, so that the conclusion of trade negotiations will be successful and initiate a new era of political and economic relations between the two regional blocs.

Brazil has assumed an increasingly important role in Latin America and strengthened its position within Mercosur. In turn, the EU was not indifferent to their growth and, given its close relationship both culturally as history, established a strategic partnership in 2007 with Brazil.

The bi-regional trade agreement, on the EU side, should increase market access for their goods and services and assist in the institutional strengthening of Mercosur, due to the free movement of goods and services as well as clearer and more efficient customs procedures.

Towards Mercosur, negotiations should provide, on the one hand, greater access for Mercosur products and services to the European market and, on the other hand, a greater incentive for European direct foreign investment. Hence, Mercosur is expected to increase its exports to the EU due to the removal of trade barriers in the European market.

Regarding the role of Brazil, its dominance in Latin America and particularly Mercosur and its long-term relationship with the EU could facilitate the successful conclusion of negotiations between the two blocs, functioning as a mediator. Thus, on the EU side has to mediate the reduction of protectionist policy of the Mercosur and consequently the opening of the European markets and industrial sector, particularly the automotive sector. On the side of Mercosur, you have to mediate EU barriers to agricultural sector.

Keywords: Multilateralism; Regionalism; Preferential trade agreements; Market Access; Brazil.

Resumo

O multilateralismo global tem sido a opção para a expansão do comércio e dos investimentos económicos. Os objectivos do livre comércio superaram a noção tradicional de liberalização do comércio de produtos para incluírem temas contemporâneos, como serviços, investimentos e propriedade intelectual e serem consistentes com as regras estabelecidas pela Organização Mundial do Comércio (OMC).

O interesse dos países em desenvolvimento de implementar acordos de comércio inter-regionais com países desenvolvidos é assegurar uma via para reformas políticas e económicas necessárias e atrair um volume maior de investimento estrangeiro directo.

Neste contexto, a ordem económica e mundial pode ser caracterizada pela coexistência do regionalismo e do multilateralismo.

Em geral, os acordos preferenciais de comércio têm assumido maior relevância desde o fracasso da Rodada de Doha e, conseqüentemente têm proliferado nos últimos anos. Estes acordos são uma excepção ao princípio da nação mais favorável, previsto e regulado pela OMC.

As negociações de acesso aos mercados entre as maiores e mais influentes regiões da Europa e da América Latina podem variar desde influências políticas mútuas a retornos económicos. Deste modo, surgiu as negociações de um acordo preferencial comercial entre a União Europeia e o Mercosul, em 2000 até aos nossos dias. Estas negociações já sofreram muitos avanços e recuos, estando previsto a sua conclusão num futuro próximo.

O futuro das relações políticas e económicas e da cooperação entre a UE e o Mercosul dependerá dos resultados finais das negociações já iniciadas. Deste modo, os interesses em jogo devem ser expressos em toda a sua diversidade e considerados integralmente, de forma que a conclusão das negociações comerciais obtenha sucesso

e inicie uma nova era das relações políticas e económicas entre os dois blocos regionais.

O Brasil tem assumido um papel cada vez mais importante na América Latina e fortalecido a sua posição dentro do Mercosul. Por sua vez, a UE não foi indiferente ao seu crescimento e, tendo em conta a sua relação de proximidade tanto nível cultural como histórico, estabeleceu uma parceria estratégica em 2007 com o Brasil.

O acordo comercial bi-regional, do lado da UE, deve incrementar o acesso ao mercado para os seus bens e serviços e auxiliar no fortalecimento institucional do Mercosul, devido à livre circulação de bens e serviços, bem como procedimentos aduaneiros mais claros e eficientes.

Em relação ao Mercosul, as negociações devem proporcionar, por um lado, maior acesso dos produtos e serviços do Mercosul ao mercado europeu. E, por outro lado, maior incentivo para o investimento estrangeiro directo europeu. Deste modo, o Mercosul deverá aumentar as suas exportações para a UE, devido à remoção das barreiras comerciais do mercado europeu.

Relativamente ao papel do Brasil, a sua posição dominante na América latina e, particularmente no Mercosul e a sua relação de longa duração com a UE poderá facilitar a conclusão com sucesso das negociações entre os dois blocos, funcionando como um mediador. Assim, pelo do lado da UE, tem de mediar a redução da política proteccionista do Mercosul e, conseqüentemente a abertura aos mercados europeus do sector industrial e, em particular, o sector automóvel. Pelo lado do Mercosul, tem de mediar os entraves da UE ao sector agrícola.

Palavras-chave: Multilateralismo; Regionalismo; Acordos preferenciais de comércio; Acesso aos Mercados; Brasil.

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List of Abbreviations

ACP- African, Caribbean and Pacific

BRICS- Brazil, Russia, India, China and South Africa

CRTA- Committee on Regional Trade Agreement

COMECON – Council for Mutual Economic Assistance

EC – European Community

EEC - European Economic Community

EU – European Union

EEAS – European External Action Services

FTA – Free Trade Agreement

FCA – Framework Cooperation Agreement

FDI – Foreign Direct Investment

GATT – General Agreement on Tariffs and Trade

GATS - General Agreement on Services

IMF – International Monetary Found

ITO – International Trade Organization

LAFTA – Latin American Free Trade Association

LAES - Latin American Economic System

LAIA - Latin American Integration Association

LAC - Latin American and Caribbean

MFN – Most Favoured Nation

MTN – Multilateral Trade Negotiation

MERCOSUR - Southern Common Market

GDP – Gross Domestic Product

PTA – Preferential Trade Agreement

TTIP – Transatlantic Trade and Partnership

US – United States

UNCTAD – United Nations Conference on Trade and Development

WTO – World Trade Organization

Introduction

Throughout modern history countries have secured and strengthened their trade relations through various arrangements, since colonial preferences to bilateral commercial treaties to broader regional agreements.

International trade has been a feature of the world economy for millennia. The volume and pattern of whatever trade has taken place has largely been determined by trade cost.

Technology and power have been the major forces determining trade flows over time, defining at any point in time the ability of regions to exploit their comparative advantages technological and institutional innovations that reduced transactions costs have had enormous impacts on what can be and is traded.

The history show us that periods of hegemonic dominance have been associated with trade expansion because the hegemonic power controlled a specific set of trade routes provided the peace and security as well as the institutional infrastructure to enforce contracts and protect property rights.

In more recent times, this infrastructure has been provided in part through cooperation between states, the GATT/ WTO being one important vehicle for such cooperation.

In recent years, a process of regionalization toured the world, in parallel to the globalization process. The proliferation of regional and bilateral trade was witnessed. At the same time, there is growing interest in the developing world and between developed and developing countries in the supply of regional cooperation projects such as environmental preservation and the promotion of research networks.

In this context, come the bi-regional negotiations between the EU and the Mercosur. These negotiations extend in time since 2000, without the prediction of a successful trade agreement between the two blocs.

The Doha Round and the EU-Mercosur negotiations seem to be an impasse and that open and deeper trade between the two parties could be mutual beneficial for them. Currently, the main problem of the bi-regional negotiation is agricultural issue and the consequent protectionism given to the Mercosur countries, in case of the economic difficulties.

Further, with global financial crisis, there was a process of assessment of international trade within Mercosur and Latin America with significant changes in the pattern of regional trade.

The EU has in recent years developed strategic partnerships, particularly with Brazil.

At the same time, Brazil has become an active member of the BRICS and it assumes the strongest position on Mercosur countries. On one side, for Brazil the Mercosur organization is too important, both politically and economically motives, to be abandoned. And, on other side, the Brazil-EU relationship is too important to be held hostage to an impasse with Mercosur.

Purpose of our work

This globalized economy generates a new business landscape with new actors, which influence the world economy.

The EU is currently negotiating a Free Trade Agreement with Mercosur as part of the overall negotiation for a bi-regional Association Agreement, that also cover a political and a cooperation pillar.

For the purposes of this research I am concerned about what changes in the trading relationship between the EU and Brazil with the EU-Mercosur Trade Agreement.

The purpose of my research is to analyse, firstly, on one hand, the advantages which the Trade Agreement UE-Mercosur brings to both blocs and to world economy. On other hand, the aim is verify the concessions made by both groups.

It is important for this research analyse the role of Brazil in these negotiations, since this country has great weight into Mercosur, on one side and, the Brazil has privileged trade relations with the EU, on other side.

Thus, in the first chapter will be analysed, at the first place the evolution of trade agreement in general. On other side, will be examined the Preferential trade Agreements, in particularly. Yet, in this chapter will be highlighted the creation of EU PTA and the Mercosur PTA.

The second chapter will be dedicated to the EU-Mercosur Trade Agreement. This chapter will approach the trade relationship between the EU and Mercosur, since their evolution to the commercial exchanges, the imports and exports of goods and services between them.

Finally, third chapter will focus in the role of Brazil on the trade relations between EU-Mercosur, given this presence in both blocs.

1. Trade Agreements in general

Currently, there have two significant trends in international trade relations. The first is the continuing growth and increasing of the Preferential Trade Agreements (PTAs). In accordance with WTO report (WTO, 2011)¹ the number of PTAs has increased more than four-fold, to around three hundred active agreements today. Secondly, the trade agreements have generally become deeper and wider, involving new policy areas such as services trade, foreign investment, intellectual property and government procurement.

The history has shown us that the stimulus for a more open and inclusive trading order has been strongest during periods of economic expansion and international peace. One of the most remarkable examples is the creation of the GATT (General Agreement on Tariffs and Trade) in 1947, in the post-war period as consequence of the restrictive and discriminatory trade blocs of the 1930s that had aggravated the economic crisis and contributed to the eruption of the Second World War.

In 1944, at the Bretton Woods Conference was created three new international economic institutions, which would form the pillars of a new economic order: the International Monetary Fund (IMF), that would maintain exchange rate stability; the International Bank for Reconstruction and Development, or the World Bank, which would provide reconstruction capital for war-torn countries and the International Trade Organization (ITO), that would supervise the administration of an open and non-preferential multilateral trading system.

The negotiations on the Charter of ITO were concluded successfully, but the establishment of this organization does not happened, because the United States Congress could not agree to ratify this agreement. In this impasse came the GATT, initially as one multilateral agreement for the reciprocal reductions of tariffs on trade

¹ World trade Report (2011), *The WTO and preferential trade agreements: from co-existence to coherence*, WTO.

in goods. Afterwards, it would over the years successfully to transform into an international organization, through the establishment of the World Trade Organization (WTO).

The GATT was founded to facilitate the cooperation between countries through multilateral institutions. This cooperation was important to reduce the risk of war, because there was interdependence between countries and for economic reasons, such as substantial reduce of tariffs, the elimination of discriminatory treatment in international trade and others barriers to trade.

The Agreement Establishing the World Trade Organization was signed in Marrakesh in April 1994 and entered into force on 1 January 1995. The WTO is an international organization which administers multilateral agreements concerning to trade in goods (GATT, 1994a)², trade in services (GATS) and trade related aspects of intellectual property rights (TRIPS).

The Most Favoured-Nation (MFN) is “one of the pillars of the WTO trading system”³ set out in Article I: 1 of the GATT 1994 and in Article II: 1 of the GATS. The MFN rule requires that a product made in one member country be treated no less favourably than a very similar good that originates in any other country. In other words, the MFN treatment obligation requires that any advantage granted by a Member to any product from or for another country be granted to all like products from or for all other Members. Therefore, the principal purpose of the MFN clause is to ensure equality of opportunity to import from, or to export to, all WTO members. For example, if the best treatment granted a trading partner supplying a specific product is a 3 per cent tariff, thus, this rate must be applied to the imports of this good originating in all WTO members.

However, there are exceptions to this rule established in Articles XXIV GATT and V GATS that allow the PTAs since these agreements are considered by the

² In this case there is a distinction should be made between the GATT 1947 and the GATT 1994. The GATT 1947 was both a set of rules and an institution. The GATT 1994 is just one of three multilateral agreements that are supervised by the WTO.

³ See WTO Report, *supra* note 1

Committee on Regional Trade Agreements (CRTA)⁴. The first allows FTAs and custom unions if some conditions are fulfilled and the second provides legal coverage for measures taken pursuant to economic agreements that would be inconsistent with MFN obligation, in accordance with the Panel Report in *Canada-Autos*⁵.

It is significant accentuate the difference between trade in goods liberalization and trade in services liberalization, given the increasing importance of services in PTAs. Thus, the PTAs in services do not involve tariff reductions but changes to domestic regulations and the removal of restrictions on the movement of foreign investment.

In general, each WTO member may invoke Article XXIV or Article V, it is not necessary that the CRTA has emanate to a conclusion on whether a PTA complies with the WTO rules to contest the operation of a PTA.

The Doha development round is a round of multilateral WTO trade negotiations, held in November 2001. This round aims to global globalization of trade, with the opening of agricultural markets, as well as negotiations on trade in services and investment and improving the regulation of intellectual property rights.

The timetable predicted that negotiations of the Doha Round were completed by December 2005, but there was a failure of successive negotiations. Although there have been significant progress in a number of areas, it was not possible to gather consensus in relation to the special safeguard mechanism for developing countries in agricultural products trade of materials.

In December 2006 the WTO General Council established a new transparency mechanism for PTAs, as a product of the Doha Round Negotiating Group on Rules. This mechanism both imposes the obligation on members to inform the WTO Secretariat on newly launched negotiations as newly signed PTAs.

The transparency mechanism may facilitate greater use of the WTO dispute settlement mechanism to contest specific aspects of PTAs. In the opinion of some

⁴ This Committee was established by the General Council in 1996 (WT/L/127).

⁵ Panel Report, *Canada-Autos*, para. 10271.

observers this mechanism is the only result of the Doha Round negotiations that has been allowed to go forward independently of the full results of the Round. According to Mavroidis (2010)⁶ the transparency mechanism should become *de jure* new forum to discuss PTAs within multilateral trading system.

1.2 The Preferential Trade Agreements

The economic literature has highlighted two main effects associated with trade policy: the terms-of-trade effect and the production relocation effect (negative externalities).

Ossa (2010)⁷ has demonstrate that a trade agreement based on simples rules that permit countries to coordinate tariff reductions and reciprocate market access is the best option to neutralize negative externalities. However, in the absence of multilateral trade cooperation countries may seek a preferential agreement to limit cross-border effects associated with trade policy.

In principle the better access to the world market dominates what can be offered by just a few countries, and a multilateral set of disciplines should do more for credibility than a PTA. Furthermore, a PTA may offer the opportunity to negotiate disciplines on policies is areas that are not included in the WTO. Therefore, PTAs offer the possibility of deeper integration that can be more easily achieved at the regional than a multilateral level.

In general a PTA involves substantially fewer countries than a Multilateral Trade Negotiation (MTN). This situation may facilitate the negotiations between the

⁶ Mavroidis, P.C (2010), *WTO and PTAs: a preference for multilateralism?*, Journal of world Trade.

⁷ Ossa, R. (2010), *A "new trade" theory of GATT/WTO negotiation*, NBER Working Papers Cambridge MA. National Bureau of Economic Research (NBER) Working Paper no 16388

member countries, principally in obtaining agreement on sensitive policy areas, such as the environmental and labour areas.

The economic impact of PTAs on member and non-member countries will depend on the type of agreement and on degree to which intra-regional trade is liberalized. A PTA increases trade between member countries as exporters benefit from the elimination of tariffs in partner markets. On the contrary, non-member countries suffer from a reduction of exports to member countries and a decline in the price of their exports in international markets.

The PTAs have long been as playing a key role in regional political integration. Possibly the best example was the formation of the European Community (EC) in the 1950s which has been the market leader in the PTA business.

In conclusion, the specifics of each PTA vary greatly from case to case, but they all generally have one thing in common: discrimination against other countries. The PTAs may take many forms, on one hand, at their simplest they lower or remove tariffs on imports originating in partner countries. On other hand, the others may go beyond tariffs to also cover NTMs.

1.3 The creation of the European Union (EU) preferential trade

In 1951 the Europe starts with continental integration with the sectorial European Coal and Steel Community, coinciding with the first wave of regionalism. Afterwards, in 1957 the integration became broader leading to the European Economic Community (EEC) and building outwards to current on past colonial possession through a complex network of preferential, but non-reciprocal trade agreements. As a

consequence the other countries sought to mitigate the effects of European preferential trade through the lowering MFN tariffs across the board.

The Europe changes its name from the EEC to the European Community (EC) with the signature of the Maastricht Treaty in 1993. This transformation is marked by the single market programme, directed at dismantling the remaining physical, technical and tax barriers within the community and the enlargement of its membership to 15 countries, reached in 1995.

In addition, this treaty contained the instrument establishing the EU, although it did not bring this process to completion.

Thus, the EC was pushing to create a new group of bilateral PTAs with Central and Eastern European countries after the ending of the Soviet Union and the dissolution of the Council for Mutual Economic Assistance (COMECON). These agreements were dedicated on reducing tariffs and creating uniform rules of origin.

The EU, in the mid-1990s, also settled bilateral agreements with countries in the Middle East (with Israel, Jordan, Lebanon and the Palestinian authorities) and North Africa (with Algeria, Egypt, Morocco and Tunisia) with intention of establishing an open trade area similar to the North American Free Trade Agreement (NAFTA).

The European countries account for more than half of all PTAs notified to the WTO and what still in force in 2008. The major regional grouping in Europe is the EU, with 28 members. Other European PTAs include the European Free Trade Association and the Central European Free Trade Agreement. The EU has also concluded Stability and Association Agreements with countries in south-eastern Europe, has PTAs with almost all Mediterranean nations and a series of Economic Partnership Agreements (EPAs) with African, Caribbean and Pacific (ACP) countries (Hoekman and Kosteck, 2013).

1.4 The creation of the MERCOSUR (Southern Common Market) Preferential Trade Agreement

The groups of developing countries moved to established and strengthen their own regional groupings. In Latin America, the most prominent example of a new generation of developing-developing country PTAs was the Mercosur.

The Mercosur was created in 1991 and was instituted under the Treaty of Asuncion. Their original members were Brazil, Argentina, Uruguay and Paraguay. Later, the Venezuela⁸ joined in 2006, but only on July 31, 2012 became an effective member.

Furthermore, the negotiations between Latin American countries to solve common problems have started in 1960 with creation of the Latin American Free Trade Association (LAFTA) which aimed the expansion of markets and the elimination of protectionist measures, through multilateral negotiations.

Later, in 1975 was created the Latin American Economic System (LAES) with the purpose of promoting economic cooperation and development and encouraging trade.

After political problems and the lack of flexibility of the LAFTA, in 1980 arises the Latin American Integration Association (LAIA), the aim was the formation of a regional grouping in which Members would provide preferential tariffs to each other. This new treaty was intended to the gradual and progressive establishment, long - term, of a Latin American common market.

The democratic transitions of 1980s in several Latin American countries led to the beginning of a new phase in the relationship between Argentina and Brazil, promoting a series of agreements, culminating in their signature of the Integration, Cooperation and Development Treaty in 1988.

⁸ The Paraguayan government has always opposed the entry of Venezuela in Mercosur. So when the Paraguayan President Fernando Lugo was removed from office by the Paraguayan Congress due to a controversial and poorly explained impeachment process. This episode led to the temporary exclusion of Paraguay of the Mercosur and hence Venezuela had its entry into Mercosur approved as a full member.

The favourable relationship between Argentina and Brazil and the agreements achieved between them, taking into account the attainment of the free movement of goods, services and production factors in line with the objective of creating a bilateral common market laid the foundation for the creation of Mercosur.

The objective of Mercosur was to create first a free trade area, and subsequently a common market. The Asuncion Treaty establishes that the aim of regional integration is to increase the level of efficiency and competitiveness of the economies involved by expanding their market dimensions, through the protection of the environment, the development of physical interconnections, the coordination of macroeconomic policies and the complementation of the different economic sectors.

II. Trade Agreement between European Union and Mercosur

2.1 Evolution of the name of the EU-Mercosur Agreement

In accordance with Messerlin⁹ the term PTA is preferred to FTA (Free Trade Agreement) and adopted by the related WTO Report (WTO, 2011)¹⁰. He points out two reasons for this variation. Firstly, the name of the agreement does not automatically qualify for the «free-trade» term, because many FTAs, which remove tariffs on trade between member countries, have very poor market access provisions for trade in goods and trade in services. Secondly, Mercosur's economy has some impact on world prices because it is wide enough in some sectors.

Thus, a trade agreement between two blocs with large economy has the potential to generate notable discriminatory effects on the economies of the rest of the world, and so it is preferable to the term «preferential» rather than «free».

The WTO Report underlines that all trade agreements are preferential to the extent that their benefits and obligations apply only to members and the non-members are excluded.

⁹ Messerlin, Patrick, the Mercosur-EU preference trade agreement, a view from Europe, n° 377, February 2013, in CEPS Working Document.

¹⁰ See WTO Report p44 , supra note 1

2.2 Origin of the relationship between European Union and Mercosur

Since the nineteenth century there is a relationship between Mercosur and EU, because the member states of Mercosur have been a very common destination for substantial waves of European immigrants, resulting in the strengthening of European commercial interests in the southern cone countries.

Thus, in the 1990s the EU created the “interregionalism”¹¹ movement that pursues to institutionalise closer ties between economic blocs from different regions of the world.

The EU-Mercosur negotiations started formally on 29 May 1992 with the Inter-institutional Cooperation Agreement between the Mercosur Council and the European Commission. The practical objectives were basically assistance, personnel training and institutional support to the Mercosur Secretariat.

Moreover, the EU-Mercosur negotiations were in part motivated by a desire to neutralize the potential trade diversion in favour of the US (United States) in Latin America. Strengthening strategic links with emerging markets also appears to be a key motivation factor behind FTA with Mercosur.

Later, on 15 December 1995 was signed the interregional Framework Cooperation Agreement (FCA), in Madrid and entered in force on July 1999. This agreement comprised a broad set of initiatives and commitments, including economic issues and trade and aims at fortifying the existing relations between the two blocs.

Since 1996 many interregional meetings have taken place on different levels to further the aims of the FCA. In July 1998, the European Commission decided to negotiate a FTA with Mercosur and the meetings and discussions started in the same year.

¹¹ As cited in Filho, M.F. & Lixinsky, L & Giupponi, M.O (2010), *The law of Mercosur*, Hart Publishing, Oxford, United Kingdom, pp 152.

The negotiations were suspended in 2004 due to fundamental differences on trade. However, political relations have progressed, notably with the signing of an agreement to extend relations to three new areas: science and technology, infrastructure and renewable energy in 2008, during the EU-Mercosur Summit in Lima.

After being suspended for six years, negotiations were relaunched on 17 May 2010, during the EU-Mercosur Summit in Madrid and, since then, several meetings were held between Chief Negotiators of both blocs.

Currently, the EU-Mercosur Agreement has not yet been achieved.

2.3 Trade relationship EU-Mercosur

The trade agreement between the EU and Mercosur presents opportunities and threats for both blocs.

The EU saw the Mercosur economic bloc as a strategic partner in its relationship to all of the South America. Kegel and Amal (2012)¹² show us three reasons for the regional integration in South America have been looked upon positively by Europeans.

The first reason is that the Mercosur would follow the European integrationist experience, from the perception that the constitution of a customs union, that is, a free trade area with common external trade policies, and later a common market which is a custom union that also integrates factor markets, such as capital and workers, would lead to such a result.

¹² Kegel, Patricia Luíza & Amal, Mohamed (2012). *Mercosur and its current relationship to European Union: Prospects and Challenges in a Changing World* (pp18). Centre for European Integration Studies, Germany.

Secondly, the Mercosur would be a counterbalance to the presence and interests of the USA on the continent.

Thirdly, in line for the wide size of Mercosur domestic market, in special of the Brazil and Argentina which would help many European multinationals to develop new investment projects.

Summing up, for the EU the trade agreement should increase market access for their goods and services, and establish a clear and objective set of rules, facilitating the insertion of European organizations in the global production process.

For the Mercosur, the negotiations with the EU should provide two important unfolding, on one side, greater access for products and services of Mercosur to the European market. On the other side, greater incentive for foreign direct investment (FDI) European mainly in export activities.

The growth of the exports of Mercosur to the EU should grow by removing of trade barriers of European markets, which focus especially on Mercosur products originated in the agricultural business.

2.4 Evolution of trade relationship between EU and Mercosur

In relation of the most European export products to Mercosur countries was the manufactured goods and the most important category was «machinery and transport equipment»¹³, that represent two thirds of all the EU exports.

¹³ Gambini, Gilberto (2008). *External Trade: EU-27 trade with Mercosur countries 2006*, in the Statistic Focus, 32/2006, Eurostat

The EU and Mercosur have been closer in the past. In the 50s and 60s, Latin America was the largest trading partner of EU (formerly EEC).

The trade volume between the two blocs intensified greatly in 90s due to trade liberalization of Latin American economies, reinforced by the overvaluation of the currencies of the Mercosur countries.

Consequently, the imports from Mercosur grew more than exports between 1990 and 1998, in line for to the contribution of European direct investment in the region.

In 1999, the devaluation of currencies and the fall of the level of income of the countries of the Southern Cone, reinforced by the financial crisis Argentina and the reversal of the global economic growth cycle have led to a reduction of Mercosur imports.

This trend was highlighted in 2001 with the appreciation of the European currency, the euro, being accentuated the fall in European exports, rising again from 2004 onwards to regain the 2000 level in 2006. At the same time, the EU-27 progressively imported more from Mercosur countries.

As a consequence the trade balance between EU-27 and Mercosur countries was consistently negative during the period 2000 to 2006.

The Germany was the most important partner for exports accounted to 29.8%¹⁴ ¹⁵ of total EU exports. Additionally, Germany, France and Italy together accounted for over 50% of the total value of EU exports to Mercosur countries and 40% of EU imports from this bloc. On the side of the Mercosur countries stands out the Brazil as the main partner for both EU exports and imports. The Brazil accounted 75.1% of total EU exports to Mercosur and represented 76.6% of EU imports from Mercosur countries.

¹⁴Castilho, Marta (2005). *Acordo de Livre Comércio com a UE: a vulnerabilidade dos produtos industriais produzidos pelo Mercosul à competição europeia*. In Nova Economia 153-182, Belo Horizonte.

¹⁴ See Gambini, supra note 13

¹⁵Idem

Further, relatively to the data importation, the «food products»¹⁶ dominated with 35% of the 2006 total.

In 2010, the exports from Latin America and the Caribbean to the EU have been recovering, although they are still below pre-crisis level. Thus, by the first half of 2009 these exports fell 35% over the same period in 2009 and in the first half of 2010 they were growing to an estimated 19% (ECLAC 2010)¹⁷.

Nevertheless, since 2009, particularly with global financial crisis, there was a process of assessment of international trade within Mercosur and Latin America with significant changes in the pattern of regional trade.

In your studies, Kegel and Amal (2012)¹⁸ establish three changes in the trade flows of regional trade. First of all, is highlighted the strengthening of Latin America trade with Asia and China in particular. The share of Asia in exports from Latin America accounted for only 5% of the total in 2000 but has risen to 14.5% in 2009, thus exceeding the EU as the main destination for its exports. In relation to the imports there was the same performance between the commercial relations with Asia and China (this country had the largest increase with a rise from 1.8% in 2000 to 12% in 2009). These data are beginning to show the growing shift in the strategic trade policy of Latin America from Europe to Asia.

Secondly, a decrease in the role of traditional partners involving Latin America and the Caribbean (LAC) is demonstrated by data. In 2000, the US and EU which represented for 73% of exports of goods and services, in 2012 represent only 53% of total exports of the whole region. Since 2007, the participation of EU in the exports and imports into LAC has been decreasing gradually.

Lastly, the growth of intraregional trade is affected by changing partners in international trade in LAC. In the specific case of Mercosur intraregional trade grew by 40% during this period. In the same way as a destination for exports from MERCOSUR countries, China has grown at significantly higher rates than the US and the EU

¹⁶ idem

¹⁷ ECLAC (2010) *International Trade and Integration Division, Latin America and the Caribbean in the World Economy, 2009-2010*.

¹⁸ See Kegel, Patricia Luíza & Amal, Mohamed (2012) *supra* note 12

(excluding the case of Paraguay). In the regional distribution of imports the same trend and performance may be registered.

To conclude, the main goods that Mercosur is interested in exporting to EU include agricultural products, such as sugar, beef and dairy products, which are highly protected in the European market.

Currently, the bioregional negotiations between EU and Mercosur are stagnant, but there is one element that may augur greater progress in the negotiations this time is the sustained increase in the share of China in the foreign trade of the region.

According to Economic Commission for Latin America and the Caribbean (ECLAC) projections (ECLAC 2010)¹⁹, China could take the place of the EU as the second largest trade partner region after US, if this trend continues.

In this context, getting preferential access to Mercosur for its exports would allow the EU to compensate at least partially, for the cost advantages usually associated with Chinese products.

2.5 Trade in services

Equally important is trade in services²⁰, which have a major role in all modern economies and is considered crucial for trade and economic growth.

The share of services in EU-27 exports of goods and services was relatively stable during the period from 2001 to 2008, fluctuating between 28% and 29%. The services share of EU-27 imports of goods and services remained relatively unchanged since 2006 with 22.3% until 2009.

¹⁹ See ECLAC 2010, *supra* note 17

²⁰ Eurostat (2013). *International trade and foreign direct investment*.

The Northern America was the principal extra-EU trading region for the international trade in services in 2010 (EU-27), accounting for 26.4% of total credits and 31.4% of total debits.

In 2011, more than two thirds of the credits of EU-27 (67.7%) and the debits (70%) in the international trade services were accounted by three categories: transport, travel and other business services.

During the global financial crisis, the trade in services showed greater resilience since the production of services is less geographically dispersed and that many specialized service contracts in such areas as accounting, information technology and legal services are not necessarily subjected to economies of scales.

In the service sector, imports have rebounded more strongly than exports, primarily because of the impulse given to the transport sector by the recovery in international merchandise trade.

2.6 Foreign Direct investment (FDI)

The ability of a country to participate in global activity is an important indicator of its performance and competitiveness.

In the world of increasing globalization, where political, economic and technological barriers are rapidly disappearing, the FDI may be seen as an alternative economic strategy, adopted by enterprises that invest to establish a new office or purchase existing assets of a foreign enterprise.

In accordance with Eurostat (2013)²¹ there are two categories of FDI, on one hand, the creation of productive assets by foreigners and, on the other hand, the purchase of existing assets by foreigners, for instance, through acquisitions, mergers.

The FDI is made with purpose of having control in the management of the enterprise concerned and a lasting interest in the enterprise differing, thus, from portfolio investments.

Conventional trade is less important for services than for goods. Therefore, FDI is expanding more rapidly for services than for goods. For this reason, the share of services in total FDI flows and positions has increased significantly, as the service sector has become progressively international.

The FDI flows are influenced by large mergers and acquisitions and, thus, can vary considerably from one year to another.

During the period 2008 to 2010, EU-27 FDI flows were largely affected by the recent financial and economic crisis. In 2010, both outward and inward flows of FDI halved when compared with the previous year. In 2011, EU-27 FDI flows showed signs of recovery of crisis.

Further, there was some evidence of new partners gaining importance for EU-27 investment. For instance, in 2010, Brazil became the major destination for EU-27 outflows of FDI, onward of the US and during the period 2008 to 2011 the EU-27 FDI outflows to Brazil tripled. EU-27 stocks of FDI in Brazil grew by 73% in the course of 2008-2010, accentuating the growing activity of EU-27 investors in this country.

At the end of 2010, North America had the biggest share of outward FDI stocks from EU-27. In the same period, the US accounted for 41% of inward stocks of FDI of EU-27 from the rest of the world. Thus, the US consolidated its position as the main holder of FDI stocks in the EU-27, having invested mostly in financial and insurance activities.

²¹ Idem

The income balance of EU-27 for FDI in 2010 was equal to 0.91% of Gross Domestic Product (GDP), compared with 0.61% in 2009.

In relation to the Latin America, this region is ranked second among developing countries receiving FDI, its share in total flows has been decreasing since 2007. On the contrary, Brazil has grown significantly; its participation has increased, occupying the third position among developing countries receiving FDI, in accordance to data from United Nations Conference on Trade and Development (UNCTAD)²².

In Latin America, Mercosur holds the first position as the destination of FDI global flows. This position is largely due to the growth of FDI flows to Brazil which holds 34% of the flows destined for LAC and over 80% of the flows to Mercosur.

The US and the EU are the main regions of the origin of the distribution of FDI flows. However, due to the effects of the crisis, there was a decline in US investments in Brazil in favour of investments in other countries, such as Netherlands, Luxembourg and Japan.

Hence, Mercosur has established itself as the main destination of EU FDI flows, leave behind China in this competition for investments by European multinationals. In other words, European multinationals have kept Latin America, and in particular, Mercosur and Brazil, as the major destination of their overseas investments. Therefore, these business strategies should be considered in the broader context of the negotiations between EU and the Mercosur.

²² UNCTAD, 2010, data base FDI statistics.

3. The Brazil perspective of the EU-Mercosur Agreement

The Brazil active role in a new generation of international mini-lateral coalitions, including the WTO G-20 and BRICS²³ have greatly helped to improve its profile as a global actor.

According to European External Action Services (EEAS) Brazil is the largest economy of Latin America and its trade with the EU accounts for 34.4% of the total trade of EU with the Latin American region (2013). Relatively to the investments, Brazil holds 53% of the entire EU investment stocks in Latin America (2012).

The first trading partner of EU is Brazil, accounting for 21.2 % of its total trade (2013). During the last 10 years bilateral trade between the EU and Brazil has grown on average by 10.3% per year to more than double its volume.

The imports of EU from Brazil are dominated by primary products, in particular agricultural products and fuels and mining products. As regards to the Brazilian exports to the EU are the manufactured products such as machinery, transport equipment and miscellaneous manufactured products, representing around one fourth of the exportation.

²³ The BRICS is an economic grouping currently composed of five countries: Brazil, Russia, India, China and South Africa. There is not an economic bloc or an international institution, but an international mechanism in the form of an informal grouping, which is not registered bureaucratically with status and charter.

Currently, the BRICS are holders of more than 21% of world GDP, forming the group of fastest growing countries on the planet. In addition, they account for 42% of world population, 45% of the workforce and the greatest power of the world consumption.

Among the most promising aspects of the BRICS, there is the economic and financial area, having been signed two especially important tools in the VI Summit of BRICS: on one side, the constituent agreements of New Development Bank (NBD), facing the financing of infrastructure projects and sustainable development in emerging economies and developing countries. And, on other side, the Contingent Reservations Arrangement (RTA) intended to provide mutual support for BRICS members in scenarios of fluctuations in the balance of payments.

The policy coordination among members of the BRICS is made and will continue to be without confrontation elements with other countries. The BRICS are open to cooperation and engaging constructively with third countries and with international and regional organizations, in the treatment of current international issues.

The European Union share with Brazil an enduring relationship based on strong cultural and historical ties, a common heritage which contributed in time to reinforce their economic and political relations.

In 2007, the EU recognized the economic and political leadership role of Brazil, particularly at the regional level by establishing a formal the EU-Brazil Strategic Partnership, thus, the EU and Brazil are also strategic partners.

The issues to be worked on together It includes an extensive set of areas since the promotion of multilateralism and human rights, to reduction of inequality and poverty, as well as environmental issues, such as alternative energy and climate change.

Brazil is a key country in Mercosur therefore this partnership will be also focused on reaching a conclusion in the bi-regional negotiations between EU and Mercosur. As a consequence, part of the plan was to hold bilateral annual summit meetings and to establish a plan of action. Until now, there have been some summit meeting nonetheless the stress on bi-lateral relations was not reflected in the concession of reciprocal trade preferences, as mandated in the WTO.

In the Doha Round it was clear that no deal could be done without the support of Brazil, because it was suggesting some concessions from the emerging and developing countries, while EU was trying to do the same for industrial countries.

The trade agreement between EU-Mercosur for Brazil indicates a huge potential for increased trade between the EU and Brazil. Nevertheless, the growth potential has not yet been fully recognized and some policies to protect domestic markets both in the EU and in Brazil, can be an obstacle to concessions and desires to explore more aggressively existing business opportunities.

Nonetheless, there are difficulties with sustained the constructive dialogue between Brazil and the EU during the active years of Doha Round, due the failure of the Round in June 2008 and the major economic crisis since then.

Thus, one side of Brazil, the balance between offensive and defensive interests has clearly changed in favour of the latter under administration of President Dilma

Rousseff, not only for purely domestic reasons but also because of the increasing pressures of the protectionist approach, followed by Argentina and Venezuela.

In the EU side, the economic and monetary crisis has captured the attention of the top decision-makers, leaving trade a frozen negotiation until last year.

In the last two years, the gap between Brazil and the EU has increased. Brazil has been gradually dragged by the Argentine protectionism. By contrast, the EU adopted a new dynamic in favour of PTAs with large partners. In this context, negotiations were launched with Japan and, soon after, with the United States.

Accordingly to Messerlin (2013)²⁴ the economic crisis requires which the EU open its markets in priority to economies that fulfil three conditions: first, they have to be very large; second, well regulated and, finally, well connected through PTAs with rest of the world.

In the early 2010s, Brazil does not meet the three conditions. Its GDP represents only 11% of the GDP of EU, much behind that of the US, China and Japan. Thus, in 2012, the European Commission launched PTA negotiations with Japan and, soon after, with the US.

On the contrary, Brazil is large enough to be a major international actor in some sectors, such as agriculture, raw materials and few industrial sectors. However, Messerlin (2013) indicates the following reasons that do not create a favourable situation to the negotiations with the EU.

First, the offensive interests of the EU are concentrated in sectors where Brazil has strong protectionist interests, such as manufacturing, investment and property rights.

Second, the defensive interests of the EU are equally strong and well organized (agriculture), as evidenced by the long periods of negotiation with little progress on tariff quotas for beer or other strictly agricultural products.

²⁴ See Messerlin (2013) supra note 9

Finally, some EU members have crucial defensive interests in Brazil and the EU - blocking the progress of the negotiations on both sides of the Atlantic (such as the automobile industry).

In short, the political economy of trade talks leaves little hope that significant results will be achieved in negotiations for a PTA between Mercosur and the EU.

Consequently arises the question to know what can be done if a Mercosur-EU PTA fully developed is out of reach. The suspension of negotiations, as occurred in 2004, is not a satisfactory alternative because it gives rise to that strong protectionist forces to operate in Mercosur. Thus, the option is to focus on those areas in which negotiations can proceed with a chance of being completed successfully, thus preparing the ground for a full PTA between Mercosur and the EU in the future.

The subjects with the greatest potential agreement are those related to the preparation of market access - for example, customs administration, technical barriers to trade, industrial cooperation, research and technology, environmental law, financial assistance and visas for workers.

Further, among the topics on which the agreement is feasible, it is part of issues of great interest to Brazil, such as those related to research, industrial cooperation and technology transfer, environment, climate change and trade facilitation.

However, if the Transatlantic Trade and Investment Partnership (TTIP) and negotiations between the EU and Japan reach promising results, then Brazil should reconsider its approach and become more decisive in negotiations with the EU to not be discriminated against in these major markets.

Conclusions

Currently, the regionalism and multilateralism coexist. On one hand, there is a proliferation of bilateral agreements and, on other hand, the international trade are subject to the WTO rules and in, particularly, to the MFN clause which is the exception to allow PTAs.

The negotiation process between EU and Mercosur is taking a lot of time. However, some progress has been made recently. For instance, the Mercosur countries have begun to work on a joint negotiation position. The position of Mercosur was supposed to be ready in December 2013, although delay, its position suggests that Mercosur wants to bring the whole process to a successful conclusion.

The agricultural issues still remain one of the major obstacles to the conclusion of the EU-Mercosur PTA. EU members states are, on one hand, anxious to give access to their markets to agricultural products from South America, such as beef, sugar, milk and cereals. On other hand, they are apprehensive than an expected increase in imports will prejudice domestic products.

The Mercosur countries are blocking any progress on opening the auto industry and public procurements to the EU.

Moreover, in Latin America countries the protectionism is a way of dealing with economic difficulties, which creates more problems in opening the South American market to the EU.

The negotiations between the two blocs have become faster in recent years by some reasons. Firstly, the EU is negotiating a free trade agreement with the US (TTIP) and similar negotiations with Canada (CETA). Secondly, some of the American countries are also trying to sign a PTA with countries in the Pacific region. Thus, all these agreements create significant pressure on Mercosur to get a PTA of its own, to help the trade of its member states.

In relation to the Brazil position, it should be able to get a PTA with the EU by itself, for the reason that has already been named a strategic partner of the EU. But a separate deal between the EU and Brazil would have to overcome one very serious obstacle, due to commitments of the Brazil to the other countries in the region. Further, Mercosur members agreed about 15 years ago on joint trade negotiations with third countries, without exceptions.

Therefore, Brazil can hope for changes of this rule in a close future or another solution would be allowing different member states to negotiate the PTA with the EU in their own time or not at all, since already a precedent exists: the EU – Andean Community agreement.

Brazil needs Mercosur because prestige. In other words, Mercosur is a project on which Brazil had begun to really focus during administration of Lula da Silva. It aim at improving the status of Brazil and proving that her dedication to regional integration, and thus to the stability of the whole continent.

Relatively to foreign relations, the relationship with the EU is not at the top of the most important international ties of Brazil. Brazil are focusing the most on relations within the region, for instance there are ties with the BRICS countries.

The presence of China in Latin America cannot be forgotten. The China position in bilateral trade with Brazil has transformer China into an important element for strategic cooperation in the region.

Thus, in this sense, the growth of emerging countries has substantially changed the economic and political situation. This had resulted in an effective shift of relative power on the international scene, with obvious implications for the international trade relationships of Mercosur.

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