GEOPOLITICS AND TRADE: FUTURE RELATIONS BETWEEN THE EUROPEAN UNION AND LATIN AMERICA AND THE CARIBBEAN

Antoni Estevadeordal
European Representative, Inter-American Development Bank

The COVID-19 pandemic has hit the global economy and posed a number of enormous challenges to developing regions such as Latin America and the Caribbean (LAC). The health crisis came at a time when the multilateral system of economic governance was weakened by the geopolitical rivalry between the United States and China and rising protectionism since the 2008–9 global financial crisis. In this context, relations with the European Union (EU) emerge as a strategic option to help the region overcome the pandemic's effects and establish the conditions for a sustainable and inclusive recovery. As this chapter relates, despite China's growing influence and traditional US dominance, the EU remains a major economic partner for Latin America and the Caribbean. These economic ties are supported by a formal integration architecture that has made great advances in recent years, helping to strengthen rules-based trade. The present context gives an opportunity to deepen this relationship, drawing on the EU's global leadership on issues such as climate change, the digital transformation and social inclusion. In this sense, EU–LAC relations are well placed to promote the transformations the region needs more than ever.

1. Evolution of trade and investment between Latin America and Europe

Trade between the EU and LAC grew rapidly in the first decade of the 21st century, driven by high commodity prices and strong economic growth in the region. But after reaching an all-time high of $287 bn in 2013, exchanges between the EU and LAC began to fall and, despite a moderate recovery in 2017–8, sat at $248 bn by 2019. The contraction in interregional trade has been particularly evident in LAC exports to the EU, which began to decline in 2012 and by 2019 had fallen by 24% from their peak – compared to the 12% decline in Latin American imports.[1] These lower exports are largely due to global commodity prices, as three products – crude oil, iron ore and copper cathodes – account for nearly a third of the region's decline in exports in this period.

1. Author's calculations based on IMF direction of trade statistics.

The rising trade between LAC and China since the start of the 21st century has diminished the EU's relative importance as a trading partner for the region, especially for South American commodity-exporting countries. Nevertheless, Europe continues to play a key role in LAC trade relations, especially for economies such as Argentina, Brazil, Costa Rica and Ecuador, where the EU accounts for between 12% and 17% of total trade, making it one of the two largest extra-regional partners.

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LAC also exports a relatively diversified basket of goods to the EU, especially compared to China. While the region's main exports are mining and agricultural raw materials, manufactured goods such as cars and cellulose pulp have figured among the ten largest LAC exports to Europe since 2017. Overall, Latin American exports to the EU are less concentrated than they are to China: mining and agricultural products account for only 28% of the region's sales to Europe, compared to 64% for China.[2]

Trade in services represents another dynamic field of LAC–EU economic relations. Indeed, since 2005, it has been growing at a much higher rate than the trade in goods.[3] Services exports to the EU have grown more than imports in this period, although they are concentrated in categories like travel and transport, which are highly affected by the COVID-19 pandemic. Knowledge-intensive services still account for a small percentage of LAC exports to Europe (11%), but constitute a larger share of the region's imports (28%), creating opportunities to improve the productivity of Latin American companies.[4]

As well as trade, the EU is LAC's main source of foreign direct investment (FDI). Annual FDI flows reached $64 bn on average between 2012 and 2018, representing 42% of foreign investment in the region during this period.[5] Investment from the EU has also accelerated in recent years: annual flows grew from $47 bn in 2012 to $63 bn in 2018, during which time FDI from the US declined. Apart from the amount of investment, European companies stand out for their presence in strategic sectors in the region, such as renewable energy, information and communication technologies (ICTs), infrastructure, and industries like the automotive and aeronautics sectors, which form the backbone of the region's manufacturing sector.

2. The current commercial and investment architecture between Latin America and Europe

The development of trade and FDI between the regions has been underpinned by a network of free trade agreements (FTAs). Currently, 11 LAC countries – Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama and Peru – participate in various FTAs with the EU. In this regard, the 2019 conclusion of negotiations on the agreement between the European Union and Mercosur (an area of economic integration formed of Argentina, Brazil, Paraguay and Uruguay) represents a very important milestone in formal integration between the regions.

Even so, the consolidation of the architecture of LAC–EU integration faces a number of political economy challenges. Firstly, on the European side, powerful agricultural lobbies have opposed greater access to the

2. Author's calculations based on UN Comtrade data.
3. Trade in services between the EU and LAC grew 23% on average per year between 2005 and 2019, compared to 5% for trade in goods. Data based on WTO trade in services statistics.
4. Knowledge-intensive services include insurance and pensions, financial services, telecommunications and information and charges for the use of intellectual property.
5. While some of the FDI attributed to the EU is investment from other regions that is redirected via jurisdictions such as Luxembourg and Dutch overseas territories, even when these countries are excluded, the EU remains the leading investor in the region.

European market for industries in which LAC has significant comparative advantages. EU civil society organisations also exert influence on FTA negotiations, criticising them for potentially diluting European standards in areas such as environmental protection, GMO food, and more recently, the privacy and processing of personal data – concerns shared by various European governments. Secondly, on the LAC side, there is resistance to liberalising strategic manufacturing industries in some countries and protectionist instincts exist in areas such as public procurement, which is increasingly important in trade negotiations. All these issues have arisen in the EU–Mercosur negotiations – now ongoing for 20 years – and are obstacles to the ratification of the agreement by national legislatures.

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On the other hand, a number of factors have favoured the resolution of these issues. First, the importance of the European market, especially for LAC agricultural exporters, has created incentives for governments in the region to strengthen protection in areas of great importance to Europeans like the environment. That the EU negotiates trade policy on behalf of member states only strengthens these dynamics. Moreover, EU agreements and cooperation have appeared more attractive due to the contrast with overtly protectionist and unstable US trade policy and the growing caution of some actors in the region about China's influence.

As well as the EU–Mercosur agreement, recent achievements have been made in the EU's integration processes with Mexico and Chile. In the first case, in April 2020 the parties concluded a modernisation of the trade component of their 2000 economic cooperation agreement. The updated treaty significantly expands market access, particularly in the agricultural sector, with 85% of tariff headings fully liberalised. It also contains new measures to promote trade in services, investment protection and competition in public procurement, where for the first time in an FTA Mexico will open up subnational tenders to European proposals. In the second case, a modernisation of the existing EU–Chile agreement is being negotiated that would expand the scope and depth of the agreement, especially on issues such as trade in services, public procurement and digital commerce, among others.

3. Impacts of the COVID-19 pandemic on LAC–EU economic relations

The COVID-19 pandemic has severely affected many aspects of the global economy, but it has also created opportunities for positive transformations. The importance of relations with Europe for the LAC region has been revealed. Interregional trade remained relatively healthy during the first half of 2020, mainly due to the robustness of the exchange of agricultural and food goods. The category of food, beverages and tobacco, which accounts for 30% of the region's exports to Europe, even rose by 1% compared to the same period in 2019.[6] In terms of foreign investment, the effects have varied by sector. The automotive and aeronautical industries, in which European investment is important, suffered significant supply and demand shocks and foresaw large production and investment declines for 2020. Tenders for energy projects, including renewables, have also been postponed or even cancelled in several countries, affecting European companies operating in the sector.

6. Based on Eurostat data

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On the other hand, EU institutions mobilised funding and cooperation funds for the immediate response to COVID-19, redirecting cooperation funds to address the effects of the pandemic. Economic integration processes have not stopped during the pandemic, which is reflected in the completion of the modernisation of the EU–Mexico agreement and the continued progress in the negotiations to modernise the EU–Chile agreement. All of this demonstrates the importance of the EU-LAC partnership on both sides and its future potential, especially in today's difficult environment.

4. Opportunities for a new trade and investment architecture in the context of economic recovery

The multilateral system crisis and the growing geopolitical rivalry between the United States and China have undermined the opportunities for global cooperation in response to the pandemic and worsened the protectionist pressures that had been growing for several years. However, this scenario also opens the door to greater leadership by actors such as the European Union, both globally and in the LAC region. On trade and investment, paralysis in the WTO has encouraged the emergence of regional attempts to deepen integration. In Asia, after the US left the original treaty, the Trans-Pacific Partnership (TPP) was consolidated under Japanese leadership. Participants include three LAC economies (Chile, Mexico and Peru). In recent weeks, negotiations for the Regional Comprehensive Economic Partnership (RCEP), the first trade agreement to include Japan, China and Korea, have also been concluded.

The EU has also been central to promoting regional and interregional integration agreements. In recent years it has negotiated and implemented major agreements with Japan and Canada and, as mentioned above, a historic agreement was reached in 2019 with the Mercosur bloc, the conclusion of which creates one of the largest integration areas in the world, covering some 780 million consumers and accounting for more than a quarter of global GDP. It is also an ambitious agreement, which completely liberalises all manufacturing imports into the EU from Mercosur countries and 82% of agricultural products. For its part, Mercosur has agreed to eliminate tariffs on 90% of EU manufacturing imports and 93% of agricultural imports. The alliance also establishes measures to facilitate trade in services, remove technical barriers to trade, simplify customs procedures and increase access to public tendering processes. Finally, labour and environmental issues played an important role in the negotiations, as reflected in commitments to implement the Paris Agreement and guarantee the right to collective bargaining.

These agreements are key advances in extending the architecture of formal integration between the regions, and help support rules-based international trade in an adverse global political context. They also create opportunities to expand the scope of interregional integration, enabling the inclusion of critical public policy issues such as climate change, the digital transformation, and an inclusive recovery from the pandemic. Its global leadership in these areas means the EU is well placed to promote them in LAC and consolidate its strategic relationship with the region.

In the field of climate change, promoting sustainability at the global level has been a central pillar of European foreign policy, and the EU has several tools for advancing this agenda in its relations with developing regions. First, the European Union has included a chapter on sustainable development in all its free trade agreements in order to link economic relations with environmental protection. In the case of the EU–Mercosur agreement, endeavours are made to ensure the parties comply with the Paris Agreement. Beyond trade agreements, the EU supports sustainable development through the EIB, a leading provider of global climate change financing, with an LAC portfolio that includes 15 sustainable development and climate change projects worth over $650 m in total. What is more, the official development aid provided by the European Commission to governments in the region has a strong sectoral focus on climate change, and accounts for 30% of bilateral aid in recent years. The EU also supports sustainable development policies in the region through technical cooperation and public policy dialogues like the Global Climate Change Alliance Plus, seeking to share the knowledge of European countries on a wide range of public policies.

EU financial and technical cooperation is essential to support green recovery strategies in the region. As well as highlighting the vulnerability of our economic and social systems to the environment, the pandemic has created enormous pressures to immediately generate employment while the fiscal margin is severely reduced. This may lead short-term projects to be prioritised over the medium-term investments needed to achieve sustainable transformations in the economy. To avoid this trade-off, the region's governments need external funding for sustainable development projects, as well as technical cooperation and political support for green recovery strategies.

EU–LAC relations can also encourage the use of new digital technologies in the region – another key task on the development agenda. The pandemic has served to reveal the region's weaknesses in the regional digital transformation. While examples of successful digital endeavours and innovative e-government tools exist in LAC, significant gaps remain in the access to and use of digital technologies in the region. To work around this situation, both digital hardware and software need to be improved. In terms of hardware, expanding and renovating digital infrastructure, including the deployment of 5G networks, is critical to ensure that businesses and consumers can use the latest technologies like artificial intelligence and the internet of things. Software improvements should include regulatory and public policy frameworks that facilitate data flows and the provision of digital services.

The EU can help the region in both fields. First, it can play an important role as a source of external financing and technology for the expansion of digital infrastructure. The European Commission has invested in major digital connectivity initiatives such as the Building Europe Link to Latin America (BELLA) project, which is laying an underwater fibre optic cable between Portugal and Brazil. In the private sector, European companies such as Nokia and Ericsson are among the handful of global players developing 5G networks that, unlike existing infrastructure, rely on a large number of small cells. In terms of regulatory frameworks, the EU's experience in promoting the Digital Single Market in Europe provides a relevant precedent for LAC in its efforts to improve connectivity at regional level. In general, cooperation and knowledge sharing between regulatory entities and private sector actors in the two regions would be productive, as the speed of innovation in digital services is a challenge for regulators. Brazil, for example, has launched several public policy dialogues with the EU and industry players on the deployment of 5G and the internet of things, which has guided the government's strategy on these issues. As with climate change, free trade agreements themselves can be tools for promoting the digital economy, as in the case of the EU–Chile agreement, where the modernisation process seeks to establish measures to facilitate the trade in digital services.

Finally, LAC governments face the serious challenge of preventing the pandemic from worsening already high inequality levels and reversing the social progress many countries have made since the 1990s. In the short term, workers and businesses whose incomes have severely declined during the pandemic must be supported, and the measures to contain the pandemic must be backed. In the medium term, access to public services such as health, education, pensions and childcare, which are essential to creating more equitable societies, needs to be strengthened and expanded.

The region's governments will face these challenges in a context of limited fiscal resources and rising debt levels. The EU can be a key source of external funding, both through its traditional aid budget and with new tools such as mixed financing and guarantees that help mobilise private resources. Through multilateral institutions the EU can play an important role in finding mechanisms that allow regions like LAC to continue to access external financing while gradually refinding the path of fiscal sustainability.

As well as highly important to the region, this agenda advances the EU's development cooperation and foreign policy priorities as it seeks to position itself as a global leader on issues such as combating climate change and digital policy. In the difficult global context, where multilateral action is lacking, the EU has an opportunity to consolidate itself as a strategic partner for LAC.