The EU-Mercosur Free Trade Agreement: Is it time to revive talks on a Canada-Mercosur Agreement?

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Context

Reports out of Washington indicate that the United States is poised to impose "universal" tariffs (that is, tariffs on imports from all its trading partners) on health care and other "critical" goods on the basis of "national security". This would or could – the situation remains "fluid/uncertain", as reported – include tariffs on imports from Canada and Mexico, five years after President Trump agreed to the Canada-U.S.-Mexico Agreement precisely prohibiting such measures.

Meanwhile, on the other side of the Atlantic and the Americas, the world's second largest trade superpower and the second largest trading bloc are charting a different path. The European Union (EU) and Mercosur – the "Southern Common Market" consisting of trade giant Brazil, Argentina, Bolivia, Paraguay, and Uruguay – have just announced the conclusion of a free trade agreement. To be fair, it took twenty-five years to get there, but this is momentous. Not just because of the divergent paths that we observe on different sides of the North Atlantic, but because of the sheer size and scope – that is, the *ambition* – of the deal.

Our closest friend and ally, the country with which we have had a "free trade" agreement since 1988 – an agreement on which the government of the time went to the polls – and the country that accounts for 75 per cent of our international trade, is about to wilfully overturn the international legal order it negotiated and agreed to. Our trade diplomats will be hard at work to limit the harm, but the die appears to be cast – the U.S. has done it before, they will do it again, and we have few arrows in our Northern quiver to fight back. The time is ripe to revisit the Confederation-old question, the Third Option – *other* markets in the world – to reduce dependence on our Devoted Friend.

Or, perhaps, to *re*-revisit.

After all, as part of our national strategy of trade diversification, Canada has already entered into a free trade agreement across the Northern Atlantic. The Canada-EU Comprehensive Economic and Trade Agreement (CETA)[1] – provisionally applied since

2017 pending ratification by the EU – now accounts for approximately 12 per cent of our trade.[2] And growing. To the far west, beyond the Pacific, the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) is growing with the recent accession of the United Kingdom.[3] In 2023, Canada boasted $130 billion in trade with all CPTPP partners, representing an increase of 5 per cent from 2022.[4]

This brings us back to the Americas.

In 2023, South America accounted for approximately 1.5 per cent of Canada's merchandise exports and showcased impressive year-over-year growth in bilateral merchandise trade, with Brazil and Argentina posting increases of 6 per cent on $13.2 billion of trade and 9 per cent on $1.8 billion of trade, respectively.[5] Canada already has free trade agreements in place with Chile, Colombia, and Peru, amounting to over $11 billion in bilateral trade in 2023.[6]

But what about South America's largest trading bloc?

Although not an exact parallel, the experience of the EU in its negotiations with Mercosur could help identify some of the challenges, but also the enormous potential returns, of the Southern market. We begin with a brief historical overview of the EU-Mercosur trade negotiations. We then highlight some of the key achievements of the final trade deal. We close by exploring whether the time has come for Canada to conclude its own trade agreement with Mercosur, examining the factors that make this partnership both timely and beneficial.

(*Spoiler alert: it is*.)

How we got here

Rio de Janeiro. 1999 . No, not the Carnival; something far less glamorous – but far more important.

On June 28, 1999, officials from the EU and Mercosur met to kick off the negotiations for a comprehensive new free trade agreement between the two trading blocs. Because these sorts of events take a long time to organize, it's not always easy to predict, *at the time they are being planned*, how things will pan out. As it happens, the negotiations could not have started at a worse time for the Mercosur member states: Brazil was reeling from the devaluation of the real caused by the Asian Financial crisis; Argentina, for its part, was suffering because of its heavy reliance on Brazil as its main export market. Not to be deterred, the negotiators plodded on.

And on. The negotiations would eventually reach an impasse in 2004. The cause? Mercosur's caution in opening up its markets to European industrial goods and the EU's reluctance to opening up its agricultural market and removing subsidies for its farmers. At a stalemate, the two trading blocks would continue to hold on-and-off negotiations until a breakthrough agreement was achieved in 2019.

Of sorts, in that by then other issues – climate change and deforestation – were intruding on the agenda. Not to be deterred, the negotiators plodded on.

And on. And then, on December 6, 2024, after more than 25 years of negotiation, the European Union and Mercosur reached a historic free trade agreement dubbed the EU-Mercosur Partnership Agreement (the EU-Mercosur Agreement or the Agreement). In the end, the EU's decision to open up its agricultural market to Mercosur was driven by economic opportunities, a means of diversifying its economic ties (hint, hint), and a desire for geopolitical influence.

What it's about

The Agreement creates the largest free trade area by population with over 700 million people. Economically, it will affect the approximately € 109.5 billion in trade annually between the two blocs; the Agreement will result in the elimination of tariffs on over 90 per cent of bilateral trade – that is, billions in savings for both EU and Mercosur consumers, with considerable potential for expansion of trade between the two blocs.[7]

Below, we highlight two significant aspects of this Agreement.

First, the Agreement explicitly recognizes the global threat of climate change and calls for the widest possible cooperation of all member countries to reduce global greenhouse gas emissions. To that end, the EU-Mercosur Agreement directly incorporates the Paris Agreement on Climate Change as an essential clause that would allow the suspension of the Agreement if a member country were to leave the Paris Agreement.[8] Signatories of the EU-Mercosur Agreement pledge to implement measures to prevent further deforestation and enhance efforts to stabilize or increase forest cover from 2030 onwards.[9]

Second, the Agreement includes a novel dispute settlement mechanism that can be activated if one party's unilateral measures nullify or substantially impair the benefits provided under the Agreement to another party. In such a case, the complaining party can commence mediation, and escalate the dispute to binding arbitration, which has the authority to order corrective measures such as compensation.[10]

What does this mean

While the inclusion of the Paris Agreement as an essential clause is commendable, the language of the environmental obligations imposed on each member country is significantly weaker than that of other free trade agreements that have similar clauses such as the EU-U.K. Trade and Cooperation Agreement and the EU-New Zealand Trade Agreement.[11] The inclusion of deforestation language, which remains a contentious topic for Brazil, is in and of itself exemplary. However, the actual obligations are vague and non-binding, and it will remain to be seen how they are interpreted as agricultural activities are invariably ramped up and deforestation threatened in response to economic activity spurred by the newly formed trade Agreement.

In 2023, the EU adopted the Regulation on Deforestation-free Products (EUDR). This regulation aims to prohibit the entry of goods linked to deforestation such as cattle, wood, soy, coffee amongst others by requiring operators or traders to prove that those products do not originate from recently deforested land or have contributed to forest degradation.[12] Brazil, one of the most vocal opponents of the EUDR, has dubbed it a "punitive instrument" and has all but threatened retaliatory action.[13] The implementation of the EUDR, originally slated for December 2024, has been postponed to December 2025 following pressure from Brazil and other nations opposing it. It remains to be seen whether Mercosur member countries will invoke the EU-Mercosur Agreement's new dispute settlement mechanism to challenge the EUDR once ratification occurs.

As well, it remains an open question whether Brazil or other Mercosur member states will invoke (once ratification occurs) the new dispute mechanism to challenge the implementation of the EU's Carbon Border Adjustment Mechanism (CBAM), which entered into transitional application in 2023 but will, starting in 2026, impose a carbon levy on certain goods based on their embedded emissions generated during the production process.[14] While the Paris Agreement does not explicitly address border measures such as the EU's CBAM, it does emphasize the importance of minimizing adverse impacts on other countries when implementing climate-related measures.[15]

From here, the next step is for the newly minted EU-Mercosur Agreement to go through the ratification process. Ratification is rarely a straightforward process and is influenced by continuously shifting domestic political dynamics. For example, while the CETA was concluded in 2016 and entered into force provisionally in Canada in 2017, it still remains to be fully ratified by every EU member state. The delay of some member states in ratifying CETA appears to stem from a mix of anti-trade narratives, fears of unintended consequences, and political divisions.

Given the complex political dynamics of the EU's 27 member states, the Agreement's ratification is far from guaranteed. At present, there appears to be substantial pushback from EU farmers, who are fearful of Mercosur's large and efficient agribusinesses. It remains to be seen whether EU members will be able to quell rises in domestic agricultural protectionism and achieve full ratification. Of note, EU member states could block the ratification of the Agreement if at least 4 EU countries representing 35 per cent of the population were to oppose it.

Mercosur is open for business: Reviving trade talks

The EU-Mercosur deal underscores Mercosur's openness to global economic integration, signalling a readiness for partnership that Canada can capitalize on and use to diversify its trade relationships and reduce its reliance on traditional markets like the U.S. and China.

While Canada has signed individual free trade agreements with countries like Chile, Colombia, and Peru, it does not have a comprehensive free trade agreement with Mercosur. In 2018, Canada officially launched comprehensive free trade negotiations with Mercosur.[16] Since then, several rounds of negotiation have taken place, with the last occurring in 2019. However, six years later there is no indication when trade talks might resume or whether the parties have lost interest. In light of the EU-Mercosur Agreement, the EU will be able to export goods to Mercosur countries at preferential tariffs, making Canadian exports less competitive unless Canada reaches its own trade deal. For example, both Canada and the EU are significant exporters of machinery to Mercosur member countries and while import duties can range up to 35 per cent for Canadian goods, the EU-Mercosur Agreement will reduce these tariffs to zero over time for EU goods. The failure to secure a deal with Mercosur could limit Canada's ability to benefit from the rapidly growing South American market, especially given the EU's new competitive advantage. In order to retain its competitive advantage, it is in Canada's national interest to swiftly revive trade talks with the Mercosur block or risk losing influence and market access in the region.

Swiftly, because the threat of restrictions on at least a significant portion of Canadian exports to our largest market is no longer abstract. Whether it's 10 per cent or 25 per cent, and whether it is on 10 per cent of Canadian exports or 90 per cent, the threat should be taken seriously, if not literally. Diversification is no longer merely desirable; it is a national strategic imperative. We should be unlocking new economic opportunities in emerging markets in any event. Mercosur is not just the closest, but the most logical remaining trading bloc for Canada to explore.

A Canada-Mercosur free trade agreement should focus on mutual market access for industrial and agricultural goods and improved regulatory frameworks for services, amongst other trade priorities. It is expected that while Mercosur would be able to tap into Canada's agricultural Market, Canada would in turn demand market access for its industrial products and investments. Nearly half of all Canadian exports to Mercosur are currently subject to tariffs, which includes automobiles and parts (up to 35 per cent), machinery and parts (up to 16 per cent) and electronics and electronic machinery and parts (up to 16 per cent).[17] A proposed Canada-Mercosur free trade agreement could result in enhanced market access, in the form of significant tariff reductions for these products. A Canada-Mercosur free trade agreement would boost investment in Canada while creating benefits to consumers and businesses alike. In a time of growing protectionism just south of the border, Canada should focus on increasing bilateral trade relations with other partners to help create alternative opportunities for growth, jobs, and sustainable development.

Footnotes

[1] *Comprehensive Economic and Trade Agreement between Canada and the European Union and its Member States*, done at Brussels on October 30, 2016 [CETA].

[2] European Commission, European Union, EU trade relationships by country/region: Canada.

[3] *Comprehensive and Progressive Agreement for Trans-Pacific Partnership*, done at Santiago on March 8, 2018 [CPTPP].

[4] Government of Canada, Global Affairs Canada, Canada to host eighth Comprehensive and Progressive Agreement for Trans-Pacific Partnership Commission meeting in Vancouver, B.C. (last modified November 26, 2024).

[5] Government of Canada, Global Affairs Canada, Highlights of Canada's merchandise trade performance - 2023 update, Office of the Chief Economist, p 9 (last modified June 17, 2024).

[6] Government of Canada, Global Affairs Canada, Canada-Chile relations (last modified October 1, 2024); Government of Canada, Global Affairs Canada, Canada-Colombia

relations (last modified October 1, 2024); Government of Canada, Global Affairs Canada, Canada-Peru relations (last modified August 28, 2024).

[7] European Commission, European Union, Trade in goods with Mercosur 4, Directorate-General for Trade, 2024, p 2.

[8] *EU-Mercosur Partnership Agreement*, Paris Agreement as an essential element, art 3.

[9] *EU-Mercosur Partnership Agreement*, Annex to the Trade and Sustainable Development chapter, art 16.

[10] *EU-Mercosur Partnership Agreement*, Dispute Settlement chapter.

[11] *EU-U.K. Trade and Cooperation Agreement*, 30 December 2020, EU and U.K., art 401; *EU-New Zealand Trade Agreement*, 9 July 2023, EU and New-Zealand, art 19.6.

[12] *Regulation (EU) (2023/1115) of the European Parliament and of the Council of 30 May 2023*, OJL 150, 9.6.2023, p 206-247.

[13] 'Punitive instrument': Brazil says EU deforestation laws will affect one third of exports, Saskia O'Donoghue, Euronews, September 12, 2024.

[14] *Regulation EU (2023/956) of the European Parliament and of the Council of 10 May 2023*, OJL 130, 16.5.2023, p 52-104.

[15] *Paris Agreement*, December 12, 2015, UNTS, vol 330, art 4, para 15.

[16] Government of Canada, Canada-Mercosur Free Trade Agreement (last modified August 11, 2021).

[17] Government of Canada, Global Affairs Canada, Mercosur trade bloc - Benefits for Canada (last modified August 11, 2021).

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