Trade agreements – What happens after EU-Mercosur?

With the Mercosur free trade agreement, the EU wants to give European companies better access to the South American market in order to offset the burden of higher US tariffs. Although the agreement is back on hold following a decision by the European Parliament, it could be applied provisionally in the future. In addition, further trade agreements are likely to follow in the coming months, which will also offer important opportunities for the German economy.

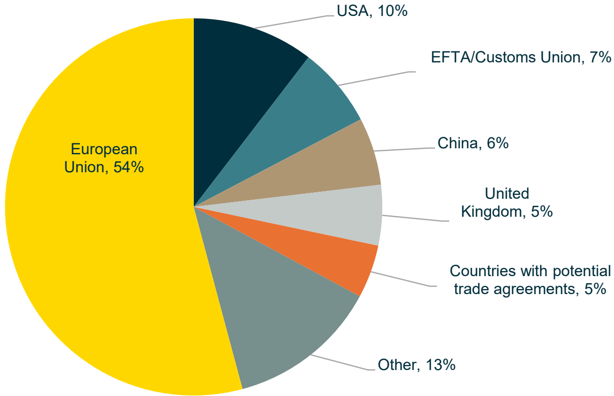
Dr. Vincent Stamer AC

Mercosur agreement fuels hope ...

This week, Donald Trump's back-and-forth on tariffs in the dispute over Greenland once again highlighted the importance of new trade agreements with other major economies. If exports to the US slump due to rising tariffs, such agreements will open up alternatives for European exporters. Currently, however, countries with a potential trade agreement account for only 5% of German exports, while the US attracts around 10% of exports (title chart).

Just a week ago, the EU Commission and the heads of state of Argentina, Brazil, Paraguay, and Uruguay signed the so-called EU-Mercosur Agreement. This agreement would significantly facilitate trade between South American countries and the EU. Ultimately, not only would mutual tariffs be eliminated, but other trade barriers would also be dismantled through the harmonization of technical standards, mutual recognition of patents and professional qualifications, and mutual investment protection.

Chart 1 - The United States is still the biggest trade partner outside the EU
Goods exports of Germany by partner country in 2024, shares in %



Source: German Statistical Office, Commerzbank Research

... and nevertheless faces political headwinds

However, the EU Parliament has not yet approved the agreement. Instead, on Wednesday, it decided by a narrow majority to submit the agreement to the European Court of Justice (ECJ) for review before a vote. The court is to examine whether the agreement violates EU treaties.

It appears now that the EU Commission will apply large parts of the agreement provisionally. From a purely legal standpoint, the Commission can do so even without the approval of the EU Parliament [1]. The parts provisionally applied would then include both tariff reductions and many measures to reduce further trade barriers. If the Commission does indeed provisionally apply the agreement, customs and trade barriers could be reduced as early as this spring.

However, there remain three risks:

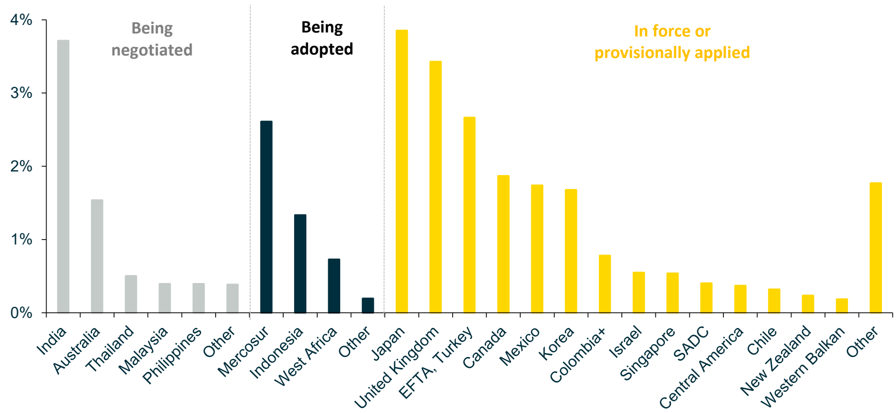
1. First, the ECJ could question the legality of the agreement or the approval process. In that case, the agreement would have to be renegotiated.
2. Second, the EU Parliament could vote against the agreement. In that case, the agreement would fail and would not be provisionally applied.
3. Third, individual states could officially reject ratification of the agreement. In that case, most of the agreement would still be provisionally applied and only the most far-reaching elements (such as cooperation on environmental standards and labor law) would never come

into force.

Further agreements are likely to follow

Important free trade agreements (FTA) are likely to be added in the coming years. Measured by the partner country's current share of the global economy – and thus the potential of an agreement – the agreement with India is the most important one, with negotiations now in the final stages (Chart 2). Agreements are also being negotiated with Australia and the Southeast Asian countries Thailand, Malaysia, and the Philippines. Like the Mercosur agreement, agreements with Indonesia and West Africa (including populous Nigeria) have already been negotiated, but they still need to be approved by the EU Council or the EU Parliament.

Chart 2 - The EU still negotiates important agreements
Share of trade partners in world GDP, further information in footnote [2]



Source: European Commission, OECD, World Bank, Commerzbank Research

If the relevant negotiations are successfully concluded and the agreements are then implemented, this would further increase the already large number of EU trade agreements. The most important existing agreement for Germany is, of course, by far its membership of the European single market. Although the European Union without Germany accounts for less than 15% of the global economy, more than half of German exports go to EU countries (Chart 1). The European Free Trade Association (EFTA, Switzerland, Norway, Iceland, and Liechtenstein) and the customs union with Turkey are further important building blocks in free trade for Germany.

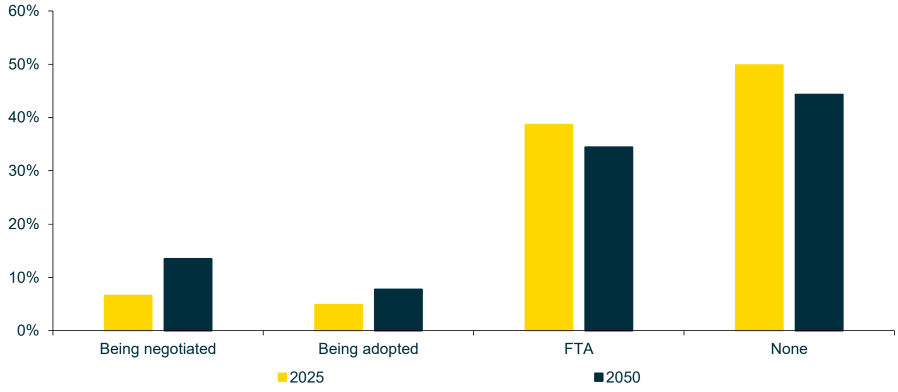
EU focuses on growth markets

The new trade agreements (both those currently being negotiated and those being adopted) undoubtedly have the potential to boost German exports. These countries currently account for around 12% of global GDP. And in many of these countries – particularly Brazil, India, and Southeast Asian countries – the economy is likely to grow strongly in the coming years. According to OECD estimates, their share of the global economy will rise to 21% by 2050 (Chart 3). The trade agreements will make it easier for German companies to benefit from this growth. Overall, current and future trade agreements already cover a good half of the global economy, and their share will grow in the coming years.

However, it is also true that the countries with which the EU is not currently planning any free trade agreements also account for around half of the global economy. The majority of this is accounted for by the US and China. Negotiations on a free trade agreement with the US (TTIP) have failed, and barriers to trade with China are currently being raised. There are also no agreements planned with Saudi Arabia, Bangladesh, and Pakistan, which are also quite large countries.

Chart 3 - Curent FTAs cover half of the world economy

Share of trading partners in global GDP in 2025 and 2050, OECD projections without purchasing power parity adjustment, in percent



Source: European Commission, OECD, World Bank, Commerzbank Research

How much do free trade agreements boost exports?

Experience from past agreements shows that in the years following the entry into force of a trade agreement, the annual growth rate of goods flows between the partners was on average about 3 percentage points higher than before. However, the positive effect varies between individual trade agreements, which is primarily determined by their design. Three factors are particularly important for success:

1. **Depth of the agreement:** According to WTO rules, a free trade agreement must at least reduce the majority of all tariffs. In addition, countries can dismantle so-called non-tariff trade barriers. These include the mutual recognition of technical standards, food sanitary standards, patents and professional qualifications, mutual investor protection and the right to participate in public tenders in the partner country. A particularly "deep" agreement can double the effect of a 'simple' customs agreement, which is largely limited to tariff reductions. The majority of agreements concluded in recent years tend to be "deep."
2. **Level of tariffs prior to the agreement:** The extent to which tariffs are actually reduced is, of course, also significant for the effect of the agreement. While industrialized countries often impose low tariffs even without agreements, the tariffs of developing countries are often still very high. India, for example, currently levies an unweighted tariff of around 15%, which means that the potential for tariff reductions is very high.
3. **Duration of implementation:** The EU agreements of recent years follow a similar pattern: tariffs are reduced immediately for some goods. For other goods, tariffs are reduced gradually over many years. This also delays the positive effects on trade. On 2,300 pages, the EU-Mercosur agreement specifies when tariffs on which products will be reduced in the 12 years following the start of the agreement.

In the short term, trade agreements are unlikely to offset higher US tariffs...

There is no doubt that every new trade agreement provides a positive impulse for German exports. However, only around 5% of German exports currently go to countries with which the EU is negotiating free trade agreements or which are in the process of adopting such agreements. Even if all these free trade agreements were to come into force at the same time, total German exports in ten years' time would probably only be 2% higher than without these agreements. This does not even include the slow reduction of tariffs. Realistically, the new free trade agreements are therefore unlikely to offset the negative effects of US tariffs in the coming years [3]. Competition with Chinese exporters will also continue to weigh on German foreign trade in the coming years.

... but probably in the long term

In the long term, however, the picture could change: economic growth in partner countries is driving German exports more strongly than any trade agreement. This is particularly true for the rapidly growing countries in Southeast Asia. If the agreements make it easier for German companies to access these markets, the German economy can benefit more from this growth. Last but not least, every trade agreement is a positive signal in times of burgeoning protectionism.

[1] The EU Council has already given the Commission permission to provisionally apply the most important parts of the agreement. These include the entire Interim Trade Agreement and parts of the Partnership Agreement. According to a literal interpretation of EU law, this is sufficient for provisional application. However, there is also a legal opinion that, without the consent of the Parliament, provisional application violates the spirit of other EU laws. Before the agreement can provisionally enter into force, it must be ratified by at least one of the Mercosur countries. (Back)

[2] We consider all agreements and arrangements that reduce the majority of tariffs on industrial goods to zero to be free trade agreements.

EFTA: European Free Trade Association (Switzerland, Norway, Iceland, and Liechtenstein).

Mexico: The active cooperation agreement is currently being renegotiated.

Colombia: Peru and Ecuador have also joined the agreement with Colombia.

SADC: Southern African Development Community with 16 member states, including South Africa.(Back)

[3] A recent Ifo study (**link**) concludes that this is possible. However, it is based on the following assumptions and findings: Due to US tariffs, German exports to the US will only fall by 15% within ten years. (However, by November 2025, exports to the US were already 23% lower than in the previous year.) In addition, the authors assume that the agreements will come into force simultaneously and that all tariffs will be abolished immediately. Another important mechanism of the Ifo study is that German industry will import cheaper intermediate goods from the new partner countries, thereby strengthening its competitiveness. We have not modeled this effect. (Back)

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