THE EUROPEAN UNION WITH THE COMMUNITY OF LATIN AMERICA AND THE CARIBBEAN: WHERE DO WE STAND?

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Latin American and Caribbean (LAC) countries have deep historical, political, cultural and economic ties with Europe. In this report, we review the main trends in trade, foreign direct investment (FDI) and agreements between the European Union (EU) and the Community of Latin American and Caribbean States (CELAC), highlighting short-term developments and risks and opportunities. CELAC was launched in 2011 as a political coordination mechanism that gathers 33 LAC countries, and is the EU’s official counterpart in the bi-regional strategic partnership that commenced in 1999.

Taking into account the differences across Latin America and the Caribbean, what stands out is that overall the EU and CELAC are major partners in trade in both goods and services. This trade relationship has been broadly stable in terms of GDP and is inherently asymmetric, with mainly primary products flowing from CELAC to the EU, and manufactured goods going in the other direction. Most countries in CELAC run trade deficits with the EU, and for them, reaping all benefits from stronger economic ties depends in particular on export diversification. Moreover, the EU accounts for more than half of FDI investment in CELAC and is particularly present in South America. Flows in the other direction have been growing recently but remain small by comparison.

The EU is building on its economic relationship with CELAC countries and is active in negotiating a number of different agreements. The reasons for the EU’s engagement are to foster regional integration, increase competitiveness vis-à-vis the United States (US) and other main economies, and promote its own regulations and standards. However, the level of regional integration in CELAC is still not as high as in other regions, possibly because of infrastructural barriers and increasing non-tariff measures.

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1 The EU-LAC Foundation kindly supported the research behind these findings. We are grateful to Inês Gonçalves Raposo and Lloyd Lyall for insightful discussions and comments.

2 Through the report, South America includes: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay, and Venezuela. Central America and Mexico includes: Belize, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Panama. Caribbean include: Antigua and Barbuda, the Bahamas, Barbados, Cuba, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.
1. Trade developments

**Key Messages**

- Overall, EU-CELAC total trade in goods has been stable in terms of GDP, and the two regions remain major partners.
- CELAC countries generally import manufactured goods and export primary products, while the region is running a trade deficit with the EU.
- Trade baskets are particularly compatible for the EU’s exports to CELAC, thus potential benefits of stronger economic ties are greater the greater the trade diversification in CELAC.
- CELAC countries still play a marginal role in global trade in services, but were collectively the third partner for the EU in 2015.
- The EU runs a trade surplus in services with most CELAC countries, while bilateral trade is moving away from ‘traditional’ services.

**CELAC is a major trading partner for the EU,** accounting for over 5.8% of extra-EU trade in goods in 2016. Ever since the trade collapse in 2009, exports and imports from CELAC have recovered to new peaks in 2012 and 2013, before decreasing to stand at $127.4 billion and $92.6 billion respectively (Figure 1a). This has been a general recent trend in CELAC, even if in the first months of 2017 the value of its exports and imports increased. In terms of GDP, trade flows have been relatively stable, with the exception of the Caribbean, where the share of total trade in GDP has slightly declined (Figure 1b). Collectively, CELAC countries would have been the 4th most important trading partner for the EU in 2016, behind the United States, China and Switzerland, though CELAC is still a relatively small market compared to the US and China. Similarly, the EU is CELAC’s third-largest partner and the second as an export destination. **The EU imports primary products, in particular food and animals, and exports mainly manufactured goods,** with machinery and transportation accounting for almost 47% of the total. The picture is consistent for different regional and economic zones, with the exception of Central America and Mexico, driven by the strong ties in the transportation sector with the latter (Figure 2).

**In 2016, the main EU trading partners with CELAC were Germany, Spain, Italy, France and the Netherlands,** even though the import figures for the latter might be overestimated because of the ‘Rotterdam effect’, as many goods destined for the rest of the EU are recorded in Dutch ports. Germany was by far the largest exporter, followed by Spain, France and Italy, whereas the main importers were the Netherlands, Germany and Spain (Figure 3).
Among CELAC countries, Mexico and Brazil accounted for 56.8% of total trade with the EU28 in 2016. Mexico is also the country with the highest deficit to the EU in 2016, followed by Cuba (€14.0 and €1.6 billion, respectively), while the largest surpluses were recorded for Peru and Costa Rica (€1.5 and €1.3 billion, respectively). In 2016, the Southern Common Market (MERCOSUR) was the origin for almost half of total exports to the EU28, with Brazil responsible for 74%. Given the different composition of imports, import shares of MERCOSUR countries and Mexico are of the same magnitude (37% and 35%, respectively), as Mexico imports a lot of manufacturing intermediates,
which in turn are used to produce final goods that are re-exported, especially to the United States (for example, vehicles).

**Figure 3: Main EU28 trade partners with CELAC (bln EUR)**

![Diagram showing trade partners with CELAC](source)

Source: Eurostat Comext.
Note: X stands for exports, M for imports.

**Sub regional patterns are visible in trade balances**, as weaker foreign demand conditions, along with trade specialisations, also contributed to the creation of deficits (Figure 4). Historically, South America has had a more advantageous balance with the EU than Central America, Mexico and the Caribbean. This trend has recently reversed, as the appreciation of the dollar and falling commodity prices caused a deterioration of terms of trade, especially in oil and derivatives. On average, the CELAC deficit with the EU has increased since 2012, driven mainly by the weak export performance, even though there were signs of recovery in 2016.

**In the EU, intra-regional trade accounts for more than 64% of total EU trade.** However, its share has been decreasing because of slower growth in many of its members since the economic crisis. In contrast, China has steadily increased its position in EU trade, whereas the **share of CELAC countries in EU trade has remained stable** on average (Figure 5).
The emergence of China has also been evident in the trade landscape of LAC countries. On average, China’s share in CELAC’s total imports increased by roughly 8% over 2009-2016 compared to 2000-2008, and its share in CELAC’s total exports by 5%. Nonetheless, while the presence of the United States decreased over time, the EU remained a stable partner for CELAC, holding approximately the same share of total trade as China [12.2% and 12.7% for China and the EU, respectively] between 2009 and 2016; over the same period, it is the second largest import market (after the US), and the third largest exporter to CELAC (after the US and China).
It is important to note that, despite the growing diversion of EU and CELAC trade towards China, the EU and CELAC traditionally had high similarity in their trade baskets, that is, products generally imported in CELAC are very similar to those generally exported by the EU, and vice versa. This could suggest significant potential benefits from stronger economic ties between the two regions (Zerka et al., 2014).

Computing trade compatibility indexes at the 4-digit HS level, one can see that in 2015 the EU’s trade flows were more similar to those of CELAC than to China’s, and for Caribbean countries and South America they are comparable to those of the US, or higher (Figure 6). However, compatibility is particularly pronounced between EU exports and CELAC imports, rather than EU imports and CELAC exports, especially for South America and the Caribbean (in Central America and Mexico, the share of manufactured exports, above all machinery and transportation, is higher than in the other regions). Thus, trade relations are quite asymmetrical. Moreover, for many CELAC countries, opening up might result in trade deficits, given relatively high import elasticity to income. In turn, those imbalances may be difficult to reverse by devaluation because of the relatively inelastic nature of CELAC exports; historically, trends have been reversed via economic contractions. Therefore, fully reaping all benefits from more openness with the EU would also need diversification.

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3 Trade compatibility index at time t of exports of country c and imports of country j, is defined as $1 - (\sum_{i \in I} |X_{i,c,t} - M_{i,j,t}|)/2$, where I is the set of products, and X (M) is the share of product i in total exports (imports).
of CELAC’s exports, to avoid the external sector ‘trap’ described above (for example, by directing investment to the development of new business).

Since the ICT revolution, many services have become tradable and increasingly important for global trade, especially in non-traditional (so-called ‘modern’) sectors such as telecommunications and financial services. Historically, LAC countries tended to participate less in world services trade (3.3% in 2016, compared to 5.6% of trade in goods), yet they are an important partner for the EU (Figure 7). CELAC accounted for 7.3% of exported services to the EU and 12.1% of imported services from the EU in 2015, making CELAC the third partner for the EU (after the USA and Switzerland). Brazil alone accounts for 1.7% and 1.1% of exports and imports, respectively. Overall, the most dynamic EU countries were Germany, the Netherlands and France⁴, which are also the main partners for South and Central American countries, while in the English-speaking Caribbean the UK has a major role.

The largest shares of exports of services from the EU were financial services and insurance in the Caribbean, other business services in Central America and transportation services in South America; whereas the main sources of imports were travel services from the Caribbean, use of intellectual property from Central America and transportation services from South America. Overall, the EU recorded a surplus in services with most CELAC countries, the largest being those with Brazil and Mexico (€6.9 and €4.4 billion, respectively). In particular, large positive balances have been

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⁴ Please note that detailed data for bilateral trade in services for Spain is confidential.
attained in commercial services other than trade and transportation, especially with respect to South America, while deficits are held with regions and countries specialised in specific sectors, such as travel services in the Caribbean.

Finally, there has been a decreasing trend in the share of transport and travel services in total trade, with a contemporaneous increase in other services, between EU and CELAC countries (Figure 8), even though in 2015 only in Brazil, Argentina, Costa Rica and Chile were they the main export category.

**Figure 7a: Selected shares of global trade in commercial services (percentages)**

![Graph showing selected shares of global trade in commercial services (percentages)](source: WTO)

**Figure 7b: EU-CELAC total trade in services (bln EUR)**

![Graph showing EU-CELAC total trade in services (bln EUR)](source: Eurostat)

**Figure 8a: EU-CELAC exports of services (percentages)**

![Graph showing EU-CELAC exports of services (percentages)](source: Eurostat)

**Figure 8b: EU-CELAC imports of services (percentages)**

![Graph showing EU-CELAC imports of services (percentages)](source: Eurostat)
2. Foreign direct investment

<table>
<thead>
<tr>
<th>Key Messages</th>
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</thead>
<tbody>
<tr>
<td>❖ More than half of inward FDI into CELAC countries comes from the EU, especially in South America, though 2015 saw a reduction of inflows.</td>
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<tr>
<td>❖ FDI flows from CELAC to the EU have been expanding recently, but remain small.</td>
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</tbody>
</table>

Europe is still the main investor in the area, accounting for more than 53% of the FDI inflows, with the Netherlands providing its largest component (12%), as reported by the Economic Commission for Latin America and the Caribbean (ECLAC, 2017). However, there is some variability: European investors are more integrated in South America, while in Central America, Mexico and the Caribbean, investment comes mainly from the United States. In 2016, Europe accounted for 71% of total investment in Brazil, while holding a smaller 12% in Central America and the Dominican Republic (Figure 9a). On the other hand, the highest dependence on the United States is in Mexico (39%). However, in 2015 there was a reduction of FDI inflows from the EU (Figure 9b), possibly driven by falling commodity prices and weaker economic growth. The decline involved roughly half of CELAC countries, with the largest reductions in Brazil, Mexico, and Chile.

In 2015, Brazil and Mexico were by far the largest recipients of FDI from the EU, and South America accounted for over 60% of total EU FDI in CELAC. On the EU side, the Netherlands and Spain are the largest investors in CELAC, even though values for the former might be driven by its intermediary role for transnational companies. In general, FDI flows into LAC countries are mostly directed to the largest economies (Brazil and Mexico on top), with large fluctuations depending on specific transactions in a given year. In 2016, total FDI inflows declined by 7.9%, with a fall in South America of 9.3% and an increase in the rest of the countries of more than 3%. Among FDI components, capital contribution and reinvested profits declined the most (10% and 6% declines, respectively), according to the ECLAC (2017). This might suggest either a more prudent approach, in light of lower commodity prices and recessions in some countries, or a decline in asset profitability. Regional specialisation is a factor in the sectoral composition of FDI. In fact, from the limited data at the sectoral level, one can indeed see for example that in Mexico the dominant recipient of investment from the EU is the manufacturing sector (64% on average from 2013-2015), probably because of the automotive sector’s links with European companies. On the other hand, in Brazil the situation is more balanced (Figure 10).
Overall, outward FDI from LAC has been recently on a sharp declining path. According to ECLAC, in 2016 aggregate flows were 50% less than in 2015, with Brazil and Mexico accounting for the largest stocks. This might be because of lower investment prospects, or reduced incentives resulting from falling commodity prices. In general, the focus of local firms is still intra-regional expansion, but as financial resources increase for some of them, global penetration might start to pick up.

However, while many large investment operations are conducted in the US, in recent years FDI flows from CELAC to the EU have been expanding (Figure 9b), a process initiated by European firms divesting assets to improve cash flows, later facilitating CELAC firms’ entry (ECLAC, 2015). In the EU, the main recipients have been the Netherlands and, to a lesser extent, Spain, both in terms of stocks (in 2015, €60 and €17 billion, respectively), and flows (in 2015, €15.6 and €2.4 billion, respectively). As mentioned above, values for the Netherlands might be partially driven by its intermediary role for transnational companies. This is consistent for South America, Central America and Mexico, whereas for the Caribbean, Germany is a major partner (no data for Spain). Most FDI flows to the EU from CELAC originate from Brazil and Mexico (stocks of €127.4 and €36.5 billion in 2015, respectively).

**Figure 9a:** FDI inflows (selected areas) (percentages)

**Figure 9b:** Bilateral EU-CELAC FDI stocks and flows (bln EUR)

Source: Economic Commission for Latin America and the Caribbean (ECLAC)

Source: Eurostat.
Note: Reporters are EU28 countries.
3. EU-CELAC agreements

**Key Messages**

- For the EU, major factors behind recent EU-CELAC economic relations are the objectives of fostering regional integration and competitiveness relative to the US and other main economies, and the promotion of its own regulations and standards.
- Agreements have expanded to include political dialogue, provisions on essential rights and cooperation on key issues such as environmental sustainability.
- The timing and success of EU-CELAC negotiations are variable, depending on specific regional/country features and incentives.
- The level of regional integration in CELAC is not as high as in other regions, possibly because of infrastructural barriers and increasing non-tariff measures.

A strategic partnership between CELAC and the EU has been pursued since LAC countries transitioned to democratic governments in the 1980s and 1990s, with bilateral summits taking place since 1999. Moreover, dialogue has been maintained also at the sub-regional level, because of the declared aim of the EU to **support regional integration in LAC**, even though it has proven very difficult to achieve. **Currently, many different organisations, institutions and state agreements coexist in LAC**, because of the different political and economic interests, visions and systems that are present. CELAC is an example of a political initiative that aims at providing a framework to encompass the whole LAC region, while sub-regionally there are many economic areas and
intergovernmental organisations, such as ALBA, MERCOSUR, the Pacific Alliance, CARICOM, etc. [see Figure 11 for a mapping of free trade agreements in CELAC].

According to the European Parliament’s DG-EXPO (2016), US foreign policy has had a significant impact on EU-LAC negotiations, as the EU was in fact competing for market access in Latin America. A turning point is identified in the creation of NAFTA, which forced European institutions to pursue trade agreements on their own, to regain lost market shares, and to pre-empt such a possibility in the future. Thus, competitiveness relative to the other main players (mainly the US and, more recently, China) has become an increasingly important element. In fact, when negotiations at a higher level faltered, the EU reverted to bilateral talks, leaving open the possibility of achieving regional integration through a “multi-speed approach” (DG-EXPO, 2016). This shift has been criticised as possibly causing divisions in the short run, for example in the case of the Andean Community: as Bolivia and Ecuador withdrew, negotiations were concluded with Peru and Colombia. Nonetheless, Ecuador accessed the agreement at the later stage, when conditions were mature (risk of expiry of its preferential access in 2014). The spread of its own regulatory model has also been highlighted as a relevant goal of the EU’s trade policy, as there is a clear advantage in terms of costs and operations for European firms in having other nations adopt their standards and rules (DG-EXPO, 2016).

In general, the scope of EU-CELAC agreements has widened to encompass political dialogue and development cooperation. For example, they have recently included, among other issues, intellectual property rights, public procurement, electronic trade, climate change, trade sustainability, education, employment and social cohesion. Moreover, they allow the legal possibility of suspension, if certain conditions on human rights and the rule of law are not observed (even though the actual feasibility of enforcement has been questioned; e.g., Hachéz 2015). It has also been noted that the EU-LAC partnership includes various non-governmental interactions between social partners and institutions, like the Euro-Latin American parliamentary assembly (EUROLAT), business and social forums, and others (Gardini and Ayuso, 2015).
While most CELAC countries have agreements with the EU, the process is remains ongoing. For example, negotiations between MERCOSUR and the EU resumed in 2016 after a few years of little progress and are currently continuing [see Figure 12 for a comparison with other negotiation processes]. Market access for agricultural products has been a central point of contention, because of the discontent about the EU’s proposals. The main obstacles are the reluctance on the EU side to open up to competing agricultural products, and on the MERCOSUR side to accept intellectual property rights. Moreover, as highlighted in the trade section, there are concerns in MERCOSUR about widening trade imbalances resulting from more openness, which might be balanced by direct investment in the development of new businesses.

**Negotiations with other Latin American countries have proved to be less problematic**, as their agricultural export baskets are not a direct competitor to that of the EU. Moreover, their export capacity is relatively lower than that of MERCOSUR, and most of those countries had already trade agreements in place or under negotiation with the US, thus creating incentives for the EU to conclude its own agreements. Furthermore, a relatively advanced stage in negotiations with the US also suggests that many delicate issues were already faced, thus facilitating the dialogue with new partners. Currently, the oldest agreements (those with Mexico and Chile) are undergoing a process of modernisation [see Table 1 for an overview of the main ongoing and in-negotiation bilateral
agreements). Finally, the EU’s trade partnership with the Caribbean falls more under the scope of EU’s development policy rather than trade strategy. This is why the integration perspective was predominant over market losses to the US. Since 1 November 2017, an EU-Cuba Political Dialogue and Cooperation Agreement has been provisionally applied.

**Figure 5: Timelines for selected EU-third party trade agreements**

![Chart showing timelines for selected EU-third party trade agreements]

Source: DG Trade.

* Includes Botswana, Lesotho, Mozambique, Namibia, South Africa, and Swaziland. Angola has an option to join the agreement in future. Other bloc members are negotiating with the EU as members of other regional blocs. **Madagascar, Mauritius, Seychelles, and Zimbabwe. ***Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Saint Lucia, Saint Vincent and the Grenadines, Saint Kitts and Nevis, Suriname, Trinidad and Tobago; not yet applying in Haiti, pending ratification.

**Table 1: Main ongoing and in negotiation EU-CELAC agreements**

<table>
<thead>
<tr>
<th>Country/Region</th>
<th>Negotiating Directives</th>
<th>Current status</th>
<th>Next steps / Documentation</th>
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</thead>
<tbody>
<tr>
<td>MERCOSUR</td>
<td>Negotiating Directives of 1999</td>
<td>Negotiations resumed after an exchange of market access offers took place in May 2016. The last negotiation round took place in Brasilia between 6 and 10 November 2017.</td>
<td>The following round will be in Brussels, with talks beginning on 29 November and finishing on 8 December.</td>
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<tr>
<td>Country</td>
<td>Agreement Description</td>
<td>Details</td>
<td></td>
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<tr>
<td>--------------</td>
<td>----------------------------------------------------------------------------------------</td>
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<tr>
<td>Mexico</td>
<td>Negotiating Directives of 2016</td>
<td>The EU and Mexico met in Brussels in June 2016 to start the negotiation for the modernization of the EU-Mexico Global Agreement. Sixth round took place in Mexico City from 25 November to 1 December. The next round will be in Brussels, in the week beginning 18 December.</td>
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<tr>
<td>Chile</td>
<td>Modernized Association Agreement</td>
<td>The aim is to update the 14-year-old EU-Chile Association Agreement to bring its political and cooperation ambitions and trade provisions into line with the EU’s modern agreements. Negotiations were launched on 16 November 2017. A second round will follow in early 2018.</td>
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<tr>
<td>Caribbean</td>
<td>CARIFORUM – EU EPA</td>
<td>The CARIFORUM – EU EPA was signed in October 2008 and approved by the European Parliament in March 2009. The EPA joint institutions have met regularly since 2010: <a href="http://www.consilium.europa.eu/en/documents-publications/agreements-conventions/agreement/?aid=2008034">http://www.consilium.europa.eu/en/documents-publications/agreements-conventions/agreement/?aid=2008034</a> Both regions will: • continue working on further implementation; • agree on a joint monitoring system; • negotiate an agreement to protect geographical indications [GIs], valuable regional product names.</td>
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<td>Colombia,</td>
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<td>Ecuador</td>
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</table>

Source: DG-Trade, European Council

3.1 CELAC integration

In a recent survey conducted by the IMF [2017], views of country authorities reflect a general commitment to regional initiatives. This was particularly so for Caribbean countries (that see
collective negotiations as advantageous for small countries) and, to a lesser extent, Central America, which also expressed mixed views about extra-regional integration. Potential barriers include product competition between potential partners, asymmetries in size, and prioritisation of bilateral initiatives.

**Overall, regional trade flows are a not a significant share of total trade in CELAC**, compared, for example, to the EU (Figure 13). According to Cerra et al (2016), possible causes might be the relatively poor connections between regions, arguing that this is principally due to geographical and infrastructural barriers, with substantial differences between countries, while Gordon and Suominen (2014) argue that technical barriers and entry-trade costs are particularly binding for small firms in LAC countries. Hence, export markets are particularly concentrated, thus restraining development and business dynamics.

**Figure 13a: Intra-CELAC exports of goods**

![Intra-CELAC exports of goods](image1)

**Figure 13b: Intra-EU28 exports of goods**

![Intra-EU28 exports of goods](image2)

Source: IMF (DOTS).

Furthermore, non-tariff measures are increasingly in play, especially for intermediate and capital goods, affecting the ability to enter regional value chains (IMF, 2017). According to ECLAC (2015), **Central America and Mexico benefit from relatively greater integration**, also because of the nature of trade agreements with partners outside of the region. Importantly, by allowing cumulation of origin within the region, trade in intermediates has been particularly fostered, because inputs can be used in goods to export to those partners outside the region.

Finally, the IMF (2016) points out that while **financial integration** is not as advanced as in other emerging regions of the world, there have been some developments such as the merging of Chile’s, Colombia’s and Peru’s stock exchanges in 2011 (Mexico joined in 2014), and the increase in cross-border financial actives in Central America, with Panama and Colombia acting as hubs.