

Effects in Argentina of a liberalization in the Mercosur common external tariff

June 2019

1. Introduction

This activity builds on the previous work developed during 2016—17 by the World Bank Group to strengthen Argentina’s integration into the global economy. This agenda delivered robust analytical foundations for an actionable reform strategy, established a solid dialogue with the government, and informed some first reforms in trade, investment and competition policy. A flagship report (Licetti et al., 2018) summarizes detailed policy recommendations with suggestions for actions at the short, medium and long term.¹

To continue informing ongoing and future trade policy reforms, this note generates new results related to possible tariff liberalization in the Mercosur common external tariff. These results are based on a general equilibrium model, custom build for the earlier flagship report. However, the model and earlier simulation scenarios were updated in important ways in discussion with Government counterparts to generate initial results to help focus the technical discussions and negotiations likely to take place inside Mercosur.² As agreed with government counterparts, the purpose of this phase is to develop a series of new empirical findings that can inform a fact-based policy debate on identified areas of reforms, with short, just-in-time technical notes and policy dialogue surrounding these findings.

The rest of the note briefly describes tariff policy in Argentina (section 2), defines the reform scenario considered in the modeling of the CET liberalization (section 3), and summarizes main findings in terms of economy-wide and sectoral effects (section 4).

2. Overview of Tariff Protection in Argentina

As part of Mercosur, Argentina holds a common external tariff (CET) with the other Mercosur parties with respect to imports from outside Mercosur since 1995. The CET, however, is perforated in at least two ways. First, parties to the Mercosur are allowed to a list of exceptions. These exceptions are national (in that each country determine its exceptions) and limited to a number of tariff lines. They were conceived as temporary exceptions to the common external tariff, but in practice they have remained in place over subsequent decisions of the Mercosur parties.

The second important perforation to a common tariff policy refers to preferential rates. While the CET applies on a most-favorable nation (MFN) basis, bilateral preferences with non-Mercosur parties can

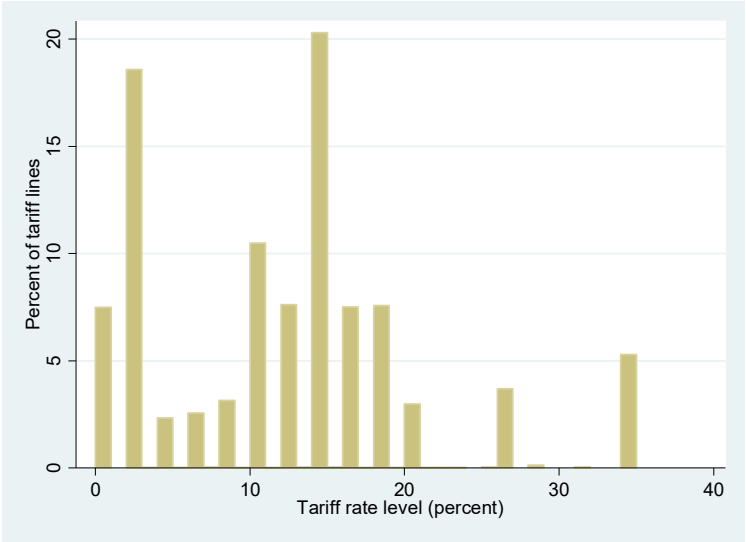
¹ Licetti, M., M. Iooty, T. Goodwin, and J. Signoret, “Strengthening Argentina’s Integration into the Global Economy: Policy Proposals for Trade, Investment, and Competition, 2018.

² According to some sources, Argentina and Brazil are initiating discussions to the possibility of reforming the CET, with the technical discussions likely to gather speed after the elections in Argentina (Reuter, “Brazil, Argentina discuss lower Mercosur external tariff: sources,” June 5, 2019).

deviate from the CET, although this is limited to certain other Latin American countries. As part of the Latin American Integration Association (LAIA), the Mercosur countries have engaged in trade agreements either bilaterally or as a block with other Latin American countries and bilateral preferences have not been “multilateralized.” For instance, Argentina may extend a preferential tariff to Mexico for a product that faces the CET in Brazil and vice versa. As individual Mercosur countries have established similar LAIA agreements with the same partner, and as most of trade outside Mercosur is not with other Latin American countries (but to partners such as the United States, the EU, and China), in practice this perforation is small.

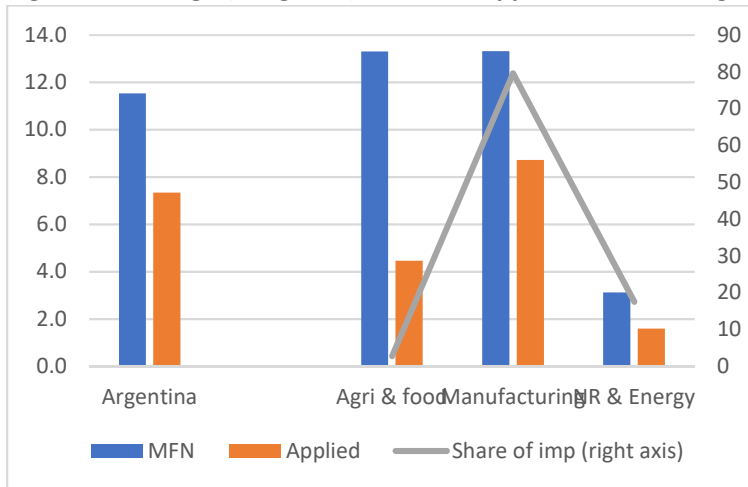
On a MFN basis, Argentina imposes relatively high tariffs to its imports from the world. The simple average tariff in 2015 was close to 14 percent. Figure 1 shows a histogram of Argentina’s tariff schedule. The most frequent tariff rate level is 14 percent, accounting for slightly more than 20 percent of the tariff lines. The second most frequent tariff level is a rate of 2 percent, accounting for slightly less than 20 percent of tariff lines. In addition, almost as many lines are duty-free (about 7 percent of lines) as they are set at the WTO bound rate of 35 percent (about 5 percent of line). This leads to a somewhat polarized tariff schedule, with a coefficient of variation of about 74 percent.

Figure 1. Histogram of MFN tariff rates for Argentina, 2016



Argentina’s import tariffs including preferences are significantly lower than its MFN tariffs, but still relatively high at a trade-weighted average of about 7 percent (figure 2). The difference is primarily due to tariff preferences within the Mercosur zone, and to a lesser extent to preferences to other Latin American countries within the LAIA framework. Mercosur provides for virtually duty-free trade among the parties, except for sugar and automobiles, where national tariffs apply. Automobiles, however, have been liberalized in bilateral, partial-scope agreements among Mercosur parties. On a trade-weighted basis, the tariff Argentina charges to imports from other Mercosur countries is essentially zero.

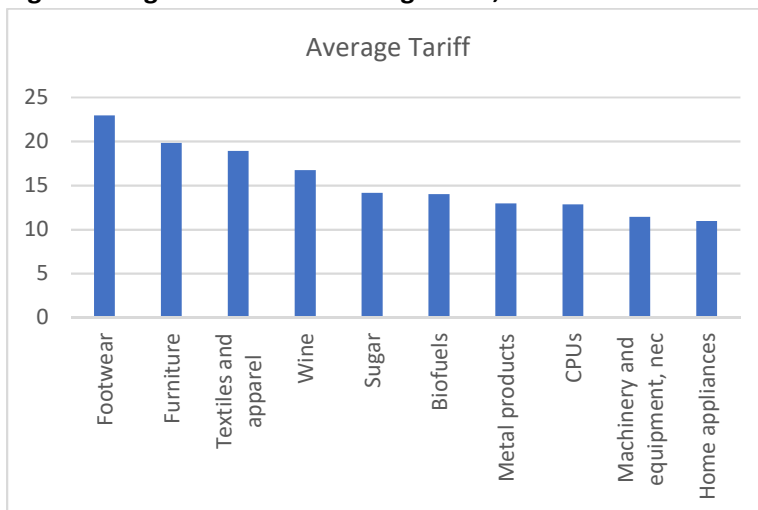
Figure 2. Average (weighted) MFN and applied tariffs in Argentina, 2015



Applied tariffs for imports into Argentina from the world are higher for manufactured goods. The trade-weighted average tariff for manufacturing is close to 9 percent, about double the tariff for food and agricultural imports. Meanwhile, manufactured goods represent most imports into Argentina, accounting for about 80 percent of total imports on a value basis. Food and agricultural imports, on the other hand, are small, accounting for less than 3 percent of imports. The average applied tariff for natural resources and energy products is the lowest, at less than 2 percent, on a trade-weighted basis.

In terms of specific sectors, the highest tariffs are seen in light manufacturing industries, such as footwear, furniture, and textiles and apparel. Figure 3 shows the top-ten sectors with the highest import tariffs, ranging from 23 percent for footwear to 11 percent for home appliances. Wine and sugar are two agricultural sectors deemed as high-tariff sectors. Combined, these sectors accounted for more than 20 percent of imports in Argentina in 2015. Imports in some of these sectors, however, are relatively small, in large part because of the tariff barriers.

Figure 3. High-tariff sectors in Argentina, 2015



A Mercosur agenda can be an important catalytic of trade integration reform for Argentina. As discussed above, a broad tariff liberalization in Argentina is restricted by the Mercosur common external tariff. In practical term, this means to reform the common external tariff regime, or otherwise to leave it. This highlight the importance to work with other Mercosur partners to dismantle tariff barriers as a block to maintain a customs union. Intra-Mercosur tariff barriers are virtually zero.³ Yet, Mercosur’s tariffs with respect to the world remain high.

3. Potential Economic Effects of Mercosur’s CET liberalization: A CGE analysis

The economic effects in Argentina of reducing import tariffs across all Mercosur countries is modeled using CGE simulations. In this analysis Mercosur is comprised of Argentina, Brazil, Paraguay, and Uruguay.⁴ The model used is the LINKAGE model (a dynamic CGE), with modifications to the GTAP database to identify particular sectors of interest (see table 1), and with updates to the input-output structure of Argentina and Brazil. Additional details of the modeling frameworks are described in Licetti et al. (2018).

Table 1. Model Sectors

| Agri/Food | NR and Energy | Manufacturing | Services |
|-------------------|-------------------------|-----------------------|---------------------------------|
| Corn | Biodiesel | Pharmaceutical | Comm, financial, and business |
| Wheat | Fuels and fuel products | Computers | Distribution and other services |
| Beef | Steel | Electronics | |
| Poultry and swine | Other natural res. | Metal products | |
| Dairy | | Furniture | |
| Soybean | | Footwear | |
| Soy meals & oil | | Vehicles | |
| Sugar | | Auto parts | |
| Veg and fruits | | Agri machinery | |
| Wine | | Home appliances | |
| Other food and ag | | Machinery & equipment | |
| | | Textiles and apparel | |
| | | Other manuf. | |

The specific scenario used here is hypothetical by nature, given than given that the discussions are not public and at an early stage. The policy scenario is compared to a long-term baseline through 2030, and implementation of the policy changes is assumed to enter into force in 2019 for illustrative purposes. Further, all goods subject to tariffs are assumed to be liberalized by 50 percent (i.e., under this scenario there are no carve outs or more aggressive liberalization for particular industries). However, these initial results can help inform subsequent scenarios with differential liberalization by sector.

³ As part of the Mercosur agreement, parties eliminated tariffs horizontally, except where parties maintain national tariffs for sugar and vehicles. Vehicles, however, have been treated in bilateral agreements.

⁴ Venezuela is not participating in the FTA negotiations involving Mercosur.

The model and earlier simulation scenarios were updated in several important ways, including:

- The model baseline was revisited to include newer macroeconomic forecasts used to project the Argentinean and global economy on a yearly basis to 2030. This uses the most recent numbers from the WBG Global Economic Prospects publication (June 2019). In general, most macroeconomic numbers were revised downward, relative to the macro forecasts used for generating the baseline in Licetti et al. (2018).
- Significant reforms in Argentina with respect to export taxes were added to the model. This includes the newer schedule with export taxes from 2018 forward at 18 percent for the soybean complex (soybeans and soybean products) and at 15 percent for biodiesel.
- Based on feedback received by the Government, the policy simulations related to the Mercosur-level reforms (i.e., “enhanced Mercosur”) in the flagship report were revised to estimate the impact on the overall economy and sectors of the economy from a reduction of tariffs applied by all Mercosur countries to third countries by 50 percent in 4 years (in 4 linear cuts), without altering the export tax regime or other non-tariff measures.

4. Simulation results

The following charts and tables represent the output of the CGE simulation analysis for delivery and discussion with government counterparts. They show the economy-wide effects in terms of real GDP and trade (exports and imports). The analysis also provides detailed assessments of output and trade at the sector level (tables 2-4), as well as charts with effects by broad sectors of the economy, including: i) agriculture and food; ii) manufacturing; iii) natural resources and energy products; and iv) services.

The following summarizes key results:

- The overall effects on the economy are positive, with real GDP expanding relative to the baseline by 2030 by about 0.21 percent. The effects are modest relative to the size of the economy, but they are permanent and the cumulative gain over time can be significant.
- Total export and imports expand by 4.6 and 4.1 percent, respectively, relative to the baseline projection to 2030. These expansions in trade are not insignificant, especially given that tariff barriers are only partially reduced.
- All sectors of the economy experience an expansion relative to the baseline, except for manufacturing, which is the sector with the highest tariff protections
- Imports of manufacturing expand with the reduction of tariffs, while imports of other goods and services actually decrease
- Similarly exports of all sectors, but manufacturing, expand as these other sectors benefit from the proportionally larger liberalization in manufacturing
- Particularly large negative effects are observed for the automobile sector (both vehicles and parts), textile and apparel, furniture, and other manufacturing (table 2). Services, soybean products (meal and oil), and other agriculture and food products benefit from the liberalization in terms of sectoral output and exports.

Figure 4. Economy-wide effects of CET liberalization, deviations from baseline, 2030

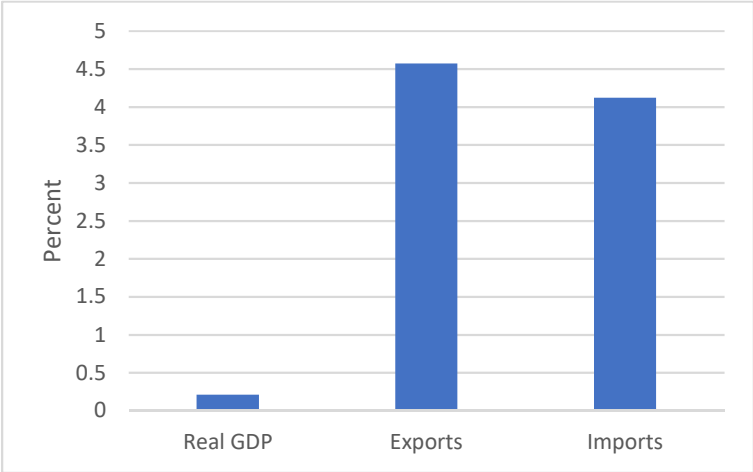


Figure 5. Sectoral output effects of CET liberalization, deviation from baseline, 2030

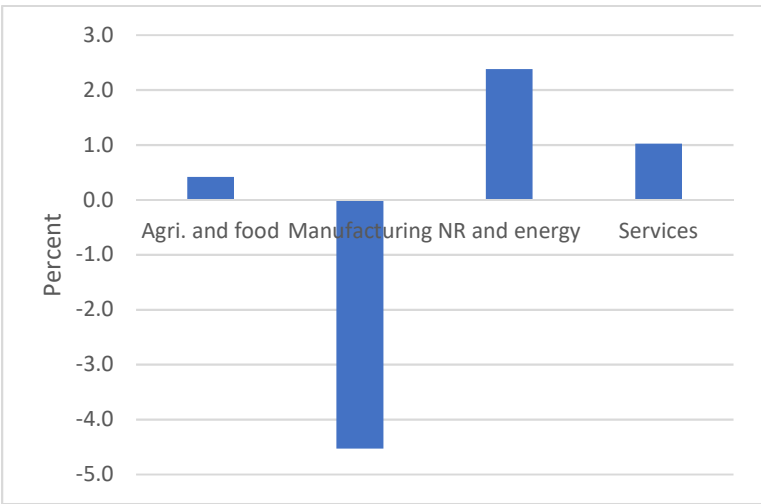


Figure 6. Sectoral export effects of CET liberalization, deviation from baseline, 2030

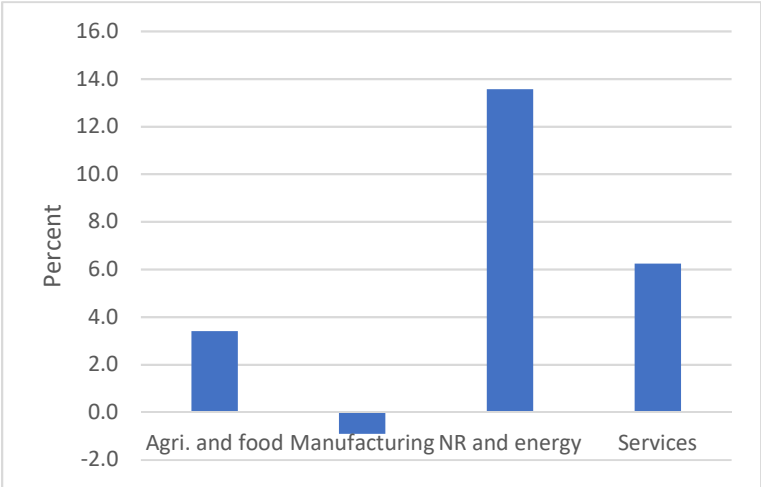


Figure 7. Sectoral import effects of CET liberalization, deviations from baseline, 2030

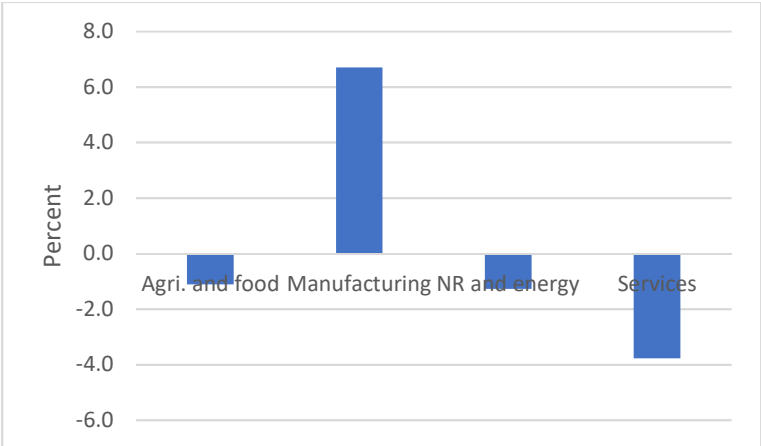


Table 2. Effect of CET liberalization on sectoral output, 2030

| | Deviations from baseline | |
|------------------------|--------------------------|---------|
| | US\$ million | Percent |
| Beef | 117 | 1.3 |
| Corn | 245 | 2.4 |
| Dairy | 25 | 0.1 |
| Poultry and swine | -11 | -0.1 |
| Sugar | 9 | 0.9 |
| Soybean | 247 | 2.1 |
| Veg and fruits | -46 | -1.0 |
| Wheat | 47 | 0.6 |
| Wine | 31 | 0.3 |
| Other food and ag | 1432 | 1.4 |
| Soy meals & oil | 1107 | 5.8 |
| Ag machinery | -67 | -2.8 |
| Computers | -189 | -6.5 |
| Electronics | -107 | -4.1 |
| Metal products | -332 | -7.6 |
| Footwear | -318 | -9.9 |
| Furniture | -1053 | -5.8 |
| Home appl | -142 | -6.2 |
| Other machinery & equi | -43 | -1.7 |
| Pharma | -94 | -0.3 |
| Vehicles | -1694 | -14.6 |
| Auto parts | -1345 | -6.2 |
| Other manuf | -1627 | -2.8 |
| Textiles and apparel | -1358 | -5.2 |
| Biodiesel | 145 | 0.5 |
| Steel | 200 | 3.7 |
| Fuels and fuel product | 1603 | 2.9 |
| Other natural res | 959 | 2.8 |
| Comm financial and bus | 615 | 0.4 |
| Distribution and other | 1610 | 0.2 |
| | | |
| Agri. and food | 3706 | 0.4 |
| Manufacturing | -8369 | -4.5 |
| NR and energy | 2907 | 2.4 |
| Services | 1722 | 1.0 |

Table 3. Impact of CET liberalization on sectoral imports, 2030

| | Deviations from baseline | |
|------------------------|--------------------------|---------|
| | US\$ million | Percent |
| Beef | 0 | -0.9 |
| Corn | 0 | 1.2 |
| Dairy | 15 | 16.4 |
| Poultry and swine | 5 | 1.4 |
| Sugar | -4 | -2.3 |
| Soybean | 1 | 4.0 |
| Veg and fruits | 5 | 1.0 |
| Wheat | 0 | -0.5 |
| Wine | 19 | 17.1 |
| Other food and ag | 194 | 7.2 |
| Soy meals & oil | 1 | 2.0 |
| Ag machinery | 111 | 4.1 |
| Computers | 164 | 8.8 |
| Electronics | 70 | 1.7 |
| Metal products | 217 | 9.2 |
| Footwear | 214 | 22.7 |
| Furniture | 882 | 36.2 |
| Home appl | 129 | 9.7 |
| Other machinery & equi | 127 | 1.9 |
| Pharma | 493 | 4.4 |
| Vehicles | -41 | -0.4 |
| Auto parts | 876 | 4.4 |
| Other manuf | 1568 | 8.4 |
| Textiles and apparel | 1014 | 23.6 |
| Biodiesel | -29 | -8.1 |
| Steel | 46 | 2.9 |
| Fuels and fuel product | -348 | -3.7 |
| Other natural res | 116 | 2.0 |
| Comm financial and bus | -272 | -3.8 |
| Distribution and other | -402 | -3.7 |
| | | |
| Agri. and food | -167 | -1.1 |
| Manufacturing | 5824 | 6.7 |
| NR and energy | -215 | -1.3 |
| Services | -271 | -3.8 |

Table 4. Impact of CET liberalization on sectoral exports, 2030

| | Deviations from baseline | |
|------------------------|--------------------------|---------|
| | US\$ million | Percent |
| Beef | 154 | 7.1 |
| Corn | 222 | 2.6 |
| Dairy | 48 | 4.1 |
| Poultry and swine | 24 | 8.2 |
| Sugar | 6 | 12.9 |
| Soybean | 84 | 0.9 |
| Veg and fruits | -50 | -2.3 |
| Wheat | 35 | 0.6 |
| Wine | 45 | 6.9 |
| Other food and ag | 853 | 4.5 |
| Soy meals & oil | 1446 | 6.0 |
| Ag machinery | 68 | 17.3 |
| Computers | 2 | 8.9 |
| Electronics | 13 | 26.7 |
| Metal products | 4 | 2.1 |
| Footwear | 0 | -1.8 |
| Furniture | 6 | 3.7 |
| Home appl | 1 | 0.8 |
| Other machinery & equi | 124 | 12.8 |
| Pharma | 516 | 12.0 |
| Vehicles | -1537 | -22.0 |
| Auto parts | 40 | 1.1 |
| Other manuf | 465 | 8.2 |
| Textiles and apparel | 83 | 15.3 |
| Biodiesel | 64 | 18.0 |
| Steel | 298 | 14.6 |
| Fuels and fuel product | 706 | 13.0 |
| Other natural res | 1142 | 13.5 |
| Comm financial and bus | 201 | 8.7 |
| Distribution and other | 423 | 8.2 |
| | | |
| Agri. and food | 1844 | 3.4 |
| Manufacturing | -215 | -0.9 |
| NR and energy | 2210 | 13.6 |
| Services | 1647 | 6.2 |