GROWTH NARRATIVE DEBUNKED, INEQUALITIES UNCOVERED:

ECONOMIC STUDY ON THE EU-MERCOSUR TRADE AGREEMENT

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Authors: Orsola Costantini and Alex Izurieta

Orsola Costantini is Senior Research Associate at the Institute for Economic Justice, a Johannesburg-based think tank, where she works on food security and macroeconomic analysis. She previously served as Economic Affairs Officer at UNCTAD (2020–2025) and as Senior Economist at the Institute for New Economic Thinking (2015–2020). An alumna of Ghislieri College, she graduated from the University of Pavia and received her PhD in Economics from the same institution in 2013. She is Associate Editor of the International Journal of Political Economy.

Alex Izurieta is a former Senior Economist at UNCTAD, Geneva, Switzerland (previously at UN-DESA, New York, USA), in charge of developing and maintaining the UN Global Policy Model. Earlier functions include academic positions at the University of Cambridge, UK, the Levy Economics Institute of Bard College, NY (USA), and the Institute of Social Studies of Erasmus University (ISS-EUR), The Netherlands, where he obtained his PhD and MA in Economics. Prior to becoming an economist, he was a social worker, developing methods of 'Popular Education' à la Paulo Freire in Colombia, Ecuador and Nicaragua.

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Executive Summary

The proposed EU–Mercosur Free Trade Agreement (FTA) is presented as a strategic response to rising geopolitical tensions, economic rivalry, and supply-chain disruptions. Yet, our analysis shows that once more realistic economic dynamics are considered, the agreement is unlikely to deliver the benefits its supporters promise.

Our assessment is that:

- ➔ **Projected growth gains are negligible and may disappear entirely** once fiscal constraints, income distribution effects, and market concentration are taken into account.
- ➔ **Mercosur economies would likely experience slower, not faster, growth**. Tariff cuts would significantly reduce public revenues in Mercosur countries, where tariffs remain an important source of government income. Under existing fiscal constraints, this is likely to trigger public spending cuts, leading to slower economic growth rather than expansion.
- ➔ **The EU would see little or no growth benefits**. Increased competition between unequal economies with large wage gaps tends to put downward pressure on workers' share of income. The agreement could lead to a **shift of up to €60 billion annually away from wages to companies' profits in the EU** once fully implemented. Moreover, even when accepting the European Commission's economic assumptions of projected GDP gains, the calculations presented in this paper show that the cumulative effect of falling labour income shares would, in the years following full implementation, eventually eliminate the expected growth boost and lead to a **net GDP slowdown of approximately 0.01%.**
- ➔ **Inequality would increase**. Small and medium-sized farmers, workers in exposed sectors and regional economies would be particularly affected. Even small declines in agricultural producer prices could push thousands of farms into economic vulnerability, **driving further land concentration in the agricultural sector and the dominance of large agribusiness**. Our analysis shows **that a drop of 2% in beef producer prices** – consistent with official projections – would increase the number of economically unviable farms across several EU member states.
- ➔ **Public policy space and governments' ability to pursue alternative economic policies would be reduced**, limiting their capacityto manage economic, social and climate transitions.
- ➔ **Consumers would not necessarily benefit from lower prices.** In highly concentrated food supply chains, lower producer prices are unlikely to translate into cheaper food because the gains are more likely to be captured by large processors and retailers.

More fundamentally, the EU–Mercosur agreement is built on an outdated **neoliberal trade framework centred on tariff cuts and market liberalisation**. This mindset also relies on economic models, like the computable general equilibrium (CGE) model used by the European Commission, which systematically downplays power imbalances, inequality, fiscal constraints, and ecological limits. The result is a trade strategy that promises geopolitical stability and economic growth but risks **deepening inequality, weakening policy space, and reinforcing unsustainable production patterns**.

The paper argues that cooperation between the EU and Mercosur should move **beyond narrow neo-liberal free-trade logic** and focus instead on a development-oriented economic model, and discusses the bases of an alternative strategy for future trade and cooperation.

1. Introduction

Supporters of the EU–Mercosur free trade agreement frame it as a geopolitical necessity. In an increasingly unstable world, they argue, Europe and South America must deepen their economic ties to counter the unilateral actions of self-serving global powers and to overcome the vulnerabilities created by their own internal political fragmentation (Malamud and Schenoni 2025).

This narrative may sound strategic and forward-looking policy response; however, it is not. In reality, it relies on an **outdated economic recipe – one that has repeatedly failed to deliver shared prosperity, resilience or sustainability.**

The EU–Mercosur Agreement itself is neither new nor well-suited to today's challenges. After more than two decades of negotiations, it doubles down on a failed neoliberal model that has produced many of the problems it claims to solve: **concentrated economic power, weakened governments, social polarisation, and growing dependence on external markets**.

Claims that free trade agreements support economic growth are misleading, as demonstrated by a large literature we discuss below. In this case, the European Commission projects that the EU-Mercosur agreement would generate a very small long-term GDP gain.

Yet, even if one accepts the main premises of the Commission's projection as a starting point, our analysis shows that gains disappear, and the net effects even turn negative, once a few basic real-world dynamics are taken into account. When income distribution, fiscal constraints, and the demand effects of lower wages and reduced public spending are considered, the costs become tangible and unevenly distributed: **workers, small and medium-sized enterprises, small and medium farms, and local economies bear the adjustment burden, while environmental pressures intensify**. These effects are further amplified by rigid fiscal frameworks in both regions, which severely limit governments' capacity to cushion social and economic disruption.

Even some assumptions of the official projections are themselves questionable. For instance, current estimates assume that tariff cuts automatically translate into lower consumer prices, that higher profits are fully reinvested in productive activity, and that trade flows would smoothly adjust in response to price changes. **Once these assumptions are removed, the gaps between the promises and the outcomes of the agreement become clear**.

The final agreement text implicitly recognises some of these risks. It includes clauses that delay liberalisation, tariff reductions, and environmental obligations, and it allows tariffs to be reinstated under certain conditions.

Yet these safeguards rely on legal procedures that can lead to lengthy disputes, and their effectiveness ultimately depends on the political priorities and on the bargaining power of the governments in charge. In the meantime, the deal restricts the space for alternative economic strategies.

Free trade agreements also set precedents that are hard to reverse. Over time, trade rules

become legally embedded, fragmented, and insulated from public scrutiny, particularly in areas like pharmaceuticals, finance, and public procurement. Once implemented, regulatory commitments and privatisation processes can be difficult to undo.

The growing push for bilateral trade deals reflects the declining role of the World Trade Organisation (WTO). As multilateral rules weaken, governments increasingly use bilateral agreements to advance deregulation outside multilateral oversight. **This risks embedding fragmented trade regimes that become progressively harder to revise through democratic processes.**

This policy brief examines these dynamics in detail.

Section 2 focuses on income distribution, showing how the agreement reinforces existing inequalities within sectors and across firms, while putting downward pressure on labour-income shares - the proportion of national income earned by workers, as opposed to profits.

In agriculture, even modest declines in producer prices can have major effects on farm viability. Our analysis shows **that a 2% reduction in beef producer prices** — consistent with official projections – **would increase the number of economically unviable farms** across several EU member states. Similar dynamics are likely to affect the EU sugar sector, which is already under severe economic pressure.

Importantly, due to concentrated food supply chains, such price reductions are unlikely to translate into lower consumer prices. **The result is greater market concentration, rather than consumer benefit.**

Labour markets across sectors are also affected: When firms compete across regions with large wage and productivity differences, the share of income going to workers tends to decline. This is not a marginal outcome that can be corrected through sustainability chapters in trade agreements. It is a core feature of trade liberalisation between structurally different economies. Of course, national policy responses may soften or delay all these repercussions, but they do so at the cost of public resources, effectively subsidising the gains of the main beneficiaries of the deal: export-oriented corporations.

Section 3 revisits claimed growth potentials in the EU and Mercosur by estimating the agreement's macroeconomic growth implications. Tariff reductions would reduce public revenues, particularly in Mercosur countries, where tariffs remain an important source of government income. Under existing fiscal constraints, these revenue losses would likely trigger public spending cuts. Instead of the projected **0.25% increase in GDP by the European Commission**, the projections calculated in this report show Mercosur economies could experience a **growth slowdown of around 0.1%**, **while the EU's already minimal projected gain could disappear entirely.**

Section 4 examines the economic model used to justify the agreement, which belongs to a family of models that systematically understate distributional effects, ignore power asymmetries, financial dynamics, and ecological constraints. As a result, **they mislead policymakers and blindside them against alternative economic strategies, especially at a time of rising inequality and climate urgency.**

Section 5 outlines elements for an alternative economic strategy.

2. The agreement will increase inequality

The EU–Mercosur Free Trade Agreement (FTA) will not affect all economic actors equally. Its core mechanisms systematically favour large, export-oriented companies while exposing small producers, workers, and local economies to intensified competitive pressures.

Rising inequality is therefore not an unintended side effect of the agreement; it is a structural outcome of the way liberalised trade operates under conditions of unequal market power, productivity, and fiscal constraints.

2.1 The agreement will increase intra-firm inequality

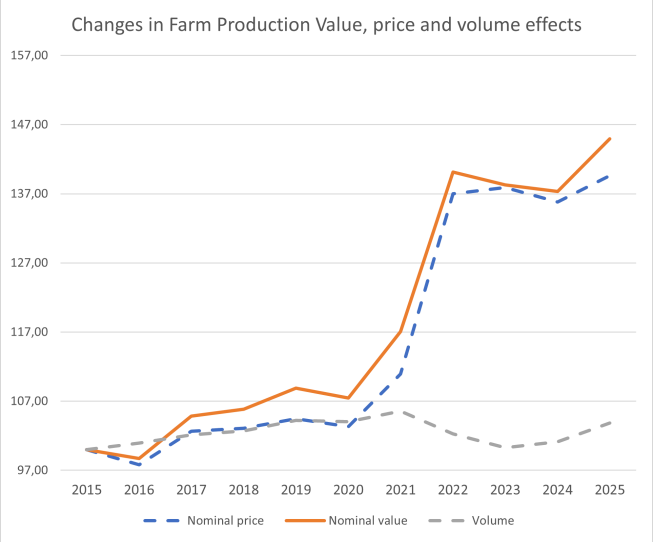
2.1.1 The case of EU Farms

Trade liberalisation in agriculture typically lowers producer prices – the prices farmers receive for their products. Under the EU–Mercosur agreement, this dynamic is likely to reinforce two dominant trends in both regions: growing market concentration and environmental degradation.

Lower producer prices do not affect farms equally. Small and medium-sized farms are the most vulnerable (European Commission 2025a). Large agribusinesses, by contrast, are largely shielded from competitive pressures due to economies of scale, vertical integration, diversified activities, and sustained profit margins. As a result, **liberalisation tends to accelerate farm exits, increase land concentration, and strengthen the dominance of large agribusiness**.

Evidence from the EU illustrates this trend. Figure 1, below, suggests that agricultural profitability has been resilient at the aggregate level, while Figure 2 reveals how unevenly these gains are distributed. Taken together, these figures suggest that while the **agricultural sector remains profitable overall, income is highly concentrated among larger farms**.

In this context, any fall in producer prices – such as those expected from increased Mercosur imports – would disproportionately affect smaller farms and further concentrate the sector in the EU.



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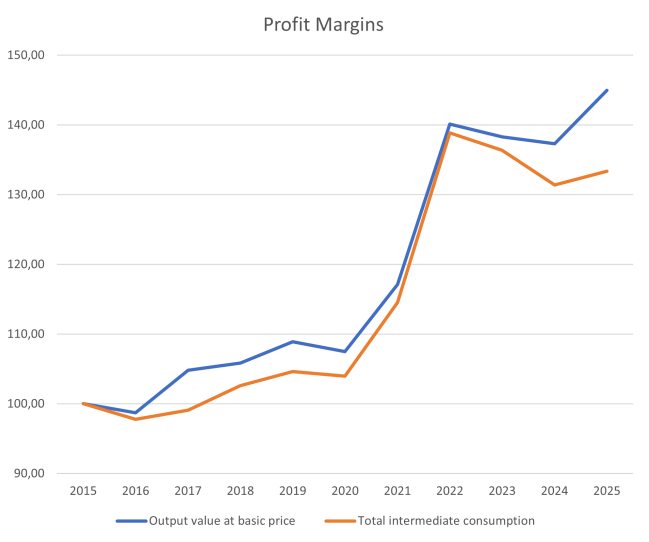
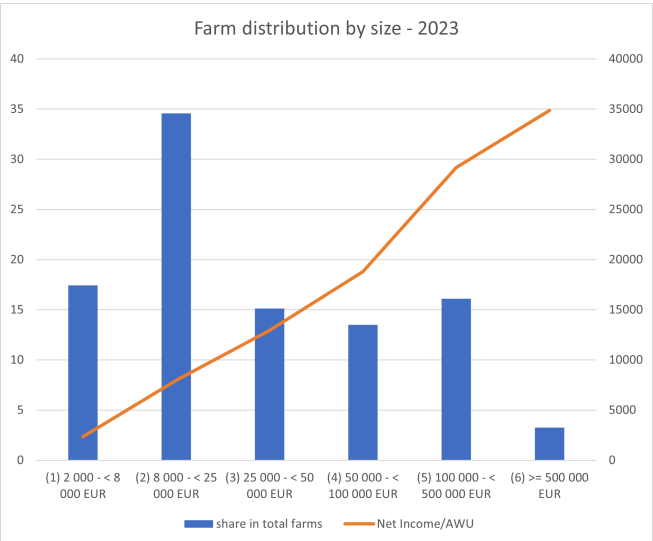


1B

Figure 1: **Aggregate profitability and cost dynamics in agriculture (2015=100).**

Aggregate profit margins were temporarily compressed during the 2021–2022 surge in input costs. However, they were never eliminated and have since recovered sharply. *Note: Basic price is the producer price plus subsidies. Source: Eurostat. Economic Accounts for Agriculture. [aact_eaa05__custom_19545158].*



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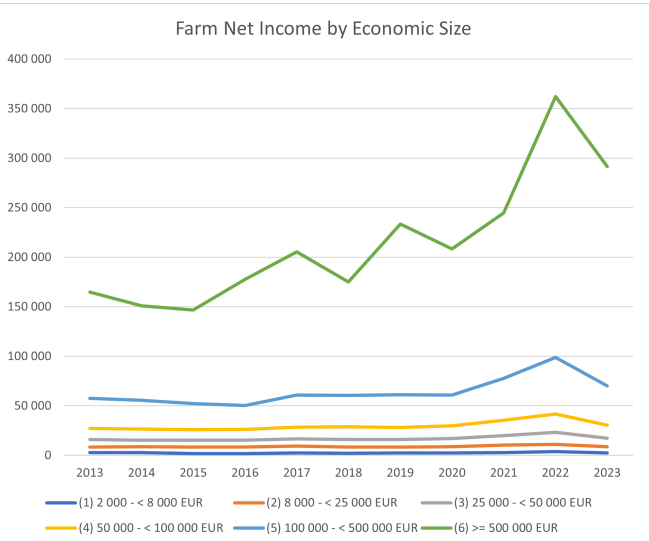

2B

Figure 2: **Intra-firm distribution in the EU agricultural sector.**

2A - The majority of farms are small or small-medium, yet income rises steeply with economic size. Bars show the percentage share of farms (left axis); the line shows net income per Annual Work Unit (right axis). 2B - Farm net income by economic size shows widening income divergence between large and small farms. N*ote: Net income includes subsidies. Source: FADN*

In the past, the trend toward market concentration has been less pronounced in Brazil's domestic agricultural sector than in the EU's. In the Latin American country, public policies aimed at food security and the protection of smallholder farming, particularly under the PT governments, helped cushion structural pressure: Farm survey data show a largely unchanged farm-size distribution between 2006 and 2017 (FAO WCAD 2025). In the European Union, instead, agricultural markets have exhibited a clearer tendency toward consolidation, with fewer policy mechanisms directly addressing these structural dynamics. At the same time, Mercosur agriculture includes a relatively large share of very large farms, which are precisely the producers best positioned to expand exports to the EU under the agreement. Trade liberalisation, therefore, links two agricultural systems that are structurally different.

These pre-existing difficulties of EU agriculture are acknowledged in the European Commission's own analyses. Official projections, unrelated with the EU–Mercosur Agreement, indicate that the share of farms in the most economically viable category will decline from 45% in 2020 to 41% by 2035. Conversely, the proportion of farms classified as economically non-viable – those recording negative income and losses exceeding depreciation – is expected to increase from 4% to 5%. More than one-fifth of non-milk cattle farms are projected to struggle with economic viability, with little improvement anticipated over the next decade (European Commission 2025a).

Against this background, sector-specific simulations suggest that the EU–Mercosur agreement could reduce EU beef producer prices by approximately 2% (Matthews 2025). While a fully precise assessment would require access to FADN (Farm Accountancy Data Network) micro-data, even a simple exercise based on published averages illustrates the magnitude of the risk.

In 2023, non-milk cattle farms that already failed to cover both input costs and capital depreciation accounted for **65.5%** of all EU farms in that sector. With a 2% price reduction, additional farm categories in the Netherlands, Austria, and Spain would likely become economically unviable. These groups – small farms in the Netherlands and medium-sized farms in Spain and Austria – represent an additional 4.3% of all EU farms.[1]

Similar challenges are likely to affect the EU sugar-beet farming and sugar-processing sectors, which are already facing declining profit margins and shrinking cultivation area (Gitau 2025).

Importantly, these **losses for farmers would not necessarily translate into lower consumer prices.** EU food supply chains are highly concentrated in processing and retail. In such markets, economic theory and recent empirical evidence show that reductions in input costs are often absorbed by intermediaries rather than passed on to consumers (Kalecki 1954; Sylos Labini 1962; Weber and Wasner 2023). Recent inflation dynamics confirm this pattern: while producer prices declined in 2024, consumer food prices continued to rise, albeit more slowly (European Central Bank 2023).

2.1.2 The self-reinforcing nature of market concentration

The recent inflation dynamics in the EU have illustrated the extent of market concentration across many sectors. A growing body of evidence, including margin-decomposition analyses by the European Central Bank, shows that much of the inflation surge after 2021 was driven to a significant extent by rising profit margins rather than by wage growth or excess demand (European Central Bank 2023). Especially from mid-2022 onward, profits accounted for a substantial share of inflation dynamics, with labour costs playing a secondary role.

[1] 2023 is the latest available year in the EU farm survey FADN. Calculations are based on the change in input to output value ratio in the non-milk cattle sector: https://agridata.ec.europa.eu/extensions/FSDNPublicDatabase/FSDNPublicDatabase.html

This pattern was visible across many sectors, including energy, food processing and retail, shipping and logistics, chemicals, and parts of manufacturing, where dominant firms were able to increase margins well beyond input shocks. In food and energy value chains, for example, margin growth persisted even after wholesale prices began to stabilise.

In this context, **further trade liberalisation and tariff reduction do little to support firms with limited market power, typically small and medium-sized enterprises.** Instead, increased exposure to international competition tends to favour large companies with greater pricing power, financial resources, and control over supply chains. Smaller firms face stronger competitive pressures, shrinking margins, and higher risks of exit. The effect is asymmetric: firms with market power can absorb shocks, adjust mark-ups, or relocate production, whereas weaker firms cannot. The opening of the public procurement to foreign firms is a particularly heavy enhancing factor.

Crucially, this dynamic is self-reinforcing. Once dominant positions are established, large firms can further restrict entry and expansion by absorbing competitors through acquisitions, financial leverage and supply-chain power. The result is slower demand growth, fewer opportunities for smaller firms, and further market consolidation.

Special provisions included in trade agreements, such as bilateral safeguard clauses, SME cooperation chapters, or delayed tariff liberalisation schedules, cannot fundamentally reverse this dynamic once it is embedded in the productive structure. At best, such measures may temporarily slow adjustment. They do not change the underlying configuration of market power that drives consolidation in both the EU and Mercosur.

2.2 The agreement will put downward pressure on wages

Beyond agriculture, the agreement also affects income distribution through its impact on labour markets.

Economic growth is shaped by the interaction between demand creation, income distribution, and productivity growth. When demand is weak, employment opportunities decline. In the absence of strong institutional safeguards, excess labour supply can put downward pressure on wages, increase inequality, and ultimately slow productivity growth – even in relatively dynamic sectors. Lower wages and higher inequality, then weaken domestic demand further, generating a self-reinforcing downward cycle (Storm 2017).

These dynamics are intensified when trade liberalisation occurs between countries with large wage and technological differences (Capaldo and Omer 2025; Gaddi and Garbellini 2021). Empirically, this has been associated with:

- deindustrialisation in developed economies through outsourcing of lower value-added activities (e.g. France, Germany, Italy);
- deindustrialisation in many developing economies unable to compete through innovation (e.g. Brazil, Argentina, parts of North Africa, South Africa and Turkey);
- industrialisation accompanied by de-specialisation in other economies, developed or developing (e.g. Poland, Czech Republic);
- rising unemployment and intensified competition on wages and working conditions.

How strongly wages are affected depends on several factors, including labour protections, union strength, industrial structure, and the ability of economies to create new jobs.

Nonetheless, there is broad consensus – outside a narrow circle of think tanks strongly committed to free trade – that large wage gaps between trading partners tend to put downward pressure on wages, particularly for low-paid workers, and reduce the overall labour income share. One widely cited example is the “China shock” following China’s entry into the WTO in 2001, which many studies link to job losses and wage pressures in manufacturing sectors (Autor et al. 2016). Similar warnings were raised before

the North American Free Trade Agreement (NAFTA), and later research documented wage suppression and job losses linked to outsourcing to Mexico (Leamer 1992). The labour chapter of its successor agreement, the USMCA (United States-Mexico-Canada Agreement), was explicitly redesigned to address these concerns, yet outcomes remain widely viewed as insufficient, including by major trade unions such as the AFL-CIO (American Federation of Labor and Congress of Industrial Organizations) (Drake 2018).

Comparable findings emerged from research by the ILO and UNCTAD during the 2010s, using the UN Global Policy Model to assess trade agreements such as the Trans-Atlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP).[2] These studies consistently showed that trade integration between high-wage and low-wage economies tends to reduce labour income shares unless strong policy protections are in place (Jomo K.S. 2016, Capaldo 2015).

Applying these insights to the EU–Mercosur context suggests that downward pressure on EU wage shares would be present but more moderate than in agreements such as TTIP or TPP. Several factors explain this: Mercosur's economy represents roughly 16% of the EU's size, potentially rising to around 20% by 2040. Even under optimistic assumptions, Mercosur exports would account for no more than 4% of EU extra-bloc imports. Moreover, European labour institutions and collective bargaining structures remain more robust than in other developed economies, even though they have weakened over time.

Even so, several factors could reinforce downward pressure on wages: slow productivity growth in many EU economies, modest expansion in dynamic sectors, and potential job losses in vulnerable industries such as agriculture (see Capaldo and Omer, 2025).

Our estimates indicate that the impact on workers' share of income would become visible approximately three years after implementation, **with the EU labour income share around 0.04% of GDP lower than in a no-FTA baseline.** Over time, as trade volumes expand and feedback mechanisms between income and demand strengthen, the cumulative impact could reach a reduction of approximately 0.28% of GDP in the wage bill after 15 years, when the agreement is assumed to reach full implementation.

Expressed in constant euro of 2024, this corresponds to a transfer of roughly €7 billion from wages to profits by year four, rising to about €60 billion annually once the agreement is fully implemented.

Mercosur economies could face similar pressures, as exporters attempt to keep costs competitive. However, given the modest wage-compression projected in the EU, competitive cost pressures in the Latin American countries are likely to be marginal and absorbed through small productivity gains or mark-up adjustments rather than substantial wage declines.

Importantly, these estimates capture only the effects of the agreement itself. They would therefore add to **existing structural trends**. **In many export-oriented economies, operating under fiscal constraints, the share of income going to workers has already been declining for decades** (Capaldo and Izurieta, 2013).

[2] See joint and separate ILO-UNCTAD analyses of wage-share dynamics using the GPM, such as UNCTAD (2019, 2022), ILO interventions at technical-level meetings of the G20 Macroeconomic Framework Group: ILO, 2018, 2015a,b; or other studies: Izurieta et al (2018), Kohler et al (2018), Strauss et al (2017).

3. The growth narrative collapses once fiscal reality is considered

Standard trade models portray tariffs as simple price mark-ups. Reducing them lowers import prices, increases trade volumes, and generates efficiency gains. Consumers are assumed to benefit from lower prices, exporters from higher sales volumes or profit margins, and governments are expected to recover lost tariff revenues indirectly through higher growth and broader tax bases.

This sequence underpins the official economic justification of the EU–Mercosur Free Trade Agreement.

In practice, this narrative is highly misleading.

It relies on a chain of assumptions that rarely hold in real economies: that tariff cuts fully reduce consumer prices, that higher profits are reinvested productively, and that governments face no binding fiscal constraints. As discussed in previous sections, market concentration often prevents price reductions from reaching consumers, income gains tend to accrue disproportionately to actors who spend little domestically, and shifts in income distribution weaken overall aggregate demand.

Even if these shortcomings are ignored, and the European Commission's initial growth projections are accepted, the agreement's macroeconomic outlook changes fundamentally once fiscal responses imposed by existing budgetary rules are taken into account. When fiscal responses and the distributional effects discussed in Chapter 2 are included, the agreement's projected growth gains largely disappear.

3.1 Re-assessing tariff losses, fiscal responses and economic growth.

To estimate these dynamics, we revisit the European Commission's official impact assessment of the EU–Mercosur agreement (European Commission 2025b), focusing on merchandise trade.

Our analysis follows three steps.

- ➔ First, we reconstruct the tariff structure by product category using the Commission's Table 7 and the projected increases in bilateral exports using Table 10 of the study. All values are converted into constant 2024 prices, based on long-term deflators derived from IMF World Economic Outlook projections (October 2025) and OECD forecasts. (OECD 2025, IMF 2025)
- ➔ Second, we estimate first-round tariff revenues by comparing government revenues under a scenario where the agreement is fully implemented by 2040 with a counterfactual scenario without the agreement, holding all other assumptions constant.
- ➔ Third, we incorporate a second-round trade diversion effect, the likelihood that imports from Mercosur or the EU will replace imports currently coming from other trading partners such as China, East Asia, or the United States. Because those imports would have faced higher tariffs than the ones allowed under the FTA, this substitution further reduces government revenue. The magnitude of this effect is estimated using recent import structures by product category for both the EU and Mercosur economies (see Appendix).

We then compare these tariff losses with the additional tax revenues governments might receive if the Commission's projected growth gains were realised. Importantly, this assumption is already generous because it ignores the negative demand effects identified in Chapter 2.

The results reveal a stark asymmetry.

For the European Union, tariff revenues play only a minor role in total government income. Under the agreement, the estimated loss

amounts to approximately 0.01% of GDP.[3] Even under conservative assumptions, this loss is macroeconomically negligible and would not, on its own, require a fiscal response.

For Mercosur countries, however, the situation is fundamentally different, as tariff revenues are a significant source of public income.[4] Under full implementation of the agreement, tariff losses could reach around **0.3% of GDP**.

Even if the Commission's projected growth gains of 0.25% materialised, only a small share of this loss would be recovered through higher tax revenues – around **0.05% of GDP**.

The net result is therefore a persistent fiscal shortfall of roughly **0.25% of GDP** across Mercosur economies.

This matters because Mercosur countries operate under tight fiscal and financial constraints. Like EU member states, they face institutionalised budget rules, but they are also exposed to volatile capital flows, exchange-rate pressures, and higher borrowing costs. Under such conditions, sustained fiscal revenue shortfalls typically lead governments to cut spending rather than raise taxes. Tax increases are politically difficult, especially when the agreement is promoted as a driver of growth and competitiveness. As a result, the adjustment usually takes the form of public spending cuts. Such cuts have well-known negative effects on economic activity.[5] Cuts to public investment, social spending, and public services weaken demand, reduce employment, and slow long-term productivity growth. In our estimates, a tariff-related fiscal shortfall of about **0.25% of GDP** would translate into spending cuts that reduce growth by roughly **0.36%**—more than offsetting the Commission's projected **0.25% growth gain** from the agreement.

Once fiscal responses and distributional effects are taken into account, the macroeconomic picture of the EU–Mercosur agreement changes significantly.

For Mercosur economies, instead of the projected 0.25% increase in GDP relative to a no-FTA baseline, the combined effects of lost tariff revenues, spending cuts, and weaker demand **would lead to a growth slowdown of approximately 0.1% relative to the baseline. The main driver is fiscal adjustment triggered by falling tariff revenues**.

For the **European Union, the picture is different but no more favourable. While tariff losses are negligible, the agreement's impact on income distribution – particularly wage-share compression – has known negative effects on growth** (Lavoie and Stockhammer 2012; Onaran and Galanis, 2013; Storm and Naastepad, 2013; Storm and Capaldo, 2018).[6]

Based on the calculations presented in the previous section, the cumulative effect of declining labour income shares between its

[3] Tariff revenues in advanced economies do not usually represent a large portion of government budgets. Furthermore, bilateral imports from Mercosur represent merely 0.3% of EU GDP (calculated from Table 3 of the EC report).

[4] The significance of tariffs is a known feature of most developing and emerging economies. Throughout the 'Uruguay Round' negotiations at the WTO, which started in the 1980s and culminated in 1994, developing economies painfully accepted to lower tariffs that were levied to both protect nascent local industries from greatly capitalized competitors of industrialized economies, as well as to support government budgets. The expectation was that following the Uruguay Round, a 'Development Round' would ensure viable paths for their industrialization strategies. That Round never culminated; tariff revenue for developing economies nowadays remain admittedly low, but nonetheless critical.

[5] Extracting from multiplier tables published by the UN (UNCTAD (2019), chapter 3, fiscal multiplier tables, revised using the GPM exercise of 2024), they can be calculated for the Mercosur as a whole to be about 1.47. The estimation of multipliers is generally a matter of controversy as they are usually 'imposed' ex-ante on parameters of standard models and hardly ever re-evaluated ex-post. Interestingly, the IMF undertook one such evaluation, published in the World Economic Outlook of October 2012. It found that contrary to their own ex-ante estimates that put the fiscal multipliers at around 0.5, ex-post analyses showed that they actually range between 0.9 and 1.7. Developing economies, as much as distressed economies (like Greece at the time) are on the higher end (IMF, 2012)

[6] See footnote 2; as above, the wage-share multiplier tables were revised using the GPM exercise of 2024. Borrowing from these studies and empirical analyses undertaken jointly by UNCTAD and the ILO, the first-year multiplier from reductions in the labour share for the EU economy (calculated as a whole) is 0.23.

initial impact – around three years after implementation – and its peak at the end of a 15-years period **would offset roughly 80% of the €77 billion increase in GDP** projected in the European Commission's study. By the time the agreement is fully implemented, a projected **0.34% decline in the wage share** would reduce growth by around **0.07%**. Although this effect would gradually diminish in subsequent years, it would fully **erase the Commission's projected 0.05% growth above baseline and ultimately result in a net GDP deceleration of approximately 0.01%.**

Admittedly, these are conditional projections over a distant horizon (15 to 20 years). They should not be read as forecasts of what will happen, but as simulations based on the European Commission's own projections. Even so, they strongly suggest that once fiscal effects from tariff losses and wage-compression effects from increased international competition are properly taken into account, **the EU cannot expect more than maintaining the same GDP growth path as in a no-FTA scenario, while Mercosur economies are likely to experience a relative deceleration in growth.**

The European Commission argues that the gains from this agreement, while small taken in isolation, should be seen together with those from other trade deals currently under negotiation. Our analysis questions this favourable interpretation. Not only are the gains projected for the EU-Mercosur agreement not going to materialize, leaving nothing to aggregate with other expected benefits, but similar methodological and structural issues suggest that the projected gains from comparable trade agreements may also be overstated.

4. The deeper problem: a failed economic worldview

After more than three decades of neoliberal dominance, free trade is no longer an unquestioned orthodoxy. Yet the EU–Mercosur agreement remains firmly anchored in that outdated framework. This reflects not only a lack of strategic vision but also the difficulty of moving away from a familiar path. The search for *comfort in conformity* is reinforced by continued reliance on economic modelling tools that misguide policy by systematically obscuring power relations, distributional conflict, and macroeconomic fragility (Capaldo 2021).

Economic policy debates in both regions reflect this tension. Governments increasingly look for strategies to strengthen domestic markets and economic security. Yet these ideas remain largely absent from the EU–Mercosur agreement, where they appear only as secondary safeguards rather than guiding principles. The agreement includes safeguard clauses that formally recognise some of the risks associated with trade liberalisation. However, these mechanisms depend on governments' political willingness and institutional capacity to counter market pressures that the agreement itself may intensify.

Worse still, the agreement weakens the very policy tools governments would need to make such safeguards effective – fiscal space, regulatory autonomy, and political leverage. By constraining policy space and reducing public revenues, it undermines governments' capacity to deploy the instruments required to make safeguards meaningful.

Moreover, these clauses do not articulate any alternative strategy. If fully activated, they would merely suspend or neutralize the treaty's operation, leaving no substantive framework through which genuine cooperation could be pursued. Such cooperation would require the capacity to define objectives that are not only reciprocal but also economically coherent and mutually achievable over the long term.

The following sections discuss three core issues that shape the current impasse: the fixation on tariffs, the shallow integration of climate concerns, and the methodological inadequacy of prevailing economic models.

What is needed is not a more refined version of the same models, nor additional safeguard clauses layered onto an unchanged core. It is a strategic rethinking of trade as a tool of economic governance, embedded in long-term objectives of social inclusion, ecological sustainability, and democratic control.

Without such a reorientation, the agreement risks locking both regions into a path that is economically fragile, socially divisive, and environmentally unsustainable.

4.1 Tariff fixation

The current lack of vision is well illustrated by a generalised persistent fixation on tariffs as the prime policy option in trade relations, whether it is to lift them or to set them up. In this perspective, trade policy is reduced to adjusting prices through tariffs, based on the belief that markets can be efficiently steered through price signals alone and that tariffs are sufficient instruments either to correct market failures or to guide economic development. This is further exaggerated by how standard trade models treat qualitative changes in labour market protections, environmental standards, and phytosanitary measures by assigning similar tariff parametrisations to them. But removing tariffs can permanently alter production structures, market power, and technological capabilities. Reintroducing tariffs does not automatically restore what liberalisation has dismantled.

In practice, managing global trade requires far more than tariff adjustments. Historically, successful development strategies have combined industrial policy, public investment, technology transfer, and financial support and institutional coordination. Focusing narrowly on tariffs obscures these broader structural dimensions of economic transformation.

4.2 Environmental short-sight

The agreement's treatment of environmental protection and biodiversity is particularly incoherent. It not only relies implicitly on market price adjustments as a primary tool for climate change mitigation – despite the well-known inadequacy of such mechanisms – but also tolerates major inconsistencies in policy orientation (Eckes and Krajewski 2025).

The EU's own impact assessments suggest that the agreement would have a near-zero effect on deforestation and greenhouse gas emissions. This conclusion rests on two main assumptions. First, the projected GDP effects are extremely small, implying limited increases in production and therefore minimal additional environmental pressure. Second, trade is assumed to operate primarily through substitution effects, whereby increased EU–Mercosur trade replaces production elsewhere that is presumed to be more emissions-intensive, thus reducing global emissions.

In addition, the agreement assumes that improved access to EU chemical inputs, technologies, and capital goods will raise land productivity in Mercosur countries, allowing agricultural expansion without further deforestation.

This reasoning is deeply problematic. It treats input-intensive technologies and chemical use as unambiguously beneficial, ignoring their well-documented environmental and social costs. It assumes that environmental damage in one location can be offset by reductions elsewhere, abstracting from ecological thresholds, irreversibility, and the spatial concentration of harm. More fundamentally, **it relies on price-based modelling frameworks**

that presume environmental damage can be adequately corrected through market signals—despite overwhelming evidence to the contrary in the context of climate change and biodiversity loss (Woillez et al. 2020; Dafermos et al. 2024).

Most strikingly, this approach disregards a large and growing body of research demonstrating that productivity-driven, large-scale, input-intensive agriculture tends to reinforce monocultures, land concentration, soil degradation, water contamination, and social displacement. It stands in direct opposition to agroecological approaches centred on small- and medium-scale farming, biodiversity, resilience, and local food systems.

It overlooks the progress made in fora such as the UN Committee on World Food Security (CFS), the South Africa-led G20 Food Security Task Force, and the COP processes, where increasing emphasis has been placed on food sovereignty, agroecology, resilience of local food systems, and the need to move beyond productivity-centred, trade-driven approaches to sustainability.

If the two regions were serious about their stated goal of building a strategic partnership alongside environmental sustainability, the agreement should prioritise and effectively support the double challenge of green industrialisation and economic development facing Mercosur economies. This would mean moving past a reliance on tariff reductions and market price signals. Instead, the partnership should focus on development finance and technology transfer aimed at supporting productive transformation in line with these priorities; at the very least ensuring food security and employment generation.

4.3. Misguiding economic models

Most official assessments of trade agreements, including the EU Commission's evaluation of the EU-Mercosur deal, rely on variants of the Global Trade Analysis Project (GTAP) and related computable general equilibrium (CGE) models. Although technically sophisticated, these models have been widely criticised for their methodological and theoretical biases and share structural features that severely limit their usefulness for policy evaluation (Izurieta 2017; Storm 2021).

In the long run, these models effectively assume full employment. Even when short-term frictions are introduced, labour markets ultimately clear through wage adjustments, labour mobility, or the exclusion of discouraged workers from the labour supply. As a result, unemployment, wage suppression, and inequality largely disappear from the model's results.

Moreover, CGE models rely on the notion of a "representative agent." That is not only a simplification, but it ignores the heterogeneity of economic actors and, in particular, the asymmetries of power that shape global markets, which reflect ever more complex and concentrated structures of financial ownership determining trade flows, prices, and economic policies (Pistor 2019).

Even abstracting from power, CGE frameworks suffer from a fundamental aggregation problem. Individually rational responses do not necessarily generate desirable outcomes at the macroeconomic or global level. What appears efficient for each actor in isolation can produce deflationary, employment-reducing, and inequality-enhancing dynamics once generalised.

Two modelling assumptions are particularly consequential for the EU–Mercosur projections.

First, the models assume that trade flows can quickly shift away from other partners – such as the United States or China and other suppliers currently subject to Most Favoured Nation or Common External Tariff regimes – in response to tariff changes. This outcome requires a chain of highly restrictive assumptions: high substitutability across origins; rapid reconfiguration of complex global value chains in response to price signals alone; inability or unwillingness of displaced exporters to respond through price adjustments, outsourcing, or retaliation. **Taken together, these assumptions**

significantly overstate the malleability of real-world trade patterns.

Second, the models assume that savings generated by tariff reductions – whether accruing to consumers or firms – automatically translate into productive investment. In reality, such savings can just as easily flow into financial assets, speculation, or debt reduction rather than productive investment.

Conversely, there is no economic basis for assuming that investment is constrained by prior savings. In modern economies, firms invest when they expect demand and profits to grow – not simply because savings already exist. By treating the financial sector as a passive intermediary that mechanically transforms savings into investment, **CGE models fundamentally misrepresent its actual role in shaping economic outcomes.**

5. Elements for an alternative strategy for trade, development, and peace

Historically, developing economies have argued that trade liberalisation should be accompanied by broader frameworks addressing finance, development policy and structural transformation. Yet the evolution of international trade institutions has largely moved in the opposite direction, progressively separating trade governance from these wider development concerns.

In this context, the EU presents trade agreements as instruments capable, on their own, of generating economic integration, growth and geopolitical reorientation, even though they do not address many of the policy areas essential for achieving these outcomes, particularly in developing economies. **On the contrary, they undermine the policy space that both regions need to pursue sustainable and equitable economic policies.**

It should be clear at this point that the EU-Mercosur agreement will not be able to deliver its promises of fair and sustained economic integration, productive transformation along environmental objectives, and faster and inclusive economic growth. What is more, the agreement **risks locking both regions into a trade framework that limits alternative economic strategies that could deliver a more peaceful and sustainable global landscape**.

This paper does not present a complete blueprint for such alternative strategies. It does, however, suggest that any viable re-orientation must begin with the recognition that development cannot rely on trade alone, just as meaningful trade cannot exist without development. Both depend on strong domestic economic capacities, which for far too long have been constrained by austerity policies and deepening inequality, and by implicit or explicit support for the concentration of global corporations and financial players.

The EU and Mercosur are characterised by a form of sectoral dualism between high- and low-productivity sectors, as well as by centre–periphery dynamics (Storm 2017; Halevi 2019; Capaldo and Ömer 2025). These problems arise from the interaction between income distribution and productivity growth across sectors and countries. When wages and employment grow unevenly across sectors, structural imbalances emerge, weakening overall demand and slowing productivity growth. **Moving beyond a system that privileges competition over labour costs requires, first, an active industrial policy capable of coordinating production across sectors and regions, and second, sustained**

international cooperation in areas such as finance and technology. Drawing on more rigorous analyses conducted in other contexts, we identify several points of departure.

A first step is to analyse existing trade patterns together with how income is distributed across the sectors involved, in order to identify and replicate successful development strategies (UNCTAD TDR 2018; Wirkierman 2023, UNCTAD TDR 2022). In less developed regions, industrialisation should move away from labour-intensive activities gradually rather than abruptly. This is particularly important in agriculture and aligns with agroecological approaches that prioritise sustainability, biodiversity, and resilient local food systems. A gradual transition can also help formalise large parts of the workforce while expanding public services such as education, health, and care (UNCTAD TDR 2022). It also implies accepting that certain sectors may be geographically concentrated.

At the same time, large and persistent differences in the terms of trade – the prices countries receive for their exports relative to their imports – should be avoided. Wage growth across all sectors should broadly keep pace with that of the most productive ones, while working conditions for lower-skilled workers should steadily improve (Storm 2017).

Additionally, countries must be willing to cooperate and to share – at stable contractual prices – key commodities such as energy, food, and critical minerals on the one hand, and green technologies on the other. In this respect, a revival of public stockholding mechanisms in the EU could help stabilise commodity markets and reopen discussions on coordinated price agreements (UNCTAD TDR 2022; Costantini 2022). This is also crucial to avoid unnecessary inflationary pressures.

Finance plays an equally important role. Reducing financial speculation and redirecting credit toward productive investment is essential for economic transformation. When financial markets focus primarily on short-term profits, they increase price volatility and divert resources away from productive investment. By contrast, financial systems oriented toward long-term development—through public development banks, targeted credit policies, and appropriate regulation of capital flows—can support industrial upgrading, technology diffusion, and the expansion of productive capacity (UNCTAD TDR 2022).

Finally, many developing economies currently lack access to the technology and financing needed to transform their productive structures and pursue green industrial development. Only if decisive and affordable cooperation from advanced economies is ensured can developing economies undertake such a transformation at a pace compatible with meaningful global climate mitigation (UNCTAD TDR 2022).

The goal of achieving peaceful economic coordination originally inspired the institutions established in the aftermath of the Second World War, and during the decolonisation processes of the past century, imperfect their implementation has been. Indeed, engaging in multilateral negotiations implies that countries must confront the global implications of their policies. Bilateral free trade agreements between uneven economies, by contrast, bypass this challenge and effectively leave critical decisions on production, employment, technology, finance, and climate increasingly in the hands of the most influential market actors.

Effectively opposing this trend is not unrealistic. Important foundations for this perspective are today emerging in international fora. For instance, South Africa–led G20 task forces on critical minerals and food security have explicitly acknowledged the need to move beyond narrow reliance on free trade and toward more coordinated, cooperative, and strategic forms of international economic governance (Costantini and Muthayan 2025).

6. Conclusions

The EU–Mercosur agreement has been presented as a strategic breakthrough that would strengthen cooperation between Europe and South America. Accordingly, deeper economic integration would allow the EU and Mercosur to better withstand mounting pressures and coercion from external powers – most notably the United States, China, and Russia.

Such ambitions would indeed be welcome. Unfortunately, the agreement largely reproduces the same neo-liberal economic framework that has contributed to many of today's economic and political tensions. Over the past decades, this framework has been associated with deindustrialisation and deepening economic inequality – dynamics which have fuelled political polarisation.

Importantly, it has also weakened the traditional link between national economic interests and the strategies of large multinational corporations, once mediated by policies targeting full employment and industrialisation. This helps explain the growing political tensions surrounding trade policy, together with what appears to be a genuine inability to devise new strategies to protect the growth and stability of domestic markets.

After decades in which trickle-down economics has been promoted as a guiding principle, the challenge lies in identifying common interests between regions that can sustain a genuinely cooperative economic relationship. Doing so requires the capacity to define objectives that are not only reciprocal but also economically coherent and mutually realisable over the long term for the world as a whole. In economic terms, this means keeping in view the conditions necessary to sustain effective demand, which is the mechanism through which market-oriented policies can also generate broad-based social benefits.

This paper has assessed the EU–Mercosur agreement by situating its projected trade gains within a broader macroeconomic and structural context, including fiscal constraints, income distribution, market concentration and policy space. Our findings suggest that once these factors are taken into account, the agreement is not going to generate benefits in terms of economic growth, while amplifying inequality, fiscal pressures and structural imbalances in both regions.

Taken together, these results offer more than sufficient elements to reject the current deal and rethink trade relations on a deeply different basis.

The analysis presented in this paper suggests that the EU–Mercosur agreement, in its current form, does not meet these conditions. **Rather than strengthening economic resilience or geopolitical autonomy, it risks reinforcing existing structural imbalances while contributing to the further fragmentation of the global trading system**.

Appendix: TARIFF REVENUE AND LOSS CALCULATIONS.

a) Accounting algebra

[1] $T^{l}_{ij} = T^{o}_{ij} - T^{p}_{ij}$

[2] $T^{o}_{ij} = t^{o}_{ij}.X^{o}_{ji}$

[3] $T^{p}_{ij} = t^{p}_{ij}.X^{p}_{ji}$

$= t^{p}_{ij}.(X^{o}_{ji} + \Delta X^{o}_{ji})$

[4] $T^{l}_{i(u,c)} = t_{i(u,c)}.X^{d}_{(u,c)i}$

[5] $X^{d}_{(u,c)l} = w_{(u,c)i}.\Delta X^{o}_{ji}$

[6] $tot T^{l}_{i} = T^{l}_{ij} + T^{l}_{iu} + T^{l}_{ic}$

T_{ij} Tariff revenue, out of '*i*' imports from '*j*'

Subscripts:

i , j represent either EU or mSUR

u , c representing US or China & EA

Superscripts:

l : loss

o : baseline

p : EMPA full implementation

t Tariff rate

X_{ji} bilateral exports of *j*, subject to tariffs by *i*

ΔX^{o}_{ji} EMPA increase of bilateral exports ΔX^{o}_{ji} relative to the baseline

$X^{d}_{(u,c)l}$ exports of *u,c* displaced by *i* from a portion of the assumed increased of bilateral exports ΔX^{o}_{ji}

$w_{(u,c)l}$ proportion of ΔX^{o}_{ji} which is diverted from *u,c*

subject to: $w_{(u)l} + w_{(c)l} \leq 1$

Appendix: TARIFF REVENUE AND LOSS CALCULATIONS.

b) The European Union [EU]

EU tariff revenue & loss outcomes. IMPORTS from mSUR (E.bn, const' 2024)				Tariff loss from trade diversion (E.Bn)		Total tariff loss
Sector (GTAP categories)	Baseline revenue	EMPA revenue	EU Loss 'EMPA	US displacement	China & EA displ.	(%GDP base.@2040)
Rice	0.010	0.009	0.001	0.000	0.000	0.0000%
Wheat	0.010	0.010	0.000	0.000	0.000	0.00000%
Cereals	0.000	0.000	0.000	0.001	0.000	0.00001%
Fruit and vegetables	0.112	0.011	0.101	0.023	0.015	0.00064%
Oil seeds	0.000	0.000	0.000	0.000	0.000	0.00000%
Sugar	0.366	0.378	-0.012	0.027	0.000	0.00007%
Fibers	0.000	0.000	0.000	0.000	0.000	0.00000%
Other crops	0.007	0.000	0.007	0.002	0.000	0.00004%
Vegetable oils	0.039	0.000	0.039	0.009	0.000	0.00022%
Live and fresh fish	0.000	0.000	0.000	0.000	0.000	0.00000%
Animal products	0.016	0.013	0.003	0.001	0.000	0.00002%
Dairy	0.000	0.000	0.000	0.000	0.000	0.00000%
Beef	0.536	0.544	-0.007	0.126	0.000	0.00055%
Other meat	0.255	0.219	0.036	0.121	0.000	0.00073%
Beverage and tobacco	0.118	0.000	0.118	0.018	0.000	0.00063%
Processed fish and agri. product	0.764	0.000	0.764	0.347	0.104	0.00561%
Wood and paper	0.010	0.000	0.010	0.002	0.001	0.00006%
Textile, apparel, leather	0.036	0.000	0.036	0.002	0.010	0.00022%
Minerals and glass	0.005	0.000	0.005	0.003	0.007	0.00007%
Energy sector	0.000	0.000	0.000	0.001	0.000	0.00001%
Chemicals	0.086	0.000	0.086	0.013	0.029	0.00059%
Pharmaceutical sector	0.001	0.000	0.001	0.000	0.000	0.00001%
Rubber and Plastic	0.007	0.000	0.007	0.001	0.001	0.00004%
Ferrous metals	0.008	0.000	0.008	0.002	0.001	0.00005%
Other metal products	0.002	0.000	0.002	0.001	0.001	0.00001%
Metal Products	0.010	0.000	0.010	0.001	0.001	0.00005%
Motor Vehicles	0.044	0.000	0.044	0.014	0.031	0.00041%
Transport equip.	0.012	0.000	0.012	0.002	0.002	0.00007%
Electrical equip.	0.010	0.000	0.010	0.001	0.002	0.00006%
Computers	0.003	0.000	0.003	0.000	0.000	0.00001%
Machinery and equip.	0.020	0.000	0.020	0.001	0.003	0.00011%
Other manufacturing	0.003	0.000	0.003	0.000	0.001	0.00002%
Total all sectors	**2.49**	**1.18**	**1.31**	**0.721**	**0.207**	**0.010%**

Appendix: TARIFF REVENUE AND LOSS CALCULATIONS.

c) Mercosur [mSUR]

mSUR tariff revenue & loss outcomes. IMPORTS from EU (E.bn, const' 2024)				Tariff loss from trade diversion (E.Bn)		Total tariff loss
Sector (GTAP categories)	Baseline revenue	EMPA revenue	mSUR Loss 'EMPA	US displacement	China & EA displ.	(%GDP base.@2040)
Rice	0.001	0.000	0.001	0.000	0.000	0.0000%
Wheat	0.000	0.000	0.000	0.000	0.000	0.0000%
Cereals	0.000	0.000	0.000	0.000	0.000	0.0000%
Fruit and vegetables	0.040	0.003	0.037	0.002	0.002	0.0011%
Oil seeds	0.001	0.000	0.001	0.000	0.000	0.0000%
Sugar	0.000	0.000	0.000	0.000	0.000	0.0000%
Fibers	0.000	0.000	0.000	0.000	0.000	0.0000%
Other crops	0.007	0.000	0.007	0.000	0.000	0.0002%
Vegetable oils	0.075	0.000	0.075	0.000	0.000	0.0020%
Live and fresh fish	0.000	0.000	0.000	0.000	0.000	0.0000%
Animal products	0.000	0.000	0.000	0.000	0.000	0.0000%
Dairy	0.014	0.007	0.008	0.000	0.000	0.0002%
Beef	0.004	0.000	0.004	0.000	0.000	0.0001%
Other meat	0.010	0.000	0.010	0.000	0.000	0.0003%
Beverage and tobacco	0.208	0.000	0.208	0.000	0.000	0.0055%
Processed fish and agri. product	0.254	0.029	0.225	0.064	0.048	0.0089%
Wood and paper	0.123	0.027	0.096	0.030	0.023	0.0039%
Textile, apparel, leather	0.148	0.026	0.123	0.098	0.046	0.0071%
Minerals and glass	0.070	0.011	0.059	0.016	0.006	0.0022%
Energy sector	0.000	0.000	0.000	0.000	0.000	0.0000%
Chemicals	0.702	0.227	0.475	0.122	0.152	0.0198%
Pharmaceutical sector	0.437	0.066	0.371	0.023	0.017	0.0108%
Rubber and Plastic	0.203	0.141	0.062	0.024	0.010	0.0025%
Ferrous metals	0.229	0.017	0.212	0.023	0.013	0.0066%
Other metal products	0.080	0.027	0.053	0.034	0.023	0.0029%
Metal Products	0.277	0.042	0.234	0.053	0.028	0.0083%
Motor Vehicles	1.736	0.159	1.577	2.125	1.159	0.1284%
Transport equip.	0.099	0.034	0.066	0.019	0.010	0.0025%
Electrical equip.	0.511	0.150	0.361	0.072	0.096	0.0140%
Computers	0.269	0.019	0.250	0.054	0.046	0.0092%
Machinery and equip.	1.508	0.078	1.430	0.183	0.214	0.0483%
Other manufacturing	0.187	0.041	0.147	0.037	0.047	0.0061%
Total all sectors	**7.20**	**1.10**	**6.09**	2.980	1.939	0.29%

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