December, 2010

Economic size and the changing international political economy of trade: The development of western hemispheric FTAs

Gaspare M Genna, *The University of Texas at El Paso*

Original Article

Economic size and the changing international political economy of trade: The development of western hemispheric FTAs

Gaspare M. Genna
Department of Political Science, The University of Texas at El Paso, El Paso, Texas 79968, USA.
E-mail: ggenna@utep.edu

Abstract Why are some free trade agreements (FTAs) in the western hemisphere successfully negotiated and implemented while others seem to stagnate during negotiations? FTAs are more likely to develop when there is an asymmetrical power relationship and potential partners are satisfied with projected trade patterns. The European Union (EU) and United States have been successful in negotiating agreements with the Caribbean and Central American (CCA) countries. However, current bilateral and multilateral trade talks between the EU, the Common Market of the South (MERCOSUR), and United States are at a standstill. Although all four sets of trade negotiations include dissatisfactory conditions for the Latin American countries, the two negotiations with the CCA countries were successful completed, but the two involving MERCOSUR countries have not. These results are partially due to two factors: the economic size differential between the CCA countries and MERCOSUR *vis-à-vis* the EU and United States, and MERCOSUR's growing economic ties with China. MERCOSUR's medium-size economy and ties with China allows it to forgo FTAs with the EU and United States until more favorable conditions are met. However the CCA countries' immensely smaller size and economic ties with China do not allow for such abstention.
International Politics (2010) **47,** 638–658. doi:10.1057/ip.2010.28

Keywords: MERCOSUR; China; free trade agreements; EU; US; power transition theory

Introduction

Over the last two decades, we have witnessed a proliferation of free trade agreements (FTAs) to the point where they are increasingly becoming a norm in the international political economy. It is therefore important to explain why certain FTA negotiations stalemate, especially those that include economic heavyweights who use FTAs to reorganize the international trade regime. This article offers an explanation for the successful and unsuccessful negotiations. The successful agreements include the Caribbean and Central American (CCA) states, European Union (EU) and United States. The EU negotiations involve the post-Lomé trade relations while the US negotiations culminated in the Central American and Dominican Republic FTA (CAFTA-DR). The unsuccessful set includes the Common Market of the South (MERCOSUR),[1] EU and United States. These are the failures in 2005 by US Trade Representative Robert B. Zoellick and EU Trade Commissioner Pascal Lamy to complete negotiations on the Free Trade Area of the Americas (FTAA)[2] agreement and the EU-MERCOSUR FTA,[3] respectively.

I seek to explain the successes and stalemates in completing FTAs in the western hemisphere by analyzing the power dynamics underlying actors' strategies. Krasner (1976) correctly predicts some of the events; however his work is silent on the behavior of medium-size economies. It is important to explain their behavior since the unsuccessful western hemispheric negotiations include states of this size. Mattli (1999), as well as others that employ hegemonic stability theory (HST), also offer potential explanations, but these fall short in explaining the FTA stalemates of the Americas.

To understand why the two important and high profile negotiations are in stalemate while others are successfully completed, I pose arguments developed from power transition theory (PTT) (Organski, 1958; Organski and Kugler, 1980) with particular attention to its recent extension into the area of regional integration (Efird and Genna, 2002). While PTT has many similarities with HST (Krasner, 1976; Gilpin, 1987), it is more capable to explain the behavior of middle-size states especially during the initial rise of an economic power such as China.

I argue that economic size of actors and the changing dynamics of the international system can help explain these successes and failures. Both the EU and United States are attempting to reorganize the global trade regime along their preferences through various FTAs. According to PTT, the more powerful states establish a *status quo* that would maximize their interests. Smaller states can either acquiesce to these preferences or attempt to challenge them is some manner. However, the likely outcome would be compliance when there is a large asymmetry among states. As a result, we would expect to see the EU and United States to successfully negotiate agreements with the CCA countries.

But what is the outcome when the asymmetries shrink? Do medium-size economies still acquiesce? This depends on the presence of a rising power. I will demonstrate that middle-sized powers have greater flexibility if they have an alternative market for goods (the rising power). In other words, they have the ability to say no to larger economic actors or at least holdout until negotiations become favorable. The members of MERCOSUR see the EU and US reorganization of the global trade regime to their economic disadvantage. In addition, having limited access to the EU and US markets is not a problem for MERCOSUR because a rapidly growing China offers a more appealing alternative market for exports. Therefore the evolving structural change of the international political economy lowers the likelihood of dissatisfied medium-size economies to sign FTAs with the EU and United States.

The remainder of this article will develop the explanation behind the western hemisphere's FTA stalemated and successful negotiations. I present evidence from the EU-MERCOSUR FTA and FTAA negotiations, the actions of the EU and United States in the Caribbean and Central America, and the indirect influence of China on all four sets of negotiations. The final section will conclude with policy implications.

Explaining the Negotiations' Outcomes

Prior research (Feng and Genna, 2003; Genna and Hiroi, 2004; Efird *et al*, 2003) indicates that successful development of regional integration depends on economic asymmetries and compatible preferences of states. Some theories stress the distribution of power among states as a central factor influencing the outcomes of international relations. Among such theories, neo-realism posits that the asymmetric gains from exchange tend to hinder international cooperation (Waltz, 1979; Grieco, 1988). In addition, proponents of HST and PTT argue that the presence of a preponderant state is a necessary condition for liberal international and regional commerce (Krasner, 1976; Gilpin, 1987; Efird and Genna, 2002). Others demonstrate empirically that cooperation can develop under asymmetric conditions if political and military alliances are present (Gowa and Mansfield, 1993; Gowa, 1994; Mansfield and Bronson, 1997; Gilpin, 2001). According to this perspective it is logical for allies to cooperate economically because of the intimate relationship physical security has with economic security; reciprocal enhancement of allies' economic strength will aid in improving military readiness.

Nonetheless the claim that alliance portfolios will always trump other rationales for trade preferences can be contested. Trade policies can run counter to the ideal suggested by the alliance portfolio literature because of the consequences a potential FTA poses to domestic groups and the related implication it would have on political leadership survival, especially in Latin America (Genna and Hiroi, 2004). The preferences of an actor would therefore also need to balance the needs of potential FTA winners and losers in the actor's society with a stronger emphasis on the more powerful and better organized interest groups (Milner, 1988, 1997; Putnam, 1988; Rogowski, 1989; Frieden, 1991, 1998; Garrett and Lange, 1995; Moravcsik, 1997).

In general, the combination of power asymmetry and domestic concerns offers an accurate explanation of the varying success of FTA negotiations. Open trade develops because the larger member of the asymmetric power relationship provides incentives to small states by leveraging its economic size. Leverage employed can vary from offering economic assistance to discontinuing assistance. It could also include retaliatory actions such as increasing existing trade barriers.

Trade pattern preferences also matter. Compatible preferences are associated with overall trade dependence; the more trade dependent the potential partners, the more likely they will integrate formally. I identify the preferences of a state through an extrapolation of the pattern of trade using the concept of comparative advantage. Specific groups who own relatively abundant factors that are used intensively in production would favor an FTA while those that do not would oppose (Magee *et al*, 1989; Rogowski, 1989).[4] In order for all sides to be satisfied, the negotiations need to favor those economic sectors that have a higher volume of trade than other sectors. Developing countries (CCA countries and MERCOSUR members) prefer a trading relationship where they can ease market entry of their primary goods while hoping to shield infant industries. Developed countries (EU and United States) prefer a relationship where they can maximize exports of their capital-intensive goods while protecting their agricultural sectors. A rapidly growing economy (China) needs access to inexpensive primary goods to feed their development.

These preferences interact with the relative size of the actors: large economic asymmetries can lead smaller actors to accept less than preferred trade patterns if being locked out of the large market would make them worse off. This argument is compatible with both HST and PTT. But a point can be reached when the economic size differential is not large enough to accept trade patterns demanded by the larger actor(s). A potential 'relative disparity shift' gives actors pause and can discourage FTAs (Grieco, 1997). Therefore, as the size differential shrinks, it becomes more difficult to explain or predict the behavior of the middle-size negotiating partner according to HST. In other words, current research does not specify under what conditions a medium-size power would or would not acquiesce to a more powerful actor. PTT predicts that as size differential shrinks, middle-size negotiating partners have a greater ability to reject proposals made by the larger partner if there is a rising economic power present that can offer a better option. Middle-size actors have greater agency in a system with a raising power because the changing structure of the international system allows for more choices.

I propose that the likelihood of noncompliance increases when the international political economy is on the threshold of systemic change. This would help explain the successes and stalemates of various multilateral negotiations in the western hemisphere since there is variation on all of the independent variables while controlling for multitude of factors which are similar to each observation. The key to explaining the stalemates is to understand how these negotiations fit into the transforming international structure. PTT has already developed predictions of the increasing challenge China poses for US physical security (Lemke, 2003; Rapkin and Thompson, 2003). However no study details the potential challenge China can have on the international trade regime and especially on EU and US trade relations with Latin American states.

The critical factor in solving the puzzle over the behavior of middle-sized actors in forming free trade accords is the influence of a third-party actor. How would China's economic rise indirectly influence the various western hemisphere's FTA negotiations? It could do this if need for primary goods can counteract the economic leverages that the EU and United States enjoy. Both the EU and United States follow a strategy of competitive liberalization. The strategy's central idea is that countries outside an FTA will believe that there is a cost by being denied access to a large market (Andriamananjara, 2003; Hufbauer and Wong, 2004). Not wanting to lose, they join the arrangement. The global trade patterns are therefore restructured with the EU or United States forming the hub of an FTA wheel and other smaller economies are the spokes. The nonmember decides that it prefers to trade-off the costs of increased competition in its domestic market with the gains of access to the FTA market. The final conclusion of competitive liberalism is that a global trading system emerges from the expanding FTAs, primarily along the preferences of the hub economy.

However, competitive liberalization has a significant problem because it assumes that economic power is static in the international structure and no other actor exists in the international political economy that can frustrate the potential hub actors' efforts. If middle-size actors have an alternative market for their goods and this market is relatively easy to access, then the leverage of the potential hub actor diminishes. Alternative markets reduces the urgency of the middle-size actor allowing leaders to gain wider domestic support since exporters are satisfied with these markets and transnational civil society oppositions to neoliberal trade pacts can also be appeased. In sum, the preponderant power's leverage is countered when a rising power can offer an alternative market to a coalition of states that are dissatisfied by the dominant's trade preferences.

The argument leads to the following hypotheses. If the EU or United States wishes to successfully negotiate an FTA along their preferences, the likelihood of success diminishes the larger the potential partners' economic size *and* the less satisfied they are with the EU or US preferences. The EU or United States have the greatest likelihood of a success when negotiating with very small economies even if preferences are not satisfactory because not joining the FTA would leave the smaller economies worse off. Finally, the presence of an accessible alternative market, like China, diminishes the likelihood of an EU or US FTA. The analysis will demonstrate that the EU and US trade negotiations with the CCA states would be successful because of extreme size asymmetries and a lack of a sizeable trade with China even though the final agreement would favor the EU and United States. On the other hand, I will demonstrate that the FTAA and EU-MERCOSUR negotiations would stalemate because of smaller sized asymmetries, a sizeable trade pattern with China, and unfavorable terms for the MERCOSUR countries.

European and US Strategies

The EU and United States adopt similar strategies regarding FTAs with economically developing countries. While the United States follows an explicit strategy of competitive liberalization, the EU follows an implicit one under its Common Commercial Policy (CCP). Their goal is to reorganize the global trade regime by establishing bilateral or multilateral FTAs outside the WTO negotiations. Each actor attempts to become the hub of an FTA wheel and thereby slowly developing a trade regime along their trade preferences.

Showing evidence of the US strategy is straightforward; a brief overview of the statements of the leading negotiators can suffice. US Trade Representative Robert Zoellick made the following statement before a US House of Representatives committee:

> We would like to pursue FTAs with the largest markets around the world, including the European Union and Japan among others. But right now, those countries are unwilling to move forward. As a result, we are pushing for the liberalization of their markets through the WTO. At the same time, as another facet of competitive liberalization, we hope our progress on other FTAs will encourage these important markets to reconsider their stance. (US House of Representatives 28 April 2004)

But Allen F. Johnson, Chief Agriculture Negotiator, goes deeper into the US strategy in his testimony before a US Senate subcommittee:

> This competition in liberalization strengthens the United States' already considerable leverage, including in the WTO … Our bilateral and regional FTAs in the hemisphere – the US-Chile FTA, the CAFTA, and the FTAA – also complement our trade objectives in the WTO. They set high standards for trade agreements and spur competitive liberalization. They provide a counterweight to the FTAs our Western Hemisphere

> partners have signed with other countries, including Canada, Chile, and the EU. Finally, US trade pacts in the Western Hemisphere deepen our ties with individual and small groups of trading partners – alliances that could help us in the WTO. (US Senate 20 May 2003)

In sum, the US strategy, under the logic of comparative liberalization, is to gather steam in the WTO by establishing FTAs with willing partners. These FTAs would begin a process of making its preferences resonate in the global trade regime by countering other FTAs and establishing greater leverage against the biggest economies, namely those of the EU and Japan.

The EU strategy is parallel to that of the United States, but not as explicit. The EU negotiates all external trade associations under the CCP. Articles 131–135 of the Treaty Establishing the European Community require members of the customs union to negotiate with one voice (Dinan, 1999). Part of the CCP is the contractual commercial policy that gives the EU Commission the power to initiate and the exclusive right to negotiate trade agreements (Marsh and Mackenstein, 2005). The Commission can use its supranational stature to negotiate with non-members not only regarding tariffs and quotas but also non-tariff barriers, without the fear that another body will amend the final trade agreement. The EU Council, however, oversees negotiations through observers and the 113 Committee.[5] Final negotiations need to be approved by the Council using qualified majority voting (Articles 133 and 300), operating like a legislature that only has an up or down vote (Hix, 1999).

Given this single voice, the Commission, through its chief negotiator, can develop specific strategies to achieve the goal of market access. The EU's pattern of FTA behavior suggests that it is following a parallel strategy *vis-à-vis* the United States. In addition to the current talks with MERCOSUR members, the EU is also in the beginning stages of negotiations with the Central American states and Andean Community for future FTAs. Given this pattern, the EU strategy reflects the competitive liberalization logic, and with it, a potential center of global trade regime reorganization.

Successful Negotiations: The Caribbean and Central America

US-Caribbean and Central America

Small, more trade-dependent countries need agreements to remove uncertainty from their trade relations with larger economies. The United States provides preferential access for Caribbean countries (including Guatemala and El Salvador but not Cuba) under the Caribbean Basin Initiative (CBI), but it did so unilaterally. The CBI came into being with the signing into law of the

Caribbean Basin Economic Recovery Act (effective 1 January 1984). Other legislation was enacted to expand the types of products and conditions for further preferential trade relationships, namely through the Caribbean Basin Economic Recovery Expansion Act of 1990 and the US-Caribbean Basin Trade Partnership Act of 2000. The CBI provides tariff reductions or exemptions for products from Central American and Caribbean countries. CBI benefits are, however, conditional. As stated in Section 202 of the Trade Partnership Act:

(1) POLICY - It is the policy of the United States -
(2) to offer Caribbean Basin beneficiary countries willing to prepare to become a party to the FTAA or another free trade agreement, tariff treatment essentially equivalent to that accorded to products of NAFTA countries … and
(3) to seek the participation of Caribbean Basin beneficiary countries in the FTAA or another free trade agreement at the earliest possible date, with the goal of achieving full participation in such agreement not later than 2005.

This section sets up the precondition of signing on to the FTAA or other FTAs on terms that were yet to be specified, but giving the CBI countries benefits immediately. The United States established a *status quo* that would cause these countries to be worse off by not signing on to an FTA because not doing so could lead to losing access to the US market. Signing the FTA will lock in the trade arrangements of the CBI. The result was the enactment of the Central American-Dominican Republic FTA and the current negotiations with the other Caribbean countries.

EU and the Caribbean

The EU practices a similar relationship with Caribbean countries that were former colonies of the member states. First initiated under the Lomé Convention,[6] the EU has a preferential trading relationship with a group of countries referred to as the African, Caribbean, Pacific group (ACP). Lomé provided a development assistance package that included free access to the European market for products that originated in the ACP countries as well as aid and technical assistance (Dinan, 1999). The EU-ACP relationship is currently evolving as a result of the Cotonou Partnership Agreement (2000). A central pillar of the agreement is the movement away from the non-reciprocal trade arrangement under Lomé to a series of negotiated economic partnership agreements (EPAs) (Articles 36 and 37 of the Cotonou Partnership Agreement). The rationale is to make the ACP economies more competitive in the global economy. However the choice for each trade-dependent state, like the case of the CBI, is to either lose access to the larger market or sign EPAs and lock-in access through a WTO recognized agreement. Again, the smaller states would opt for the free trade arrangement and diminish the uncertainty that may result from not signing.

Unsuccessful Negotiations: EU-MERCOSUR FTA and the FTAA

EU-MERCOSUR FTA

This section outlines the preferences of the EU and MERCOSUR derived from the pattern of trade. Overall, the trade relationship is asymmetric with MERCOSUR having the greater dependence on the EU market. However, the EU-MERCOSUR trade patterns illustrate a high percentage of primary goods exports from MERCOSUR and a larger proportion of manufactures exports from the EU. This characteristic of the current trade pattern leads Brazil (and MERCOSUR in general) to demand greater openness for agricultural products. The stalemate came about when the EU refused to open up their agricultural market, but made greater demands on MERCOSUR to open up markets for manufactured products.

First, MERCOSUR is dependent on the EU for their trade. In 2004 Brazil was the EU's 11th major trading partner but accounted for only 1.8 per cent of overall EU trade (Eurostat, 2005). The remaining four MERCOSUR members scored in the bottom of the rankings. However, the EU ranks as the number one trading partner for MERCOSUR, accounting for 22.9 per cent of its total trade (Eurostat, 2005).

This story is repeated in a closer examination of the trade statistics. Figure 1 illustrates the EU-MERCOSUR trade patterns (1999–2004). The first three bars illustrate the trade dependence the EU has with MERCOSUR. MERCOSUR's share of total EU trade averaged 2.46 per cent. Its per cent share of EU imports and exports averaged 2.65 and 2.26 per cent, respectively. Overall, the degree of the EU's overall trade dependence on MERCOSUR is very small. The largest category of products sold in the MERCOSUR market is machinery and transport equipment. In 2004, this accounted for 50.1 per cent of exports to MERCOSUR, but only 2.1 per cent of total EU exports (Eurostat, 2005). The next largest category is chemicals and related products, which account for 22.5 per cent of MERCOSUR trade, but only a 2.7 per cent share of total exports (Eurostat, 2005).

However, when we examine specific categories of products imported into the EU in 2004, a slightly different picture develops. The largest category is food and live animals, accounting for 37.2 per cent of imports from MERCOSUR

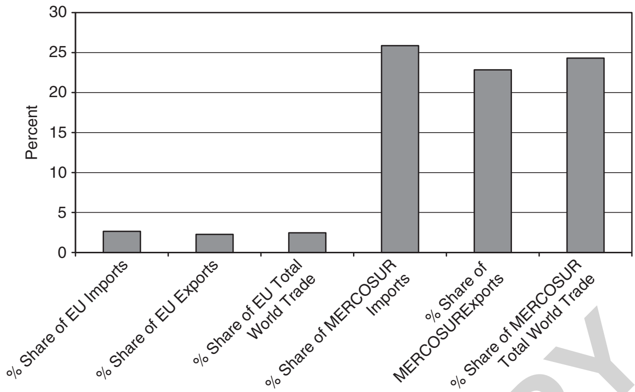

Figure 1: EU-MERCOSUR trade patterns (1999–2004 averages).
Source: Eurostat (2005).

and 20.2 per cent of total EU imports (Eurostat, 2005). The next category is raw goods (except fuels), accounting for 25.7 per cent of MERCOSUR imports and 17.1 per cent of all imports (Eurostat, 2005). In total, these primary materials comprise 37.3 per cent of all EU imports. Therefore, there is some EU trade dependence on MERCOSUR, but only in primary goods.

The last three bars display the EU share of MERCOSUR world trade.[7] From 1999 to 2004, the EU's per cent share of overall trade averaged 24.3 per cent. This is reflected in both exports and imports, which averaged 22.8 and 25.9 per cent, respectively. However, MERCOSUR's export dependence with the EU is not as high as the EU dependence on MERCOSUR. While 25.7 per cent of the EU's imports of food and live animals are from MERCOSUR, this is only 9.9 per cent of total MERCOSUR exports but 37.2 per cent of exports to the EU in 2004 (Eurostat, 2005). In addition, 6.8 per cent of total MERCOSUR exports of raw materials (excluding fuels) go to the EU, accounting for 25.7 per cent of all exports to the EU. The two items together account for 16.8 per cent of all MERCOSUR exports but 62.9 per cent of exports to the EU. In sum, MERCOSUR's main export to the EU and the EU's main dependence is in the category of primary goods.

In the case of EU exports to MERCOSUR, we again see a small amount of value, but a large share of a specific product, namely manufactured goods. The top categories of MERCOSUR imports from the EU are machinery and transportation equipment, chemicals and other manufactured goods. Together they are 22.4 per cent of world imports into MERCOSUR, but 89.6 per cent of EU imports (Eurostat, 2005). However this is only 1.7 per cent of global EU exports. Again, MERCOSUR does not represent a large value of trade for EU exports, but manufactured products do overwhelm the value of trade into MERCOSUR.

The areas of negotiation are centered on the primary products and manufactured goods. Both sides wish to maximize the amount of trade in their favored area of comparative advantage while attempting to minimize competition for domestic firms. In March 2003, MERCOSUR offered to eliminate tariffs on 83–85 per cent of the average value of EU goods over 10 years with the remaining 15 per cent eliminated over a period greater than 10 years (BBC MIR, 5 March 2003). The EU, however, wanted to see 90 per cent instead of 85 per cent. The EU's counteroffer was an exclusion from tariffs for 10 per cent of MERCOSUR imports, which were primarily agricultural goods (BBC MIR, 5 March 2003). The increase by MERCOSUR to 85 per cent was an attempt to get the EU to discuss agricultural subsidies, which the EU refuses to do bilaterally but wanted instead to hold such discussions at the WTO talks (BBC MIR, 5 March 2003).

In November 2003, the EU attempted to gain greater access for their products through the liberalization of MERCOSUR members' government procurement and services sector (Osava, 3 November 2003). The EU offered to increase import quotas for agricultural goods, but this was not satisfactory for MERCOSUR who insisted on discussing agricultural subsidies (Osava, 3 November 2003). The EU offered to further increase the agricultural import quota if MERCOSUR did not request a reform of the EU agricultural subsidies in December 2003 (Osava, 3 November 2003).

The new negotiations at the beginning of 2004 failed because of the MERCOSUR refusal to open government procurement contracts and the services sector because the EU would not allow unrestricted access for beef, cereals, poultry and other agricultural products (MercoPress, 30 March 2005). In April 2004, the same requests were made again, but both sides refused to acquiesce (Benson, 21 April 2004). MERCOSUR negotiators did budge in June 2004 and agreed to increase the percentage of manufactured goods coming in at a reduced tariff to 90 per cent, without a favorable reply from the EU side (*Latin News Daily*, 14 June 2004; O Estado de São Paulo, 14 June 2004).

At the beginning of September 2004, Pascal Lamy stated that the problem with the EU-MERCOSUR negotiations is with the MERCOSUR members because they were unwilling to match the agricultural concessions the EU made with greater access to investment markets, telecommunications, maritime transport and banking services (MercoPress, 1 September 2004). However, the MERCOSUR negotiators (after agreeing not to talk about EU agricultural subsidies) felt that the concessions were not enough and wanted larger agricultural quotas, especially for wheat and beef, and for these quotas not to have a 10-year limit (MercoPress, 1 September 2004).

On 26 May 2005, EU and MERCOSUR representatives put forth a joint communiqué reiterating their comment to finalizing an FTA in conformity with the 1995 Declaration on Political Dialogue that began the negotiation process. The publication of the communiqué signaled that the FTA would not be finalized soon. The transatlantic stalemate occurred because MERCOSUR members understood that they had nothing to lose from not signing the FTA. The EU already depends on their exports of primary goods and would continue to import. The large share of EU manufactured goods entering into the MERCOSUR market would threaten domestic producers leaving MERCOSUR economies worse off. Unless the EU liberalized their agricultural sector, it would not be in the interest of MERCOSUR members to sign the FTA.

FTAA

The conditions under the FTAA negotiations were not different than the EU-MERCOSUR patterns. Like the EU-MERCOSUR trading pattern, MERCOSUR is more trade dependent on the United States than vice versa. Figure 2 illustrates the US-MERCOSUR trade patterns. The first three bars illustrate the trade dependence the United States has with MERCOSUR. As with the EU, the overall per cent value of trade is not high. Total trade has remained somewhat level during the 1997–2001 timeframe an average value of 2.09 per cent. The per cent value of imports to MERCOSUR also has remained level averaging at 1.43 per cent. Furthermore, US exports averaged 3.02 per cent. MERCOSUR's overall trade dependence on the United States resembles the EU. Overall, the per cent share of global MERCOSUR trade averaged 19.3 per cent. Imports from the United States account averaged 21.6 per cent. Exports to the United States averaged 16.6 per cent (Figure 2).

A deeper look exposes the same pattern of trade between MERCOSUR and the United States as in the EU-MERCOSUR case. While 28.3 per cent of the US imports from MERCOSUR is in the category of primary goods, this only accounts for 5.8 per cent of total MERCOSUR exports (FTAA, 2005). Also, 83.3 per cent of the MERCOSUR imports from the United States are in the category of manufactured goods, accounting for 17.4 per cent of total US exports. Therefore, primary goods sent to the United States are a small portion of MERCOSUR exports but manufactured goods represent a larger share of US exports to MERCOSUR. In sum, while MERCOSUR is more dependent on trade with the United States, the United States also is dependent on MERCOSUR for sales of manufactured goods and acquisitions of primary products.

When examining the negotiations for the FTAA, the first item that becomes apparent is the emphasis on manufactured goods at the expense of primary

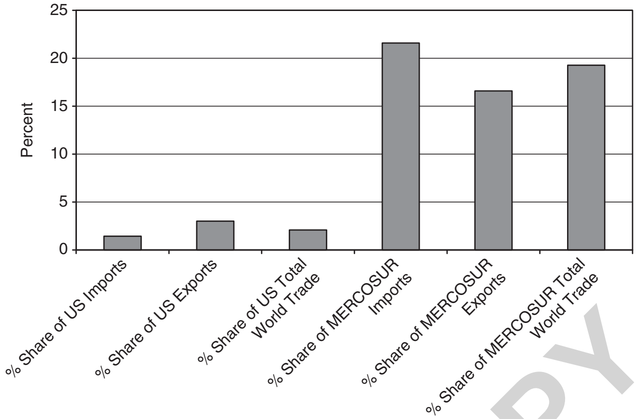

Figure 2: US-MERCOSUR trade patterns (1997–2002 averages).
Source: Free Trade Area of the Americas: Hemispheric Trade and Tariff Database 2005.

goods. Of the nine official areas of the negotiations, only a small fraction of the areas lend themselves to liberalizing primary commodity markets but many do talk about the liberalization of sectors that will increase trade in manufactured goods. Like the EU, the United States has been and continues to be opposed to discussing agricultural subsidies at the negotiating table, insisting that it be discussed at the WTO level. With this off the FTAA table, the vast majority of discussions involve manufactured goods.

The discussions of the meetings divided the participants in the predicted manner. Sides were drawn between the United States, Canada, Mexico and Central American countries favoring a comprehensive agreement while MERCOSUR members wished to remove subjects such as government procurement, services rules and intellectual property rights from discussions (Sevilla, 2004). Given the ties that Canada, Mexico and Central American countries already have with the United States, they favored the US position that included negotiation topics that would liberalize sectors and be receptive for its products. However, MERCOSUR, given the current trade pattern, would be at a disadvantage by signing an agreement that did not liberalize market sectors that would favor their products (that is, agricultural products).

To end this impasse, Brazil suggested in May 2003 a '4 + 1' set of negotiations. This would produce two versions of the FTAA. In one version, MERCOSUR members negotiate with the United States directly. The other is a parallel set of negotiations that would include the United States and the remaining states (Osava, 28 May 2003). The proposed arrangement would permit the process to continue at two speeds and allow Brazil to focus on issues that the United States and its coalition wanted to ignore. Robert Zoellick rejected Brazil's suggestion knowing that it would be possible to get a wider FTAA by keeping the US coalition together in order to thwart MERCOSUR's preferences. This would allow no discussions of agricultural subsidy cuts and anti-dumping rules, both of which the United States wanted to defer to the Doha Round. In addition, by keeping the coalition together, it would be more likely to get the service sector liberalized and reward the CCA countries with extra trade preferences (Osava, 28 May 2003).

In the hope of moving the negotiations forward, a new negotiation framework was decided ahead of the ministerial meetings in Miami in November 2003. 'FTAA lite', as it was called, would allow each country to negotiate in certain areas and not in others (Osava, 20 November 2003). However this did not stop the MERCOSUR members from continuing their common strategy, which was further developed ahead of the February 2004 meetings (Invertia, 16 January 2004). Most of 2004 resulted in the same stalemate between MERCOSUR and the United States regarding agricultural subsidies and liberalization of services. In the most recent attempt, Brazil and US representatives met in Washington, DC from 22 to 23 February 2005. The result was an insipid joint communiqué stating that both sides are committed to an FTAA in the future but without stating how this would occur.

Like the EU-MERCOSUR stalemate, the FTAA stalemate occurred because MERCOSUR members understood that signing the FTAA would place them in a worse position. The United States exports a large percentage of manufactured goods to and imports a fair percentage of primary goods from MERCOSUR members. As in the case of the EU, an increase of manufactured goods entering into the MERCOSUR market would threaten domestic producers leaving MERCOSUR economies worse off. However the final factor that gave the MERCOSUR members more incentives to reject both the EU and US proposals was the indirect impact of China's economic relations with Latin America.

The impact of China

With average annual growth rates of 8 per cent, the Chinese economy is becoming increasingly in need of food, raw materials and energy. For example, China has been the world's largest oil consumer since 2003. They continually need reliable sources of raw materials with a portion of them already arriving from Latin America. Volume of exports from the Caribbean, Central America and South America to China has dramatically increased over the last 10 years (see Figure 3). From 1994 to 2005, the proportion of total exports leaving these countries to China increased from 1.63 to 6.47 per cent. The overall growth of MERCOSUR members' exports was 73.3 per cent and now accounts for

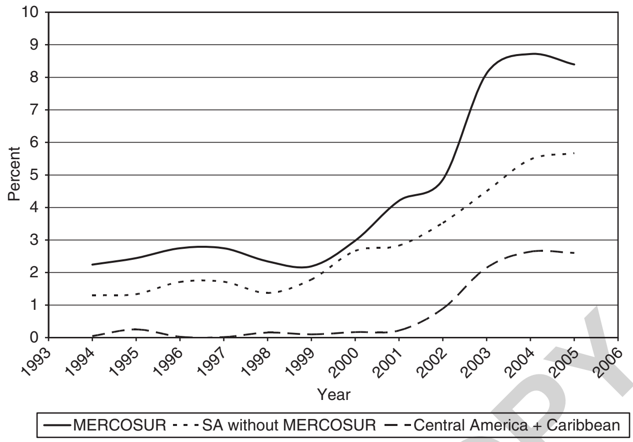

Figure 3: Percentage of exports to China (1994–2005).
Source: International Monetary Fund.

approximately 8.5 per cent of total exports. This is quite a sizable increase when compared to the EU and United States. The growth was larger among the CCA countries (98.2 per cent) but exports are still a small percentage of the total CCA exports (approximately 2.50 per cent). Other South American countries saw an increase of approximately 77 per cent, with approximately 5.6 per cent of total exports heading to China in 2005. Therefore, the MERCOSUR countries are taking a greater advantage of China's market than the smaller CCA countries.

China is also becoming an active business partner, accounting for 36.5 per cent of total foreign direct investment in Latin America in 2003 (MercoPress, 11 November 2004). Although trade with Latin America only accounted for 3.4 per cent of total Chinese trade volume in 2003, and with a growing trade deficit with Latin America, Chinese state analysts say trade is valuable if they are able to secure raw materials for their fast growing economy (Business Daily Update, 3 December 2004). If China is willing to buy more and more Latin American goods along favorable trade arrangements, then Brazil and its MERCOSUR partners would be able to expand the market for their products even with the EU and US stalemates. In addition, pressure would be off of these countries to sign unfavorable FTAs.

Latin American leaders welcome and actively seek out China's economic partnership. In May 2004 Brazilian President Luiz Inácio 'Lula' da Silva visited China with a large entourage of business representatives in order to begin the process of extending commercial ties for exports such as food products, chemicals and machinery, among others (Osava, 18 May 2004). In return for officially recognizing China as a market economy within the rules of the WTO during President Hu Jintao's visit in November 2004, China signed numerous commercial agreements with Brazil (Deutsche Presse-Agentur, 12 November 2004). One such agreement partnered Brazilian and Chinese state-owned oil firms (Petrobras and China Petroleum and Chemical Corporation) and China's Export and Import Bank for a US$1 billion Brazilian north-south natural gas pipeline construction project (MercoPress 13 November 2004). Another was a $2 billion investment in Brazilian rail so as to improve freight transportation and lower commodity prices (MercoPress, 13 November 2004). Overall, Hu pledged $10 billion for multiyear investments in Brazil during his visit (Business Daily Update, 3 December 2004).

China has wider economic plans in Latin America. China and Argentina singed a $19.7 billion investment package for infrastructure improvement and hydrocarbon exploration and production over 10 years (MercoPress, 17 November 2004). At the time of signing this agreement, Chinese sanitary authorities later certified several Argentine beef and poultry processing plants, thereby expanding trade of these products for the Chinese market and Argentina granted China WTO market economy status (MercoPress, 13 July 2005). Finally, China represents Argentina's top market for soybeans (MercoPress, 26 August 2006). Its presence in the political sphere is also growing with its acceptance as a formal observer in the Organization of American States (MercoPress 26 August 2006) and its wish to join the Inter-American Development Bank (MercoPress, 11 April 2005). The latter move has garnered MERCOSUR's support, with opposition coming from the United States and the Central American states (MercoPress, 11 April 2005).

Conclusions

The successes and stalemates of western hemispheric negotiations resulted from a combination of disjointed preferences, relative market size and the growing advantages of trade with China. For a large economy, signing FTAs with smaller economies does have a marginal economic advantage, but the primary goal is an evolution toward a global trade regime more favorable to its preferences. Smaller economies do look favorably on accessing larger markets, but they fear domestic market competition. If their domestic market is vulnerable, then they would be better off signing an FTA if their exports would suffer by being cut off or reduced by the larger economy. Medium-sized economies are less likely to sign when they cannot exploit comparative advantages. Alternative markets in rapidly growing economies also lower the incentives to sign.

The EU and the United States have similar goals. The idea of establishing FTAs allows for a reorganization of the global trade regime along their preferences. The idea is to expand markets for their exports while protecting their more vulnerable products. If they convince states to sign FTAs along these preferences, then they have a *de facto* global trade regime outside the WTO negotiations. As such they consolidate their status as hub economies and continue to compete with each other over a greater share of the global market.

While some states are willing to sign FTAs, others have deep reservations. The EU and United States have developed FTAs in the western hemisphere, but with the smaller more dependent states. The CCA states benefited from favorable trade relations established by the EU and United States through their respective unilateral policies. Therefore not signing an FTA for these countries could threaten their economic dependence on the larger actors. The MERCOSUR members, on the other hand, do not have such incentives. They primarily sell raw goods to the EU and United States who shield their domestic producers with tariffs and subsidies. The larger economies wish to increase sales of manufactured goods to MERCOSUR without exposing domestic agricultural producers to competition. In addition, China's growing economy is in need of raw materials and an improved status in the World Trade Organization, both of which MERCOSUR is willing to provide. In return, China does provide incentives for MERCOSUR cooperation. The current trajectory implies greater trade relations between the larger economies of the developing world and problems for the north-south variety of trade. Since little incentive is present, a successful end to the FTAA and EU-MERCOSUR FTA negotiations is not very likely under the current preferences of the EU and United States.

To improve the degree of regional and global trade cooperation, greater incentives are needed from the EU and United States. The liberalization of the agricultural sectors is an important first step towards this. In this way not only would the stalled western hemispheric negotiations be revived, this would also bring new life to the Doha Round. The EU and United States must concede some ground to MERCOSUR so that they can develop a more satisfactory agreement while simultaneously deflect the influence of China. In fact this would be in the best interests of both the EU and United States since they can promote greater trade dependence with these developed actors. Another policy suggestion is a slow opening for services and government procurement in the MERCOSUR members so as to improve the integration of these sectors in the international market. This has a twofold impact because it would also bring new life to the Doha Round while preparing these vital MERCOSUR industries for global competition.

Finally, it is important to note that this analysis investigates one set of factors for explaining the successes and stalemates of trade negotiations in the Americas. Other factors may also be salient but outside the scope of this research. Such factors as the emergence of populist leaders in Latin America, as well as Latin American transnational opposition to FTAs with the United

States may indicate a growing backlash against neoliberalism. There is also a weakening of support for FTAs in the United States. Consequently, we have fertile ground to investigate the domestic factors for successes and failures of FTA negotiations. This research could complement the systemic approach applied in this article and would offer an important contribution to explaining this complex story.

About the Author

Gaspare M. Genna is an associate professor at The University of Texas at El Paso's Political Science Department, where he teaches graduate and undergraduate courses regarding comparative politics, European Union politics, international relations, international organizations and international political economy. His research interests are in explaining the success and failure of regional integration in both economic and political dimensions. His work to date involves analyzing state incentives for integration as well as domestic public support. His research appears in *European Union Politics, Review of International Political Economy, International Interactions, Latin American Perspectives, Comparative European Politics* and *The Journal of Developing Societies*. In addition, he is Senior Research Fellow at the TransResearch Institute and an associate editor of the journal *Politics and Policy*.

Notes

1 The MERCOSUR customs union includes Argentina, Brazil, Paraguay, Uruguay, and with Chile, Bolivia, and Peru as associate members. Venezuela is set to the fifth full member, but ratification is still pending in the Brazilian Senate. In 2002, MERCOSUR market size was 223.4 million people with a total output of \$572 million, of which Brazil represents a little less than 80 per cent (UN Development Programme, 2005).
2 Negotiations for the FTAA began in 1994 with the idea of establishing an FTA that would include all the economies of the western hemisphere, except Cuba (34 economies in all). The total market size is estimated to be 841.2 million people with a total output of \$12.8 trillion in 2002, of which the United States would account for a little more than 81 per cent (UN Development Programme, 2005).
3 Negotiations for the EU-MERCOSUR FTA began in earnest in 1999 after years of preliminary talks. It would represent an estimated market size of 602.5 million people with a total output of \$9.2 trillion in 2002, of which the EU would account for approximately 94 per cent (UN Development Programme, 2005).
4 See also the Heckscher-Ohlin and Stopler-Samuelson theorems (Krugman and Obstfeld, 2002).
5 The name '113 Committee' comes from Article 113 using the old numbering system of the Treaty Establishing the European Community. This is the same as Article 133 using the new numbering system (Treaty of Amsterdam); however the name '133 Committee' has not come into vogue.

6 The Lomé Convention was actually a series of five agreements: Lomé I-IV and an amended IV.
7 2004 MERCOSUR trade figures are estimated based on the first nine-month figures and 2003 annual figures.

References

Andriamananjara, S. (2003) Competitive Liberalization or Competitive Diversion? Preferential Trade Agreements and the Multilateral Trading System. Working paper. US International Trade Commission.

BBC Monitoring International Reports. (IR 5 March 2003) Mercosur to Present 'Ambitious' Tariff-Elimination Proposal to EU.

Benson, T. (2004) EU nears trade pact with Latin America. *New York Times*, 21 April.

Business Daily Update. (2004) Latin American free trade. 3 December.

Cotonou Partnership Agreement. (2000) http://europa.eu.int/comm/development/body/cotonou/pdf/agr01_en.pdf#zoom=100.

Deutsche Presse-Agentur. (2004) 2nd roundup: Brazil recognizes China as market economy. 12 November.

Dinan, D. (1999) *Ever Closer Union: An Introduction to European Integration*, 2nd edn. Boulder, CO: Lynne Rienner.

Efird, B. and Genna, G.M. (2002) Structural conditions and the propensity for regional integration. *European Union Politics* 3(3): 267–295.

Efird, B., Genna, G.M. and Kugler, J. (2003) From war to integration: Generalizing the dynamic of power. *International Interactions* 29(4): 293–313.

Eurostat. (2005) EU bilateral trade and trade with the world: MERCOSUR, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113488.pdf.

Feng, Y. and Genna, G.M. (2003) Regional integration and domestic institutional homogeneity: A comparative analysis of regional integration in the Americas, Pacific Asia, and Western Europe. *Review of International Political Economy* 10(2): 278–309.

Free Trade Area of the Americas. (2005) Hemispheric trade and tariff database, www.ftaa-alca.org/NGROUPS/NGMADB_E.asp.

Frieden, J.A. (1991) *Debt, Development, and Democracy: Modern Political Economy and Latin America, 1965–1985*. Princeton, NJ: Princeton University Press.

Frieden, J.A. (1998) Who wins? Who loses? *Foreign Policy* 112: 25–40.

Garrett, G. and Lange, P. (1995) Internationalization, institutions, and political change. *International Organization* 49: 627.

Genna, G.M. and Hiroi, T. (2004) Power preponderance and domestic politics: Explaining regional economic integration in Latin America and the Caribbean, 1960–1997. *International Interactions* 30(2): 143–164.

Gilpin, R. (1987) *The Political Economy of International Relations*. Princeton, NJ: Princeton University Press.

Gilpin, R. (2001) *Global Political Economy: Understanding the International Economic Order*. Princeton, NJ: Princeton University Press.

Gowa, J. (1994) *Allies, Adversaries, and International Trade*. Princeton, NJ: Princeton University Press.

Gowa, J. and Mansfield, E.D. (1993) Power politics and international trade. *American Political Science Review* 87: 408.

Grieco, J.M. (1988) Anarchy and the limits of cooperation: A realist critique of the newest liberal institutionalism. *International Organization* 42(3): 485–507.

Grieco, J.M. (1997) Systemic sources of variation in regional institutionalization in Western Europe, East Asia, and the Americas. In: E.D. Mansfield and H.V. Milner (eds.) *The Political Economy of Regionalism*. New York: Columbia University Press.

Hix, S. (1999) *The Political System of the European Union*. Hampshire, UK: Palgrave.

Hufbauer, G.C. and Wong, Y. (2004) Grading growth: The trade legacy of President Bush. *Harvard International Review* 26(2): 72–76.

Inter-American Development Bank. (2002) *Beyond Borders: The New Regionalism in Latin America*. Washington DC: Inter-American Development Bank.

Invertia. (2004) Argentina, Brazil agree on common strategy in FTAA talks. *Latin America News Digest*, 16 January.

Johnson, A.F. (2003) Statement before Senate Committee on Foreign Relations, Subcommittee on Western Hemisphere, Peace Corps, and Narcotics Affairs. United States Senate, 20 May 2003.

Krasner, S. (1976) State power and the structure of international trade. *World Politics* 28: 317.

Krugman, P.R. and Obstfeld, M. (2002) *International Economics: Theory and Policy*, 6th edn. Boston, MA: Addison Wesley.

Latin News Daily. (2004) Brazil: Breakthrough in Mercosur-EU negotiations. 14 June.

Lemke, D. (2003) Investigating the preventive motive for war. *International Interactions* 29: 273.

Magee, S.P., Brock, W.A. and Young, L. (1989) *Black Hole Tariffs and Endogenous Policy Theory: Political Economy in General Equilibrium*. Cambridge, UK: Cambridge University Press.

Mansfield, E.D. and Bronson, R. (1997) The political economy of major-power trade flows. In: E.D. Mansfield and H.V. Milner (eds.) *The Political Economy of Regionalism*. New York: Columbia University Press.

Marsh, S. and Mackenstein, H. (2005) *The International Relations of the European Union*. Harlow, UK: Pearson Longman.

Mattli, W. (1999) *The Logic of Regional Integration: Europe and Beyond*. Cambridge, UK: Cambridge University Press.

MercoPress News Agency. (1 September 2004) EU blames Mercosur for stalled trade talks, www.mercopress.com/Detalle.asp?NUM=4191.

MercoPress News Agency. (11 November 2004) Latin America quick to dance to China's tune, www.mercopress.com/Detalle.asp?NUM=4603.

MercoPress News Agency. (13 November 2004) Brazil signs lucrative deals with China, www.mercopress.com/Detalle.asp?NUM=4614.

MercoPress News Agency. (17 November 2004) China will finance Argentine infrastructure, www.mercopress.com/Detalle.asp?NUM=4638.

MercoPress News Agency. (30 March 2005) Mercosur 'surprised' by EU uncompromising stance, www.mercopress.com/Detalle.asp?NUM=5366.

MercoPress News Agency. (11 April 2005) Latin America after closer ties with Asia, www.mercopress.com/Detalle.asp?NUM=5449.

MercoPress News Agency. (13 July 2005) New EU-Mercosur target: Vienna May 2006, www.mercopress.com/Detalle.asp?NUM=6028.

MercoPress News Agency. (26 August 2006) China's growing presence in Latin America, www.mercopress.com/Detalle.asp?NUM=8609.

Milner, H. (1988) *Resisting Protectionism*. Princeton, NJ: Princeton University Press.

Milner, H. (1997) Industries, governments, and the creation of regional trade blocs. In: E.D. Mansfield and H.V. Milner (eds.) *The Political Economy of Regionalism*. New York: Columbia University Press.

Moravcsik, A. (1997) Taking preferences seriously: A liberal theory of international politics. *International Organization* 51(5): 513–553.

O Estado de São Paulo. (2004) Mercosur, European Union unlock FTA negotiations. 14 June.
Organski, A.F.K. (1958) *World Politics*, 1st edn. New York: Alfred A. Knopf.
Organski, A.F.K. and Kugler, J. (1980) *The War Ledger*. Chicago, IL: University of Chicago Press.
Osava, M. (28 May 2003) Trade-Americas: Brazil and US face off in decisive FTAA talks. Inter Press Service.
Osava, M. (3 November 2003) FTAA is the key for a Mercosur-EU accord. Inter Press Service.
Osava, M. (20 November 2003) Trade-Americas: Flexible new trade pact welcome by most. Inter Press Service.
Osava, M. (18 May 2004) Lula is going to China, Brazil's third-largest market. Inter Press Service.
Putnam, R.D. (1988) Diplomacy and domestic politics: The logic of two-level games. *International Organization* 42: 427–460.
Rapkin, D. and Thompson, W.R. (2003) Power transition, challenge and the (re)emergence of China. *International Interactions* 29: 315.
Rogowski, R. (1989) *Commerce and Coalitions: How Trade Affects Domestic Political Alignments*. Princeton, NJ: Princeton University Press.
Sevilla, C.R. (2004) Can the United States and Brazil spur free trade in the Americas? *In the National Interest* 3(1): 23–29.
United Nations Development Programme. (2005) Human Development Reports, hdr.undp.org/statistics/data/.
Waltz, K.N. (1979) *Theory of International Politics*. New York: McGraw-Hill Publishing Company.
World Trade Organization. (2002) *WTO Trade Policy Reviews: European Union*. Washington DC: World Trade Organization.
Zoellick, R.B. (2004) Statement of US trade representative before the Committee on Agriculture of the United States House of Representatives. 28 April.