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Remapping Trade Relations in the Americas: The Influence of Shifting Power

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Re-mapping the Americas
Trends in Region-making

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Chapter 5

Re-mapping Trade Relations in the Americas: The Influence of Shifting Power

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Introduction

This chapter[1] will focus primarily on the negotiations between the European Union (EU), Common Market of the South (MERCOSUR) and the United States but will also attempt to explain why each of these actors, while unsuccessfully negotiating agreements among themselves, are successful in completing FTAs with other members of the western hemisphere. On 23 February 2005, Robert B. Zoellick, the US Trade Representative, failed to reach an agreement with his Canadian and Latin American counterparts for the establishment of the Free Trade Area of the Americas (FTAA). Negotiations for the FTAA began in 1994 with the idea of establishing a FTA that would include all the economies of the western hemisphere, except Cuba (34 in all). The potential total market size is estimated to be 923.8 million people with a total output of $22.3 trillion in 2011, of which the US would account for about 67 per cent of the total.[2] The US already established trade agreements with the following countries of the western hemisphere:[3]

- Canada and Mexico under the North American Free Trade Agreement (NAFTA) (1994);
- Chile (2004);
- Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua under the Central American Free Trade Agreement (CAFTA-DR) (2006);
- Peru (2009);
- Panama (2011); and
- Colombia (2012).

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1 This chapter draws from Gaspare M. Genna, 'Economic Size and the Changing International Political Economy of Trade: The Development of the Western Hemispheric FTAs', *International Politics*, 47 (6) (2010), 638–658.

2 World Bank, 2013. World Development Indicators. http://data.worldbank.org/data-catalog/world-development-indicators, accessed 26 December 2013.

3 Years denote date of FTA implementation.

Similarly, EU Trade Commissioner, Pascal Lamy, failed to reach a FTA with his counterparts from MERCOSUR on 26 May 2005, and while negotiations are still continuing, there has been no final resolution. The MERCOSUR customs union includes Argentina, Brazil, Paraguay, Uruguay and Venezuela. The 2011 MERCOSUR market size is 276.7 million people with a total output of US$3.3 trillion, of which Brazil represents approximately 75 per cent of the total. Negotiations for the EU-MERCOSUR FTA began in earnest in 1999 after years of preliminary talks. It would represent an estimated market size of 780.4 million people with a total output of US$20.9 trillion in 2011, of which the EU would account for approximately 84 per cent of the total.[4] The EU already has a trade association agreement with Chile (2002) and Mexico (2000) as well as a preferential trade agreement with former colonies in the region. MERCOSUR countries also have association agreements with The Andean Community (Bolivia, Colombia, Ecuador and Peru), Mexico, and Chile, with Guyana and Suriname as potential future associate members. In turn all MERCOSUR members became associate members of the Andean Community to form the South American Community of Nations.

To understand the puzzle of why some negotiations ended successfully while others have not, I conducted an analysis that includes two key interacting variables: the economic size of the three actors (EU, MERCOSUR, US) and their respective preferences. FTAs are more likely to form when actors believe that there are advantages to signing than not signing. The respective advantages are the actors' preferences which reflect a desired pattern of trade depending on the actors' level of development and strength of domestic economic actors. Developing actors (like the MERCOSUR members) would prefer a trading relationship where they can ease market entry of their primary goods while hoping to shield infant industries. Developed (EU and US) actors prefer a relationship where they can maximize exports of their capital-intensive goods while protecting their agricultural sectors.

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 larger market would make them worse off. 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). More specifically, both the EU and US are attempting to reorganize the global trade regime along their individual preferences through the EU-MERCOSUR FTA and FTAA, respectively. However, the members of MERCOSUR see this reorganization to their economic disadvantage. In addition, having the limited access to the EU and US markets do not have enough economic value for MERCOSUR because a rapidly growing China offers an alternative market for the MERCOSUR members to sell their exports, under more preferred conditions.

4 World Bank, 2013.

Explaining the Lack of Success: Relative Size and Actors' Preferences

In order to explain the EU-MERCOSUR and FTAA outcomes, a brief overview of the prior research[5] indicates that successful development of regional integration depends on the economic asymmetries and compatible preferences. Power theories stress the distribution of power among states as a central factor influencing international outcomes. Proponents of hegemonic stability theory argue that the presence of a hegemonic state is a necessary condition for liberal international commerce.[6] Others demonstrate empirically that cooperation can develop under asymmetric conditions if political and military alliances are present.[7] It is logical for allies to cooperate economically because of the intimate relationship physical security has with economic security; reciprocal enhancement of an 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.[8] The preferences of an actor would therefore also need to balance the needs of potential FTA winners and losers with a stronger emphasis on the more powerful and better organized interest groups in the society.[9]

5 For a complete assessment of regional integration theory, please see Yi Feng and Gaspare M. Genna, '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) (2003), 278–309 and Gaspare M. Genna and Taeko Hiroi, 'Power Preponderance and Domestic Politics: Explaining Regional Economic Integration in Latin America and the Caribbean', *International Interactions*, 30 (2) (2004), 143–164.

6 Stephan Krasner, 'State Power and the Structure of International Trade', *World Politics*, 28 (1976), 317; Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987).

7 Joanne Gowa and Edward D. Mansfield, 'Power Politics and International Trade', *American Political Science Review*, 87 (1993), 408; Joanne Gowa, *Allies, Adversaries and International Trade* (Princeton: Princeton University Press, 1994); Edward D. Mansfield and Rachel Bronson, 'The Political Economy of Major Power Trade Flows', in Edward D. Mansfield and Helen V. Milner (eds), *The Political Economy of Regionalism* (New York: Columbia University Press, 1997); and Robert Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton: Princeton University Press, 2001).

8 Gaspare M. Genna and Taeko Hiroi, 'Power Preponderance and Domestic Politics: Explaining Regional Economic Integration in Latin America and the Caribbean', *International Interactions*, 30 (2) (2004), 143–164.

9 Robert Putnam, 'Diplomacy and Domestic Policies: The Logic of Two Level Games', *International Organization*, 42 (1988), 427–460; Helen Milner, *Resisting Protectionism* (Princeton: Princeton University Press, 1988); Jeffry Frieden, *Debt, Development and Democracy: Modern Political Economy and Latin America, 1965–1985* (Princeton:

In sum, power asymmetry and a focus on domestically derived preferences, in combination, can offer an accurate picture of when FTA negotiations, and other developments of regional integration, are successful.[10] Integration develops because the larger member of the asymmetric power relationship provides incentives to smaller 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. Preferences in trade patterns also matter. Compatible preferences are associated with overall trade dependence; the more trade dependent the potential partners, the more likely they will integrate formally. The preferences of a state could be fine-tuned 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 favour a FTA while those that do not would oppose.[11] (See also the Heckscher Ohlin and Stopler Samuelson theorems in Krugman and Obstfeld book.)[12] Current trade patterns would reflect the preferences of potential FTA partners. In order for all sides to be satisfied, the negotiations need to favour those economic sectors that already have a higher volume of trade than other sectors. For developing countries, these are the primary goods sectors (especially agriculture) while for developed countries this includes the manufacturing, financial, and service sectors. Therefore, a smaller member would not join a FTA if it would be worse off; but if the smaller partner is satisfied with the current relationship and would not wish to harm that relationship, it would join the FTA.

Using this theory, the strategies of the EU, MERCOSUR (particularly Brazil) and the US can be understood. It is important to first look at the logic of the EU and US strategies and then Brazil's counter-strategy. Both the EU and US follow a strategy of competitive liberalization. The central idea of competitive liberalization

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Princeton University Press, 1991); Jeffry Frieden, 'The Euro: Who Wins? Who Loses?', *Foreign Policy*, 25 (September 1998); Ronald Rogowski, *Commerce and Coalitions: How Trade Affects Domestic Political Alignments* (Princeton: Princeton University Press, 1989); Geoffrey Garrett and Peter Lange, 'International, Institutions and Political Change', *International Organization*, 49 (1995), 627; and Andrew Moravcsik, 'Taking Preferences Seriously: A Liberal Theory of International Politics', *International Organization*, 51 (5) (1997), 513–553.

10 Brian Efird and Gaspare M. Genna, 'Structural Conditions and the Propensity for Regional Integration', *European Union Politics*, 3 (3) (2002), 267–295; and Gaspare M. Genna and Taeko Hiroi, 'Power Preponderance and Domestic Politics: Explaining Regional Economic Integration in Latin America and the Caribbean', *International Interactions*, 30 (2) (2004), 143–164.

11 Stephen P. Magee, William A. Brock and Leslie Young, *Black Hole Tariffs and Endogenous Policy Theory: Political Economy in General Equilibrium* (Cambridge: Cambridge University Press, 1989).

12 Paul R. Krugman and Maurice Obstfeld, *International Economics: Theory and Policy* (Boston: Addison Wesley, 2002).

is that nonmembers will fear a cost of being excluded from FTAs.[13] They perceive that an established FTA is a 'gold standard' for trade that incurs a cost for them in the denial of access to a large market for the non-member's products.[14] Not wanting to lose, they join the arrangement. Therefore, FTAs expand when a large economy forms a central hub of a FTA wheel and other smaller economies are the spokes. In sum 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 FTA and primarily along the preferences of the hub economy.

The logic of competitive liberalization is, however, problematic and as a result can explain the lack of success in the two sets of negotiations. Knowing that the larger economy has this leverage, similar sized or middle sized economies would also adopt the same strategy so that they can develop their own trading blocs. The goal would be to develop 'competitive leverage' against the dominant player that wishes to play the role of the global hub economy. It is possible for a group of economies to compete as a unit to either be that hub economy or more likely, to diminish the leveraging power of the dominant economy in its effort to reorganize the global trade regime under its preferred trading pattern. Also, the logic of competitive liberalization suggests that 'spoke' economies have no alternative but to attach themselves to a specific 'hub'. It does not include the possibility that the smaller economies have alternative markets to sell their most important exports.

Preferences therefore play a key role and interact with the asymmetric power relations for the success of regional integration. If the dominant economic power wishes to develop or expand a FTA along its preferences, the likelihood of success diminishes with the larger nonmember's economic size *and* the less satisfied it is with the dominant actor's preferences. Success will also diminish when alternative markets are available. A relatively mid-sized economic power sees that not joining the FTA would leave it better off because the dominant economy is not large enough, is dissatisfied with the dominant actor's preferences, and alternative markets are available. However, the smaller the nonmember's size, the greater the likelihood of a successfully negotiating a FTA even if preferences are not ideal because not joining the FTA would still leave the smaller economy worse off, even if alterative markets are available.

If this theory holds, then the lack of success in the trade negotiations would start to result after the small economies join the larger economies attempting to reorganize the global trade regime under their preferences. This leaves the mid-sized economies that do not have the incentive to join but do have the incentive to

13 Soamiely Andriamananjara, 'Competitive Liberalization or Competitive Diversion? Preferential Trade Agreements and the Multilateral Trading System' (Working Paper, US International Trade Commission, 2003).

14 Gary C. Hufbauer and Yee Wong, 'Grading Growth: The Trade Legacy of President Bush', *Harvard International Review*, 26 (2) (Summer 2004).

form their own FTAs in order to safeguard their interests in the reorganization of the global trade regime. Unless the global large economies are willing to yield to the preferences of the mid-sized economies, then FTAs will be difficult to conclude.

Re-mapping Trade Relations

The EU and US have different approaches to negotiating FTAs, but are of the same mind in certain key issues that have characterized the talks between these economically developed actors and their developing counterparts. While the US 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 and then use these FTAs as greater leverages inside the global trade negotiations. Each attempts to become the hub of a FTA wheel and thereby slowly developing a trade regime along their trade pattern preferences.

Demonstrating the US strategy is straightforward; a brief overview of the statements of the leading negotiators can suffice. Allen F. Johnson, Chief Agriculture Negotiator, made the following statement before a US Senate subcommittee:

> Our strategy is to incite competitive liberalization by negotiating regional and bilateral trade agreements to complement our global strategy in the WTO. If others are ready to open their markets, America will be their partner. If some are not ready, or want to complain but not lower their own barriers, the United States will proceed with countries that are ready.[15]

Echoing this view and providing greater insight is Johnson's supervisor, Robert Zoellick 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).[16]

15 Allen F. Johnson, 'Statement before Senate Committee on Foreign Relations Subcommittee on Western Hemisphere, Peace Corps and Narcotics Affairs', *United States Senate* (2004).

16 Robert B. Zoellick, 'Statement of U.S. Trade Representative before the Committee on Agriculture of the United States House of Representative', 2004.

But Johnson goes deeper into the US strategy in another quote from his US Senate subcommittee testimony:

> This competition in liberalization strengthens the United States' already considerable leverage, including in the WTO … Our bilateral and regional FTAs in the hemisphere – the U.S.-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, U.S. 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 US, but not as explicit. In 1996, the EU developed the Market Access Strategy (MAS). The MAS is a multifaceted policy with one simple goal, to obtain access to external markets through the use of bilateral and multilateral agreements. To this end, the EU negotiates all external trade associations under the CCP. 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.[17] 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.[18] Final negotiations need to be approved by the Council using qualified majority voting in an up or down vote.[19]

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 behaviour suggests that it is following a parallel strategy vis-à-vis the US. As mentioned in the introduction, the EU has trade association agreements with Chile

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17 Desmond Dinan, *Ever Closer Union: An Introduction to European Integration* (Boulder: Lynne Rienner, 1999); Steve Marsh and Hans Mackenstein, *The International Relations of the European Union* (Harlow: Pearson Longman, 2005).

18 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.

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

and Mexico. In addition to the current talks with MERCOSUR members, the EU is also in 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 centre of global trade regime reorganization.

More telling of the EU and US parallel strategies is their behaviour with the smaller economies of the Caribbean basin. Small, more trade-dependent countries need agreements to remove uncertainty from their trade relations with larger economies. The US provided preferential access for Caribbean countries (including Guatemala and El Salvador but with the exception 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.[20] 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 America and the Caribbean region countries. CBI benefits are, however, conditional. As stated in Section 202 of the Trade Partnership Act:

> (1) 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
>
> (2) 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 Caribbean countries benefits immediately. The US established a status quo that would cause these countries to be worse off by not signing on to a FTA because not doing so could lead to losing access to the US market. Singing the FTA will lock in the trade arrangements of the CBI. The result was the enactment of the CAFTA-DR and the current negotiations with the other Caribbean countries.

The EU also practices a similar relationship with Caribbean countries that were former colonies of the member states. First initiated under the Lomé Convention, the EU has a preferential trading relationship with a group of countries referred to as the African, Caribbean, Pacific group (ACP). Lomé[21] provided a development assistance package that included free access to the European market for products

20 The Act went into effect on 1 January 1984.

21 The Lomé Convention was actually a series of five agreements: Lomé I–IV and an amended IV.

that originated in the ACP countries as well as aid and technical assistance.[22] The ACP–EU 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.

I now turn to the Brazilian perspective in the re-mapping of trade patterns and policy in the Americas. During an interview with an Argentine journalist, Brazil's Foreign Affairs Minister Celso Amorim said, 'Even though Brazil is the largest economy in South America, it needs the company of other countries, and above all, it needs MERCOSUR. To have a true multipolar system, there must be some minimal correlation of power'.[23] These two sentences were given in the context of the EU-MERCOSUR FTA and FTAA negotiations, and provide the key component of the Brazilian strategy vis-à-vis the EU and US. By developing its own trading bloc, Brazil can credibility maximize the expression of its preferences in the global trade regime. While the size of the MERCOSUR economies is small when compared to the EU or US, the strategy has been endorsed by the Inter-American Development Bank (IDB 2002). By combining the economic weight of several Latin American countries, Brazil has the ability to reduce the economic leverage of the economic heavyweights. Therefore, Brazil's calculation for forming a FTA differs: it could be worse off by signing a FTA if the trade preferences of the larger states are very distant from its own. If it can convince other states to form a bloc with aligned trade preferences, then it is not stuck in the competitive liberalization trap because it will not be left out of a market that others access. By re-mapping the conditions, the cost of not joining is low.

However, Brazil must do what the other larger actors do, namely provide incentives for regional partners to form a trading bloc. Although Brazil does not have as large a capacity as the larger actors, it has demonstrated the ability to keep the block together even in the worst of times (Genna and Hiroi 2007). This leadership continued in December 2004 when a FTA was finalized between MERCOSUR and the Andean Community bringing about the South American Community (SAC). In a practical sense, a free trade area of the Americas has already formed with the SAC given Mexico's upcoming associate status with MERCOSUR. It is one, however, where Brazil is potentially the hub economy than the US.

22 Desmond Dinan, *Ever Closer Union: An Introduction to European Integration* (Boulder: Lynne Rienner, 1999).

23 Natasha Niebieskikwiat, 'Brazil's Amorim Wants Strong MERCOSUR to Negotiate with United States', *Buenos Aires Clarin* (2003).

The previous two sections laid out the trade strategies of Brazil, the EU and the US. These strategies include the desire of the larger actors to reorganize the global trade regime under their preferences and Brazil's desire to modify that reorganization. However, the central argument rests on two key variables, with relative size being only one. The other is the degree of satisfaction actors have with the reorganization of the global trade regime. This satisfaction comes out of specific preferences associated with the EU-MERCOSUR FTA and FTAA negotiations. Each of the actors wishes to maximize market access for those sectors where they have a comparative advantage while attempting to limit competition in their respective markets.

I next turn to the preferences of the EU and MERCOSUR as 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 lack of success came about when the EU refused to open up their agricultural market, but made greater demands on MERCOSUR to open up those sectors that would consume manufactured products.

First, MERCOSUR is dependent on the EU for their trade. In 2004 Brazil was the EU's eleventh major trading partner but accounted for only 1.8 per cent of overall EU trade.[24] In 2011, Brazil was the bloc's ninth major trading partner and accounted for 2.3 per cent (Eurostat 2012). The remaining three 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.[25] This ranking still holds at 20 per cent.[26]

This story is repeated in a closer examination of the trade statistics. MERCOSUR's share of total EU trade ranged from 2.7 to 2.3 per cent during 2000–04. However, the degree of the EU's overall trade dependence on MERCOSUR is very small. The same can be said for EU exports. 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, but only 2.1 per cent of total EU exports. 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.[27]

24 Eurostat, 'EU Bilateral Trade and Trade with the World: MERCOSUR', http://trade-info.cec.eu.int/doclib/html/113488.htm, accessed 26 December 2013.

25 Ibid.

26 Eurostat 'EU Bilateral Trade and Trade with the World: MERCOSUR', http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113488.pdf, accessed 26 December 2013.

27 Eurostat, 'EU Bilateral Trade and Trade with the World: MERCOSUR', http://trade-info.cec.eu.int/doclib/html/113488.htm, accessed 26 December 2013.

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 and 20.2 per cent of total EU imports. 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.[28] 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 the two categories of primary goods.

From 1999 to 2004, the EU's per cent share of overall trade ranges from 23.2 per cent to 26.8 per cent with an average of 24.3 per cent.[29] This is reflected in both exports and imports, which averages 22.8 per cent 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 is 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.[30] 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.[31] 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 centred on the primary products and manufactured goods. Both sides wish to maximize the amount of trade in their favoured 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 ten years with the remaining 15 per cent eliminated over a period greater than ten years .[32] 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

28 Ibid.

29 Ibid.

30 Ibid.

31 Ibid.

32 BBC Monitoring International Reports, 'MERCOSUR to Present "Ambitious" Tariff Elimination Proposal to EU', IR 5 March 2003.

goods.[33] The increase by MERCOSUR to 85 per cent was not for the proposed EU offer, but 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 Doha Round.[34] In November 2003, the EU attempted to gain greater access for their products through the liberalization of MERCOSUR members' government procurement and services sector.[35] The EU offered to increase the import quotas for agricultural goods, but this was not satisfactory for MERCOSUR that still insisted on discussing agricultural subsidies.[36] 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.[37] The new negotiations at the beginning of 2004 began with deep frustration on the EU side. At the commencement of the March 2004 talks, EU trade representative Karl Falkenberg questioned the integration of the MERCOSUR members when he stated that it was 'more a vision than reality' and went on to question the degree of trust among the four members.[38] This lead to a defence of MERCOSUR's integration practices by the Argentine trade representative, Martín Redrado.[39] The talks also failed due 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.[40] In April 2004, the same requests were made again, but both sides refused to acquiesce.[41] 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 favourable reply from the EU side.[42] In an interesting escalation of negotiations, MERCOSUR negotiators walked out of the July Brussels discussions after the EU negotiators reduced the quota amounts

33 Ibid.

34 Ibid.

35 Mario Osava, 'FTAA is the Key for a MERCOSUR EU Accord' (Inter Press Service, 2003).

36 Ibid.

37 Ibid.

38 MercoPress News Agency, 'MERCOSUR "is More Vision than Reality" Claims EU' (11 March 2004), www.mercopress.com/Detalle.asp?NUM-3380, accessed 26 December 2013.

39 Ibid.

40 MercoPress News Agency, 'MERCOSUR "Surprised" by EU Uncompromising Stance' (30 March 2005), www.mercopress.com/Detalle.asp?NUM-5366, accessed 26 December 2013.

41 Todd Benson, 'EU Nears Trade Pact with Latin America', *New York Times* (21 April 2004).

42 Latin News Daily, 'Brazil: Breakthrough in MERCOSUR EU Negotiations' (14 June 2004). O Estado de São Paulo, 'MERCOSUR, European Union Unlock FTA Negotiations' (14 June 2004).

on agricultural goods by half the amount they previously promised.[43] The EU delegation returned the favour by walking out of the August Brasília negotiations over the issue of agricultural products.[44]

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.[45] 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 ten year limit.[46]

On 26 May 2005, the representatives of the EU and MERCOSUR put forth a joint communiqué reiterating their comment to finalizing a FTA in conformity with the 1995 Declaration on Political Dialogue that began the negotiation process. The publication of the communiqué signalled that the FTA would not be finalized soon. The transatlantic failure to successfully negotiate an FTA 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 short of switching to another set of providers, 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 liberalizes their agricultural sector, it would not be in the interest of MERCOSUR members to sign the FTA.

The conditions of negotiations were not different with regard to the FTAA. While the US was able to develop willing partners among the small trade dependent states of the Caribbean and its NAFTA partners, it could not develop such relations with the MERCOSUR members.

Like the EU-MERCOSUR trade relationship, MERCOSUR is more trade dependent on the US than vice versa. Total US trade with MERCOSUR has remained somewhat level during the 1997–2001 timeframe: 2.3 per cent to 1.9 per cent with an average value of 2.1 per cent (FTAA 2005). The per cent value of imports to MERCOSUR also has remained level ranging from 1.6 per cent to 1.4

43 Claudia Mancini, 'MERCOSUR Suspends Negotiations for Commercial Agreement with European Union', *Gazeta Mercantil* (22 July 2004).

44 Gisele Teixeira, 'Negotiations Between MERCOSUR and European Union are Interrupted Once Again; Impasse Continues Between EU and MERCOSUR', *Gazeta Mercantil* (13 August 2004).

45 MercoPress News Agency, 'EU Blames MERCOSUR for Stalled Trade Talks' (1 September 2004), www.mercopress.com/Detalle.asp?NUM-4191, accessed 26 December 2013.

46 Ibid.

per cent and an average value of 1.4 per cent (FTAA 2005). Furthermore, as in the EU case, US exports have declined from 3.4 per cent to 2.7 per cent.[47]

MERCOSUR's overall trade dependence on the US resembles that on the EU. Overall, the per cent share of global MERCOSUR trade ranges from 17.0 per cent to 20.7 per cent with an average of 19.3 per cent during 1997–2001.[48] US imports account for 21.0 per cent to 22.7 per cent with an average of 21.6 per cent.[49] Exports to the US account for 11.3 per cent to 19.4 per cent with an average of 16.6 per cent.[50]

A deeper look exposes the same pattern of trade between MERCOSUR and the US 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 US are in the category of manufactured goods, accounting for 17.4 per cent of total US exports. Therefore, primary goods sent to the US is 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 US, the US 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 US preferences. Only a small fraction of the official areas of the negotiations lend themselves to liberalizing commodity markets but many do talk about the liberalization of sectors that will increase trade in manufactured goods. Like the EU, the US has been and continues to be opposed to discussing agricultural subsidies at the FTAA table. 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 US, Canada, Mexico, and Central American countries favouring a comprehensive agreement while MERCOSUR members wished to remove subjects such as government procurement, services rules and intellectual property rights from discussions.[51] Given the ties that Canada, Mexico, and Central American countries already had with the US, they favoured 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

47 Free Trade Area of the Americas, 'Hemispheric Trade and Tariff Database' (2005), http://www.ftaa-alca.org/HGROUPS/NGMADB_E.asp, accessed 26 December 2013.

48 Ibid.

49 Ibid.

50 Ibid.

51 Christina Sevilla, 'Can the United States and Brazil Spur Free Trade in the Americas?', *The National Interest*, 3 (1) (January 2004).

that did not liberalize market sectors that would favour their products (i.e., 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. One version is that the members of MERCOSUR negotiate with the US directly. The other is a parallel set of negotiations that would include the US and the remaining states.[52] The proposed arrangement would permit the process to continue at two speeds and allow Brazil to focus on issues that the US 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 Brazil's preferences. This would allow no discussions of agricultural subsidy cuts and anti-dumping rules. In addition, by keeping the coalition together, it would be more likely to get the service sector liberalized and reward the Caribbean and Central American countries with extra trade preferences.[53]

The talks became more heated after the failure of the September 2003 WTO Cancún talks. Both the EU and US requested that the MERCOSUR members forgo discussing agricultural subsidies until the Doha Round resumed. Brazil along with other members of the G-20[54] held the EU and US (as well as Japan) to their words, but without a satisfactory outcome. At the resumption of the FTAA negotiations, the MERCOSUR members reintroduced the topic of agricultural subsidies, which the US refused to discuss but pointed to the need for the liberalization of services, which the MERCOSUR members stated would be better discussed at the Doha Round.[55] This response prompted US Deputy Trade Representative Peter Allgeier to state that an FTAA can be created without Brazil.[56] This was not the only time a US trade representative mentioned that Brazil could be left out. In 2002, Zoellick stated that Brazil could trade in 'another direction … Antarctica' if it did not want to trade with the US.[57] In reaction, the MERCOSUR members formalized their unity by signing the 'Buenos Aires Consensus' outlining a common position regarding agricultural subsidies.[58]

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52 Mario Osava, 'Trade Americas: Brazil and US Face Off in Decisive FTAA Talks', *Inter Press Service* (28 May 2003).

53 Ibid.

54 Brazil's international strategy included commercial ties with other developing nations other than MERCOSUR. To this end it helped form a negotiating alliance first with India and South Africa, call the BIAS Group, that later transformed into the G-20, which also includes China (Brazil Report 23 November 2004).

55 Marcela Valente, 'Argentina and Brazil Claim for US Reduction of Farm Subsidies; FTAA Puts Consensus to the Test', *Inter Press Agency* (24 October 2003).

56 Ibid.

57 Andrew Hay, 'America's Trade Target lost in Politics', *Reuters* (28 December 2004), http://www.citizenstrade.org/ctc/wp-content/uploads/2011/05/reuters_ftaapolitics_12282004.pdf, accessed 26 December 2013.

58 Marcela Valente, 'Argentina and Brazil Claim for US Reduction of Farm Subsidies'; FTAA.

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.[59] However this did not stop the MERCOSUR members from continuing their common strategy, which was further developed ahead of the February 2004 meetings.[60] Most of 2004 resulted in the same negotiations failure between MERCOSUR and the US regarding agricultural subsidies and liberalization of services. In the most recent attempt, Brazil and US representatives met in Washington, DC from 22–23 February 2005. The result was an insipid joint communiqué stating that both sides are committed to a FTAA in the future but without stating how this would occur.

Like the EU-MERCOSUR failed negotiations, the western hemispheric one occurred because MERCOSUR members understood that signing the FTAA would place them in a worse position. The US 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.

An added complication to the EU-MERCOSUR-US trade negotiating relations is the growing economy 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 consumer of oil since 2003. They continually need reliable sources of raw materials with a portion of them already arriving from Latin America. In 2003, Brazilian exports to China grew 79.8 per cent and MERCOSUR exports increased by 96.5 per cent from 2000 to 2003.[61] Overall trade with Latin America increased 50.4 per cent from 2002 to 2003.[62] China is also becoming an active business partner, accounting for 36.5 per cent of total foreign direct investment in Latin America in 2003.[63] 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.[64] If China is willing to buy

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59 Mario Osava, 'Trade Americas: Flexible New Trade Pact Welcome by Most', *Inter Press Service* (20 November 2003).

60 Invertia, 'Argentina, Brazil Agree on Common Strategy in FTAA Talks', *Latin America News Digest* (16 January 2004).

61 Mario Osava, 'Lula is Going to China, Brazil's Third Largest Market', *Inter Press Service* (18 May 2004).

62 Business Daily Update, 'Latin American Free Trade' (3 December 2004).

63 MercoPress News Agency, 'Latin America Quick to Dance to China's Tune' (11 November 2004), http://en.mercopress.com/2004/11/11/latin-america-quick-to-dance-to-china-s-tune, accessed 26 December 2013.

64 Business Daily Update, 'Latin American Free Trade' (3 December 2004).

more and more Latin American goods along favourable trade arrangements, then Brazil and its MERCOSUR partners would be able to expand the market for their products even with the EU and US failures to negotiate FTAs. In addition, pressure would be off of these countries to sign unfavourable FTAs.

The Latin American process of courting China has begun. 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.[65] 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.[66] One such agreement included 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.[67] Another was a US$ 2 billion investment in Brazilian rail so as to improve freight transportation and lower commodity prices.[68] Overall, Hu pledged a US$ 10 billion multiyear investment in Brazil during his visit.[69]

China has wider economic plans in Latin America. After his Brazilian visit, Hu stopped in Argentina where he and Argentine President Nestor Kirchner announced a US$ 19.7 billion investment package for infrastructure improvement and hydrocarbon exploration and production over the five years.[70] Also as a result of Hu's visit, Chinese sanitary authorities later certified several Argentine beef and poultry processing plants, thereby expanding trade of these products for the Chinese market.[71] In addition, Chile and China began negotiations for a FTA in November 2004[72] with its enactment in August 2006. Finally, China wishes to join

65 Mario Osava, 'Lula is Going to China, Brazil's Third Largest Market', *Inter Press Service* (18 May 2004).

66 Deutsche Presse Agentur, '2nd Round Up: Brazil Recognizes China as a Market Economy' (12 November 2004).

67 MercoPress News Agency, 'Brazil Signs Lucrative Deals with China' (13 November 2004), http://en.mercopress.com/2004/11/13/brazil-signs-lucrative-deals-with-china, accessed 26 December 2013.

68 Ibid.

69 Business Daily Update, 'Latin American Free Trade' (3 December 2004).

70 MercoPress News Agency, 'China Will Finance Argentine Infrastructure' (17 November 2004), http://en.mercopress.com/2004/11/17/china-will-finance-argentine-infra structure, accessed 26 December 2013.

71 MercoPress News Agency, 'New EU-MERCOSUR Target: Vienna May 2006' (13 July 2005), http://en.mercopress.com/2005/07/13/new-eu-mercosur-target-vienna-may-2006, accessed 26 December 2013.

72 China Daily, 'Sino-Chilean FTA Talks Launched' (26 January 2005), http://www.highbeam.com/doc/1P2-8830589.html, accessed 26 December 2013.

the Inter-American Development Bank and has garnered MERCOSUR's support, with opposition coming from the US and the Central American states.[73]

The growth of Chinese importation of Latin American primary products and investment in the region can produce possible security issues for both the EU and the US. Scholars have already recognized the future power transition between China and the US and its implication for potential conflict.[74] When China and the US achieve parity in economic and military power, and should this parity come with Chinese dissatisfaction with the US management of the global status quo, there is a good likelihood of armed conflict. This conflict will not likely see the EU on the sidelines. Should the EU and the US decide to open up the markets for agricultural goods, resources can possibly shift away from China to toward EU and US markets given their higher per capita income. In addition, it will diffuse possible military alliances that may become associated with the stronger investment and trade between China and Latin America.

Conclusions

The lack of success in the EU-MERCOSUR and MERCOSUR-US negotiations resulted from a combination of disjointed preferences and relative market size. When entering into a FTA, all potential partners prefer to sign an agreement so long as they are better off than not signing it. For a large economy the goal of signing FTAs with smaller economies does have a marginal economic advantage, but the primary goal is an evolution toward a global trade regime more favourable to its preferences. Smaller economies do look favourably 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 they can take advantage of their exports. Lacking this, they would be worse off signing the FTA. Alternative markets in rapidly growing economies also lower the incentives to sign.

The EU and the US have similar goals. The idea of establishing FTAs alongside the WTO negotiations 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 without 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.

The EU and US have developed FTAs in the western hemisphere, but with the smaller more dependent states. The Caribbean states benefited from favourable

73 MercoPress News Agency, 'Latin America After Closer Ties With Asia' (30 March 2005), http://en.mercopress.com/2005/04/11/latinamerica-after-closer-ties-with-asia, accessed 26 December 2013.

74 Brian Efird, Gaspare M. Genna and Jacek Kugler, 'From War to Integration Generalizing the Dynamic of Power', *International Interactions*, 29 (4) (2003), 292–313.

trade relations established by the EU and US through their respective unilateral policies. Therefore not signing an FTA for these countries could threaten their trade dependence with the larger actors. The Andean Community will more than likely follow suit given the amount of military and other aid given to fight their domestic drug/insurgency problems (Venezuela being the exception). The MERCOSUR members, on the other hand, do not have such incentives. They primarily sell raw goods to the EU and US 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. Although they wish to address these issues at the WTO talks, the Cancún negotiations proved otherwise. Since no incentive is present, an FTAA with MERCOSUR is not very likely during the current preferences of the US.

Adding to the calculation is the growing economy of China. They are in need of raw materials and an improved status in the WTO, 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 some problems for the north-south variety of trade. Implications also spill over into the security realm as potential alliances develop among burgeoning economic partners. The growth of China on the dissatisfaction of western hemisphere can produce unwanted consequences. To improve the degree of global trade cooperation, greater incentives are needed from the EU and US. The liberalization of the agricultural sectors is an important first step towards this. Another policy suggestion is a slow opening for services and government procurement so as to improve the integration of these sectors in the international market. This will elevate the likelihood of increasing domestic stability in the smaller, poorer countries. The final policy implication is the strengthening of the Asia-Pacific Economic Cooperation (APEC) with the added membership of the MERCOSUR countries. A FTA that spans the Pacific Rim can further not only economic growth but also security. To improve APEC members' integration, the US, as the preponderant power, will need to modify its trade preferences so as to reach a common ground with MERCOSUR.