Mercosur and Brazil: a European perspective

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I had the privilege of participating in European Union–Mercosur negotiations for many years. In this article I offer an interpretation of these negotiations. The article will look at the role of Brazil in Mercosur; explain the EU interest in Mercosur; focus more closely on the current EU–Mercosur negotiations; and, finally, examine the changes taking place in Brazil and their possible effects on Mercosur.

Brazil and the European Union

The Brazilian perspective

'Brazil is a big country and Brazilian business people have "big country" ideas. They think big and act like Portuguese-speaking Texans.'[1] This comment summarizes the core of the Brazilian business mentality. Looking inwards, it has a 'big country' sense of size and shows confidence in the future promise of the country; looking outwards, it has a 'big country' sense of confidence and ease when dealing with foreign contacts and negotiators. This description applies not only to the business community but also to the Brazilian administration, in particular to Brazil's external relations ministry, often referred to as 'Itamaraty'. Practising a mix of trade diplomacy and traditional diplomacy, negotiators from Itamaraty for the most part have a reputation for competence.[2]

Brazil is not just any Latin American country. Other Latin American countries and most international partners see Brazil as the natural leader of the region, in terms of both political stability and economic growth. But notwithstanding its leadership role, Brazil's interests do not always coincide with those of others

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[1] Gerard Seeber, 'Understanding the Brazilian market', *Doing business in Brazil, an introductory guide* (Canberra: Department of Foreign Affairs and Trade/Austrade, 2001), p. 27

[2] Some dispute this; see e.g. Riordan Roett, 'US policy towards Mercosur: from Miami to Santiago', in Riordan Roett, ed., *Mercosur: regional integration, world markets* (Boulder/London: Lynne Rienner, 1999), pp. 111–13.

in the region, and Brazil and the United States tend to clash as well as to cooperate on various issues. Government subsidies for agriculture or the steel industry are only the most recent sites of friction: the two countries have different outlooks on the Free Trade Area of the Americas (FTAA) negotiations, which they co-chair; different outlooks on Colombia, Venezuela and Argentina; and different outlooks on the recent presidential elections in Peru. Alongside Brazilian diplomacy's long-standing tenet to maintain an alliance with the United States exists a propensity to set up more autonomous policies, and the latest of these is Mercosur.

Brazil is different and it knows it. During an interview at the University of São Paulo in November 2001, I raised the question whether Brazil should join the OECD, referring to the existing Mexican membership and the 2001 OECD *Economic Survey* on Brazil. The reply given to me reflected Brazil's sense of its particularity: 'Brazil does not really have to join the OECD; it is not worth the cost of trying to pass all levels of evaluation. A country that would appreciate OECD membership would be Argentina. Argentina would like to be recognized as a "normal" country, like Mexico was. But we all know Brazil as it is. Brazil is not a small country.'

The 'big country' perspective is crucial to understanding Brazil's approach to Mercosur. From a geostrategic perspective, Brazil uses Mercosur as a political and economic alliance to confront other powers, in particular the US in the FTAA and the WTO, and the EU in the EU–Mercosur context and in the WTO. With both powers agriculture is an issue of contention. In a hemisphere that easily veers towards US hegemony, Brazil as a dissenting autonomous voice in Latin America is less effective than Brazil as leader of a regional alliance.[3] The Brazilian market, in particular that of the south/south-eastern states, is the economic core of the region. Neighbours depend on the Brazilian market, as demonstrated by the direction of export flows from Paraguay, Uruguay and Argentina towards Brazil; international investors and exporters, including those in Europe, seeking access to Brazil do so on the promise of regional coverage.

The central role of Brazil as the 'big country' and 'natural leader' of the region underpins the balance of power among the Mercosur partners.[4] The timing of Mercosur's birth was no coincidence. Created by Argentina, Brazil, Paraguay and Uruguay in 1991, just after the end of the Cold War, it came into being at a point when political relations in Latin America were beginning to change and a new development called 'globalization' was starting to affect the world. The smaller countries, Uruguay and Paraguay, incline towards a stronger degree of supranational governance, but Brazil as a 'big country' does not accept this. Mercosur's immediate aim is the creation of a common market in goods, services and capital, and the 1995–2001 transition phase saw around 95 per cent

[3] Pedro da Motta Veiga, 'Brazil in Mercosur: reciprocal influence', in Roett, ed., *Mercosur*, p. 30.

[4] On Brazil's pivotal role, see OECD, *OECD Economic surveys: Brazil* (Paris: OECD, 2001); Independent Task Force on Brazil, *Memorandum on US policy towards Brazil* (New York: Council on Foreign Affairs, 2001).

of internal trade among members being liberalized, though certain industries and sectors were excluded, subject to special regimes. At present Mercosur is stuck in a suspended transition phase, comparable to where the European Community stood during the 1960s and 1970s.[5] Mercosur should provide its members with a platform for projecting themselves into world markets and a framework within which they are better able to absorb globalization. It takes a very outward-orientated view of the integration process, as a means of participating more effectively in the international economy and in international negotiations. This drive behind Mercosur mirrors Brazil's own ambition as a 'big country' or 'natural leader', namely that of establishing a regional power base.

Relations between the EU and Mercosur

In December 1995 Mercosur and the EU members signed an 'interregional' framework cooperation agreement in Madrid, in the margins of an EU summit that marked the end of the Spanish presidency during the second half of 1995. It was a successful ending for the Spanish, not only in that they were able to host the conclusion of a milestone agreement between the EU and Mercosur, but also because the agreement consolidated four years of political work aimed at creating an integration process in South America that reflected—to some extent—the integration process in Europe from which Spain itself had started to benefit ten years earlier. Whereas foreign policy priorities in Spain were focused on Europe for political and economic reasons and on Latin America for cultural and historical reasons, the first EU–Mercosur agreement meshed these strains of Spanish policy together.

Mercosur had attracted European interest from 1991 onwards, in particular because its signatories wanted to establish regional integration on the basis of European models. EU and European Commission representatives engaged in various contacts during these initial years and technical assistance was provided by the Commission. However, the future course of Mercosur was not always transparent. Did Mercosur members want to develop the process into a free trade area, or did they want to maintain the ideal of a common market? Should members establish exclusive relationships with one another, or would they be free to engage in bilateral relations with others?[6] The successful launching of the North American Free Trade Area (NAFTA), the attraction of the US market and the 1994 pledge by President Clinton that Chile could join NAFTA posed a distraction to certain Mercosur members. However, because of its fundamentally political nature, the main partners in the Mercosur project did not leave their chosen path.

[5] Andy Klom, *Association negotiations between the Mercosur and the European Union: rivalling Western Hemisphere integration or supporting Southern Cone integration?*, published in November 2000 at http://www.cap.uni-muenchen.de/transatlantic/topics/americas.htm.

[6] Susan Kaufman Purcell, 'The new US–Brazil relationship', in Susan Kaufman Purcell and Riordan Roett, eds, *Brazil under Cardoso* (Boulder/London: Lynne Rienner, 1997), p. 95.

The wish among Mercosur members to strengthen ties with the EU led Mercosur to extend its treaties through the Ouro Preto Protocol in 1994, in order to establish a legal personality for the Mercosur organization, allowing it to act as a single entity. The first major international initiative undertaken by the new 'Mercosur' was the signing of the 1995 framework agreement. Among the governments of EU members and the political leadership of the European Commission bureaucracy many favoured the idea of negotiating a free trade agreement with Mercosur. However, because of commercial and political sensitivities related to various areas, including agriculture, there did not exist a sufficient majority to support this ambitious goal in the mid-1990s.[7] Accordingly, goals were scaled back and closer EU–Mercosur relations were put on a longer-term timescale. The 1995 agreement would consolidate the political dialogue with Mercosur, provide a treaty basis for development cooperation and technical assistance, and create building blocks for further trade and economic activities. For Mercosur, this agreement not only consolidated its contacts with the EU and the Commission, but also provided formal recognition of Mercosur as an international entity. Trade and economic interests played a crucial role. Since the beginning of the 1990s the Mercosur countries had been opening up their economies through trade liberalization and macroeconomic restructuring, including the introduction of privatization and greater participation in international trade discussions. Thus, by virtue of adopting many policies linked to the so-called 'Washington consensus', these countries became an attractive destination for trade and investment. At the time the idea of 'open regionalism' was much discussed and the notion that trade and investment and regional integration would be mutually beneficial was making headway. A psychological effect on investors induced by Mercosur was also present, and at the very least consolidated the international reputation of the Mercosur countries themselves as having adopted the right macroeconomic and trade liberalization policies. Analysis since then has shown that the creation of Mercosur was one of the first three motives of investors to come to the region, next to the growth potential of the domestic markets concerned and their macroeconomic stability.[8] The Mercosur process, as a measure of trade liberalization with a protectionist dimension (common market, common external borders), had a similar effect on international sentiment as the European Community process had during the 1960s.

EU–Mercosur trade and investment grew exponentially. EU exports to Mercosur rose from €6 billion in 1990 to €24 billion by the end of the decade. In investment a similar trend is apparent. Until 1995 EU investment in Latin America ranged around an average of €1.6 billion per year; during the second part of the 1990s this shot up to an average of €26 billion per year. Of European investment in Latin America around 75 per cent went to Mercosur and another 5 per cent to Chile, while within Mercosur the major part of this investment was

[7] Ibid., p. 96.

[8] Paolo Giodano and Javier Santiso, 'La course aux Amériques: les stratégies des investisseurs européens et le Mercosur', *Problèmes d'Amérique latine* 39, Oct.–Dec. 2000, pp. 66–70.

absorbed by Brazil[9] and Argentina. In 1997 the EU overtook the US as the main investor in Latin America, with investment rising to an exceptional €43 billion in 1999 and €38.9 billion in 2000. Significantly, approximately 50 per cent of EU investment in the region during 1992–2000 came from Spain (€71 billion of a total €143 billion). Spain became the number one European investor in Argentina, Brazil and Chile. Other EU countries also participated in this investment drive, in particular the UK, Portugal, France, Italy, the Netherlands and Germany.[10]

Another trend also affected EU–Mercosur trade and investment relations. Spain and Portugal joined the European Community in 1986. Entry into the single market forced their companies to adapt to new circumstances, offering great opportunities but posing strong competition. To ease the initial challenges, various types of Community support were given to Spanish and Portuguese companies: structural funds, regional aid and subsidies for small and medium-sized enterprises alleviated the process of adaptation. These developments gave companies a stimulus to venture abroad, not only towards the European single market, but also beyond, in seeking business in the rest of the world. In view of cultural and historical ties with Latin America, great opportunities were thought to await European companies in Mercosur.

The consolidation of EU–Mercosur political ties by means of the 1995 framework agreement therefore reflected growing trade and investment relations between the two blocs. In order to consolidate the EU's position in the growing Mercosur market and safeguard it against outside competion, further action was considered necessary. The fledging common market of Mercosur was the focus of European interest.

The purpose of Mercosur

Mercosur was built upon decades of dictatorship, which in Paraguay ended only in 1989, complicated by longstanding rivalry between Argentina and Brazil, both even competing to build a nuclear device. The Mercosur process, with all its focus on trade, is profoundly political. In Mercosur the largest member covers around 75 per cent of total assets (trade, GDP, population). In comparison, the largest EU member, Germany, does not constitute more than 33 per cent of total assets, depending on which criterion is taken. The proportional difference in size of Brazil creates a different balance within Mercosur. In the EU economic differences are alleviated by financial transfers to less-developed members and by the creation of opportunities to generate growth and prosperity in the wide European single market. In Mercosur the common market is mainly based on Brazil, reaffirming other members' economic dependency. Mercosur does not make any financial transfers, stimulating members to develop and diversify.

9 Octavio de Barros and Javier Santiso, 'Terminal do Brasil? Le Brésil comme destination privilégiée de l'investissement direct étranger', *Problèmes d'Amérique latine* 45, Summer 2002, pp. 31–52.

10 Economic Commission for Latin America and the Caribbean, *Foreign investment in Latin America and the Caribbean 1999* (Santiago de Chile: ECLAC, 2000), ch. 3, 'Spain: foreign investment and corporate strategies in Latin America and the Caribbean'.

While Brazil's predominance makes it the member most opposed to any supranational development in Mercosur, Brazilian domestic policies are the real drivers behind the pace of Mercosur progress. As Pedro da Motta Veiga clearly explains,[11] two factors shape Brazil's position on Mercosur: first, a predominance of interests by import-competing sectors over export-oriented sectors; and second, a hegemony of the strategic vision of building regional power and autonomous development. Both factors can be attributed to Brazil's past visions on national development, which even today may still be playing a significant role in determining Brazilian positions in Mercosur and other fora.

Although Brazilian foreign policy was geared towards the US for most of the twentieth century, and only on occasion towards Europe, the Mercosur project has in effect pushed Brazil in the opposite direction; US difficulties with Mercosur[12] and Mercosur's strong relations with the EU have been crucial factors in inclining Brazil's foreign policy towards the EU. From a domestic policy perspective, as described by da Motta Veiga, Mercosur's integrationist tendencies form a risk for Brazil; however, from a geostrategic perspective the preferential relationship with the EU fulfils Brazilian objectives in building alliances that support its international ambitions.[13] The European preference of Mercosur would become a liability for Brazil should it become successful in the short term and expose an uncompetitive business sector to strong European competition. Hence, echoing its approach to Mercosur's very gradual pace of integration, Brazil prefers not to advance too quickly towards free trade with the EU, notwithstanding the positive effects expected for its agricultural sector. Concluding an agreement would also neutralize the positive effects that EU–Mercosur negotiations have on Brazil's negotiating position in the FTAA. Thus, a European-leaning Mercosur serves as a positive instrument in Brazil's external relations and national development strategy, as does the process of EU–Mercosur negotiations. The advantages of these two instruments would be lost should progress towards closer Mercosur integration or EU–Mercosur free trade occur too quickly.

On the European side, a complementary geopolitical approach is pursued by some EU members, balancing substantial agricultural interests with important industrial and service sector interests. Engaging in closer diplomatic ties with Latin America and Brazil projects and enhances their international position; on the other hand, as for Brazil, a conclusion of EU–Mercosur negotiations would have considerable negative short-term effects for interest groups important to domestic politics. Therefore, like Brazil, these EU members try to avoid concluding negotiations and instead to draw out the positive effects of the negotiating process. The tendency in Mercosur to 'play the European card' in order to resist US influence therefore finds a ready response in some EU states that are willing

[11] Da Motta Veiga, 'Brazil in Mercosur: a progress report', p. 26–7.

[12] Roett, 'US policy towards Mercosur', pp. 115–17; and Sidney Weintraub, *Development and democracy in the Southern Cone: imperatives for US policy in South America* (Washington DC: CSIS Press, 2000) pp. 50–71.

[13] Richard E. Feinberg, *Summitry in the Americas* (Washington: Institute for International Economics, 1997), pp. 195–6; 'Another blow to Mercosur', *The Economist*, 31 March 2001, pp. 55–6.

to play along, following the Brazilian lead. While the surge in EU–Mercosur trade and investment during the 1990s and the parallel diplomatic process of greater EU–Mercosur cooperation focused the relationship on the possibility of alliance some time in the future, certain players on both sides have an interest in prolonging the current intermediate situation, while different emphases within the mix of economic and political interests involved produce different interpretations of what 'some time in the future' might mean.

Negotiations between the EU and Mercosur

The pre-negotiation phase

Implementing the 1995 EU–Mercosur agreement involved preparing its successor agreement. It contained a political mandate for negotiating such an agreement. Its article 2 reads: 'The objectives of this Agreement shall be to strengthen existing relations between the Parties and to prepare the conditions enabling an interregional association to be created.' This links up with article 4 in the trade chapter, which states: 'The Parties shall undertake to forge closer relations with the aim of encouraging the increase and diversification of trade, preparing for subsequent gradual and reciprocal liberalization of trade and promoting conditions which are conducive to the establishment of the Interregional Association, taking into account, in conformity with WTO rules, the sensitivity of certain goods.' For the EU this mandate implied that if and when conditions were right, it would start negotiations on a comprehensive agreement, including free trade provisions. Those political and commercial interests in Europe that favoured stronger relations, particularly in industry, service provision and multinationals, all experiencing booming trade and investment relations with Mercosur, lobbied strongly for negotiations to start as soon as possible. EU politicians took enthusiasm for Mercosur to new heights, making bold promises and strengthening Mercosur's expectations that free trade would follow soon.[14] However, those interest groups in Europe that were against a deepening of relations considered that the 1995 agreement would be an end-point for the time being. These (mainly agricultural) interests called for a detailed application of the 1995 agreement before any new steps were considered.

A process followed that resembled the four years of FTAA pre-negotiations between the 1994 Miami summit and the 1998 Santiago summit. In the short period between November 1996 and May 1998 the EU and Mercosur passed through the same pre-negotiation phase, preparing an analysis of their mutual trade relations and regulations. This analysis, referred to as the 'photography', aimed at providing a clear picture to the political authorities of the state of biregional trade relations. Both the European Commission and the Mercosur

[14] The boldest statement came from French president Jacques Chirac, visiting Buenos Aires in 1997, speaking to the Argentinian Congress: 'In time, one should arrive at a complete liberalization of our exchanges' (author's translation). See the website of the French Presidency for President Chirac's speech on 18 March 1997 at: www.elysee.fr/rech/rech_.htm.

governments launched a series of studies to collect data and prepare the 'photography' document. Early in 1998 discussions began on a first draft, both sides exchanging and analysing each other's information. Areas covered included trade in goods and services, as well as investment, procurement issues, technical standards, agriculture, competition policy, intellectual property rights, veterinary and phytosanitary rules, and general trade policy. For the EU the state of Mercosur integration was crucial, as the EU aimed at strengthening its relations with Mercosur as a common market, not as four individual countries. Intensive negotiations in Buenos Aires in early 1998 laid the basis for a joint text. The photography was finalized in Brussels in April and submitted to the revelant authorities in May 1998.

The European Commission then turned its attention to internal EU processes. On the basis of the photography report, following further economic analysis, the Commission prepared an impact study. This, together with the photography report and its many specialized studies, comprised a package of analysis running to thousands of pages. Using this material, the Commission then prepared a draft text for negotiating directives, which started to circulate for consultations by early summer 1998.[15] This draft text needed Commission approval before it could be submitted to the EU Council of Ministers. It was felt that a decision on negotiating authority for the Commission was needed by early 1999. The 1999 time slot was very important, because the 1998 FTAA Santiago summit had launched formal negotiations, the March 1999 Berlin EU summit would be deciding on reform of the Common Agricultural Policy (CAP), and a first ever EU–Latin America summit would take place during June 1999 in Rio de Janeiro which could provide a launching pad for EU–Mercosur negotiations, possibly including free trade issues. Also in the background lay the preparations for a new WTO round, planned to start in November 1999 in Seattle. This density of activity looming within a short period of time led to some decision-making under pressure during July 1998. The Commission approved the negotiating directives and the impact study only after heated debate, a majority favouring giving the go-ahead for EU–Mercosur association negotiations. The decision reflected European interest groups' support for strengthening EU–Mercosur ties, but strong objections were expressed by certain groups and governments, balancing industrial and agricultural interests. In September 1998 the EU Council of Ministers started debate on the Commission proposal; now EU members had to decide if and when negotiations with Mercosur could start. The various events of 1999 limited their discretion to postpone discussions.

Mercosur governments were not party to the internal Commission and EU discussions, but nevertheless followed the EU process closely. Some did not

[15] The term 'negotating directives' in EU terminology stands for what in the US one would call 'fast track authority' or 'trade promotion authority'. The policy and political process of preparing and approving these kinds of negotiating mandates in Brussels can be as delicate as they are in Washington DC. The EU Council of Ministers decides on negotiating directives, based on the proposal of the European Commission. Once adopted the European Commission, as negotiator for the EU, uses these negotiating directives as its mandate for negotiations.

understand why they were not part of these discussions, reflecting in part an impatience about agricultural reform and in part a lack of knowledge about EU procedures. Pressure was exerted by Mercosur politicians dependent on agricultural lobbies. Most of their rhetoric was directed towards Mercosur constituencies, where negative publicity against EU interests had a numbing effect, convincing them that no real progress would be made any time soon and that therefore attention should be shifted to the FTAA. Mercosur industry, which was not competitive and not able to confront strong European competition resulting from free trade, was sidetracked by the rhetoric,[16] an error that would come back to haunt it in 2001. Brazil, as host of the first EU–Latin American summit in 1999, made clear that the summit could be a success only if EU–Mercosur free trade negotiations were launched. The urgency behind this message did not take account of the lack of preparation for negotiations with Europe on the part of Mercosur governments and economies.

The 1999 summit

Usually, EU association agreements are used for preparing neighbouring countries for future EU membership. The instrument was initially extended to the Mediterranean, then during the late 1990s also to South Africa and Mexico. Mercosur and Chile were the next in line. The EU Council was initially reluctant, as interest groups fed in resentment against the Commission's decision to propose negotiations. By early 1999 realism set in, as EU members came to see that they had to deal simultaneously with an EU–Latin American summit, a new WTO round, an EU summit aimed at CAP reform, and a decision on EU–Mercosur negotiations related to all three previous issues. Rejecting the Commission's proposals would damage relations with Mercosur; neutering the Commission's proposals and rendering the free trade elements ineffective would also damage relations with Mercosur; adopting the proposals outright would create unacceptable costs for certain members. Some preferred multilateral trade negotiations to regional negotiations with Mercosur. WTO negotiations could allow for greater gains and compensations to be obtained. Others preferred not to have any free trade discussions, under pressure from domestic constituencies, though they grudgingly accepted WTO negotiations as inevitable. Some wanted to postpone negotiations with Mercosur until WTO negotiations had been concluded.

Then discussions took an unexpected turn. First, in March 1999 the EU summit in Berlin failed to bring about bold reforms of the CAP. The main force blocking radical reform proved to be France, which outflanked the German presidency. Bold CAP reform could have facilitated EU–Mercosur negotiations, but now parties would have to negotiate on the basis of gradual reform. Second, the Santer European Commission resigned as a whole over corruption

[16] On Brazilian industry's difficulties, see 'US push for free trade deal faces hurdles', *Financial Times*, 16 Feb. 2001; Marcos Cintra, 'Brazil's options for commercial integration: FTAA, EU, WTO, 4+1, … ', in *Brazil and the FTAA* (Brasilia: Chamber of Deputies/IPRI/FUNAG, 2002), pp. 91–5.

charges. The terms of their resignation allowed the commissioners to stay on until the summer, new commissioners coming into office in September 1999. Thus new commissioners would be dealing with Mercosur and the WTO.

The EU Council edged closer to compromise, steered by the German presidency. The diplomatic activity surrounding the EU–Latin America summit created a pressure-cooker for decision-making. High-level meetings led to a Spanish–French compromise, brokered among EU foreign ministers in Luxembourg, one week before the Rio summit. Negotiations could go ahead with Mercosur, aiming at a comprehensive and final agreement, including political dialogue, cooperation and trade. Trade negotiations would aim at a progressive and reciprocal liberalization of all trade in goods and services and aim at free trade, without using the term 'free trade area'. This formulation allowed those opposed to a free trade area to argue to their constituencies that EU–Mercosur negotiations were aimed at something different. Others interpreted this compromise as meaning a free trade agreement under article XXIV of the GATT Agreement. (If a free trade agreement is to be accepted under WTO rules and ruled legal by WTO members, it has to meet the criteria of article XXIV.)

Two important restrictions were included. First, the EU could start negotiations only on non-tariff matters; tariff reductions and services would have to wait until July 2001, though the Commission could engage in consultations on the WTO round, agriculture, services, tariffs and so-called 'new subjects'. Second, negotiations could be concluded only taking into account the results of a new WTO round, thus requiring Mercosur negotiations to wait until the end of the WTO round.

The EU–Latin America summit in Rio de Janeiro proved to be a success. On the eve of the summit a meeting of EU and Mercosur/Chile heads of state took place. The joint communiqué afterwards indicated that both sides 'agreed that the expansion of trade, through the development of free trade between Mercosur and Chile and the European Union, constitutes a central element in the construction of a more dynamic relationship'. The parties went on to state that, 'with this purpose, they agreed to launch negotiations between Mercosur and Chile and the EU aiming at bilateral, gradual and reciprocal trade liberalization, without excluding any sector and in accordance with WTO rules.'

The Prodi European Commission, which took office in September 1999, had to focus initially on reform and modernization. The appointment of a new trade commissioner raised some doubts about the Commission's intentions with regard to the EU–Mercosur negotiations,[17] but attention was soon distracted by

[17] During the European Parliament hearing in September 1999 Pascal Lamy was asked when EU–Mercosur negotiations would start. He replied: 'I understand that the outgoing Commission has asked Council for a negotiating mandate for a free trade area with Mercosur and in parallel with Chile. It this question were on the agenda of a summit that took place this year, then I understand that today one cannot interpret the conclusions of this summit as being a green light for the negotiation of a free trade area. What I read into it is rather a progressive spread-out liberalization. We are going to follow the rhythm desired by the Council, that is to day a rhythm a little bit slower than needed to create a free trade area' (author's translation).

the frenzy preceding the WTO meeting in Seattle. An EU–Mercosur ministerial meeting was held in November 1999 in Brussels to adopt a structure, methodology and calendar for EU–Mercosur negotiations. However, Mercosur appeared unhappy with the EU negotiating mandate delaying negotiations on goods and agriculture until after July 2001. This meant that the first two years of negotiations would have to focus on non-tariff issues and prepare for further negotiations after July 2001. Agro-industrial interest groups in Mercosur raged against this delay, but Mercosur governments came to terms with it. Brazil, inclined in any case to prefer a long-drawn-out negotiating process, did not mind the delay, though other more agriculture-dependent members of Mercosur did.

The unforeseen turn of events in Seattle was significant for EU–Mercosur negotiations, throwing the EU timetable for negotiations into disarray. The EU position of taking WTO results into account in an EU–Mercosur agreement, concluding the agreement only after the WTO round, and postponing tariff and services negotiations until July 2001, became unbalanced. The Mercosur position of accepting the EU's timetable by necessity, but in the meantime hoping for WTO progress on agriculture, was also undermined. Under pressure from a growing economic crisis in Argentina and Uruguay, Mercosur negotiators wanted to get more short-term results. Brazil, however, preferred full parallelism between negotiations with Europe and in the FTAA.

The negotiations

The opening round of negotiations was held in Buenos Aires under great public attention in April 2000. The negotiators' agreement on trade objectives relieved many who harboured doubts about EU intentions. Nevertheless, this first meeting revealed a difference in outlook between Argentinian negotiators for Mercosur, aiming at a general framework in the short term, the details of which would be filled in later, and the EU, settling in for a long haul and preparing to make the first phase until July 2001 as useful as possible. Driven by growing trade tensions within Mercosur and unable to halt the gradual decline of the Argentinian economy, the Argentinian presidency went for a high-profile approach aimed at storming Brussels' bastions. The second round of negotiations during June 2000 in Brussels brought these differences to the attention of negotiators on both sides and months afterwards Mercosur negotiators were still making negative public statements about the so-called EU unwillingness to negotiate.

An important difference in negotiating culture existed between the Mercosur and EU teams. The major part of the EU's team consisted of highly specialized technical experts, covering details of specific sectors, used to intra-EU and multilateral negotiations. The Mercosur team, on the other hand, mostly consisted of high-level officials and politicians, often dealing with both Mercosur and FTAA negotiations, few of them really acquainted with the details of negotiations. The usual method used by Mercosur negotiators to reach agreements was a top-down one, consisting of formal consensus on objectives at the highest level within a kind of 'framework' agreement, leaving it to technical experts to flesh out troublesome details later on. For the EU the approach was the other way around, building agreements bottom-up on the basis of informal consensus on objectives. These tensions made it clear to Brazil that, during its presidency of Mercosur in 2000, it would have to take the lead and put negotiations on the right track to avoid a breakdown of the process even before it had started.

The Brazilian economy had picked up well again after the 1999 devaluation of the Real, and was showing positive growth during 2000. That year also saw a continuation of the high rates of EU investment in Mercosur. Growing trade tensions appeared containable, and Brazil embarked on the third round during November 2000 in Brasilia with the aim of creating a positive negotiating process. Technical expert negotiators were fielded by Mercosur and engaged in lengthy discussions with their European counterparts. The main result was not practical, but psychological.[18] In creating a positive and constructive atmosphere, the negotiations took a real step forwards. Momentum was maintained during the fourth round in March 2001 in Brussels, and progress was made in the presentation of negotiating texts for different horizontal issues such as competition policy, intellectual property rights, public procurement and dispute settlement.

By this time, however, Mercosur was already suffering under internal tensions, in particular following the appointment of Domingo Cavallo as Argentinian economics minister. Ideas of transforming Mercosur into a free trade area as suggested by Cavallo,[19] allowing Argentina to negotiate bilateral trade agreements with external partners, put a great deal of pressure on the internal dynamics of Mercosur. Brazil wanted to continue Mercosur for political reasons and maintain its strategy of full parallelism between the EU and FTAA negotiations.[20] Therefore, it could not accede to Argentinian demands for short-term trade agreements that would provide breathing space for the Argentinian economy. Economic instability in Argentina raised doubts about Mercosur's future. The establishment of the Mercosur common market was halted and certain temporary measures were introduced, allowing members various exceptions. At the same time, the April 2001 FTAA summit in Quebec resulted in a slowdown of FTAA negotiations. Although a joint document was presented at the summit, the main conclusions prolonged the lead time for FTAA negotiators to present their real offers until at least May 2002. These developments formed a difficult combination of factors for Brazil.

[18] The psychology of any negotiation is an essential element of the process. As an Itamaraty official responsible for the FTAA negotiations once commented to me during a private interview: 'Negotiations consist of 80 per cent psychology, 15 per cent substance and 5 per cent good luck.'

[19] 'Aumenta la tensión en el Mercosur. Brasil rechaza el área de libre comercio que propone Cavallo', *El Cronista*, 2 April 2001.

[20] During a speech to the German–Brazilian Chamber of Commerce in São Paulo on 8 June 2001, external relations minister Celso Lafer stated: 'The negotiations between the Mercosur and the EU will happen, if not simultaneously, then at least in parallel with the corresponding negotiations in the FTAA … we have not hidden our wish that our two main trade negotiations go forward with similar rhythms' (author's translation).

Intense diplomatic activity before the fifth round of EU–Mercosur negotiations, scheduled for July 2001 in Montevideo, revealed that EU negotiators wanted to accelerate negotiations, in conformity with their negotiating mandate, and exchange offers on tariffs and services. Mercosur was not able (Argentina) or willing (Brazil) to reciprocate in presenting a counter-offer, preferring to delay progress by discussing methodology. The future Uruguayan presidency of Mercosur recognized the need to safeguard Mercosur's reputation as a reliable negotiating partner; it was, after all, one of the reasons for Mercosur's existence that it should function as a means to obtain better results in international negotiations. Uruguay had to bridge the gap between an Argentina on the verge of collapse, advocating bilateral free trade deals, and a Brazil bent on maintaining parallelism between EU and FTAA processes. Confronted with pressure from the EU to accelerate negotiations, Mercosur appeared threatened in its very existence.[21]

The outcome of the Montevideo round was positive. The EU was persuaded to make a unilateral presentation of its negotiating offer, based on a Mercosur commitment to present a counter-offer by the end of October. Six years after the signing of the framework agreement in Madrid, the EU presented a historic negotiating offer to Mercosur in Montevideo, covering 90 per cent of agricultural trade and 100 per cent of industrial trade, in line with WTO rules as regards free trade areas. Only 10 per cent of agricultural trade was left aside for further discussions, representing an annual value of around €900 million. This unilateral gesture by the EU provided a boost to Mercosur's standing at a difficult time in its existence, reaffirming once again the EU's support for the organization.

The failure of Seattle led to a heavy investment in time and effort to create the right setting for developing countries to support the launch of a new WTO round. The WTO meeting scheduled for Doha in November 2001 became the main focus of these efforts, and Brazil was considered one of the leading countries whose support for a new round was essential. Notwithstanding Brazilian resistance to accelerating EU–Mercosur negotiations, the EU negotiating offer did have a positive effect for Brazil. It showed that the EU was willing to negotiate all tariff issues, including agriculture, a key area in future WTO negotiations. It showed, too, that the EU supported Mercosur, a central plank of Brazil's geopolitical ambitions, even at a time when it was in bad shape. The negative side of the EU gesture, from the Brazilian viewpoint, was that it threatened to accelerate EU–Mercosur negotiations; this caught Brazilian industry off guard, as it never expected the EU would be willing to negotiate agriculture.[22] Brazilian industrial lobbies always thought that the FTAA process would go faster, with an EU–Mercosur deal following later.

By the sixth round of negotiations, in Brussels during October 2001, Mercosur was able to present a limited counter-offer. Covering around a third of EU–

[21] 'Some realism for Mercosur: better a genuine free-trade area than a phoney customs union', *The Economist*, 31 March 2001, pp. 13–14.
[22] 'Mercosur pedirá prazo para se abrir à Europa', *Folha de São Paulo*, 16 Sept. 2001.

Mercosur trade,[23] it fell short of WTO standards; however, considering the difficult circumstances in Mercosur itself at the time,[24] the commitment was significant in symbolic terms. In November a new WTO round was launched, based on the Doha Development Agenda, with Brazil's positive input during the meeting noted. Until the final days of the year, negotiations during 2001 seemed to have been successful; then the Argentinian economic and political system imploded.

During 2002 the situation in Mercosur and in the world economy deteriorated to such an extent that both Mercosur and the EU had to scale back ambitions for the short term. European investments in Argentina, which had been the backbone of growing EU–Mercosur relations, suffered severely, while the Brazilian economy tried to isolate itself from the effects of declining intra-Mercosur trade. Already facing a difficult election year, Brazil maintained a firm hand on its rudder, but could not provide financial sustenance to neighbouring Argentina and Uruguay. Brazil had to confront international investor uncertainties, and with the help of the IMF was able to stave off financial crisis in August 2002. The Argentinian economy went through a deep trough, creating social unrest and human suffering in a country previously considered prosperous. The shock effects of the crisis also reached Uruguay. Only US financial assistance in August, followed by support from international financial institutions, could prop up the Uruguayan economy against an Argentina-style crash. However, Argentina's ideas in 2001 for a looser basis for Mercosur as a free trade area, giving its members the flexibility to negotiate bilaterally with others, gained some popularity in Uruguay. EU–Chilean association negotiations ending in May 2002 and US–Chilean free trade negotiations ending in December 2002 presented attractive bilateral escape routes from Mercosur.

In this crisis there was little scope for making progress in negotiations. A seventh round took place in Buenos Aires during April 2002, but was of a limited technical nature. The second EU–Latin America summit, held during May 2002 in Madrid, also included an EU–Mercosur summit meeting, where the political, institutional and development cooperation chapters of the future agreement were announced to be as good as finished and the political intention to continue trade negotiations was reconfirmed. To give negotiations renewed direction a high-level meeting was organized in Rio de Janeiro during July 2002. The two sides were able to agree on a work programme reaching up to the end of 2003, in order to ensure a continuation of negotiations. An eighth, technical, round took place in Brasilia during November 2002, providing agreement on methodological issues. A ninth and a tenth round were planned for March and May 2003. Most of the process now hinges on a commitment made under the current work programme to present fully WTO-coherent negotiating offers by the end of February 2003. The main problem then becomes that the parties will

[23] 'Contrapropuesta del Mercosur a la UE. Piden liberalizar un tercio del comercio de aqui a diez años', *La Nación*, 30 Oct. 2002; 'Maior aproximação com a UE', *Gazeta Mercantil*, 30 Oct. 2002.

[24] 'El Mercosur muestra sus dos caras. En los ambitos externos, sigue negociando en bloque; por dentro, las diferencias lo ponen en peligro', *La Nación*, 30 Oct. 2002.

have to disclose where they stand on all sectors in the negotiations, requiring Mercosur and Brazil to make clear how far they are willing to go in opening up industrial markets.

The delays in EU–Mercosur negotiations have had positive geostrategic consequences for Brazil. Whereas negotiations threatened to accelerate during July 2001, catching Brazilian industry off guard, delays during 2002 have reinstated the parallelism between EU and FTAA processes, supported by slow progress in the FTAA during 2001–2. With delays experienced in both processes, the Brazilian aim of conducting two parallel negotiations has been met. Although progress has been limited to date, the negotiations have served an important purpose in Brazil's foreign policy.

Change in Brazil, change in Mercosur

Systemic change

Does the election of Lula da Silva as president of Brazil in 2002 represent a systemic change in Brazilian politics? And, after eight years with Cardoso as leader of Mercosur's dominant state, does it also represent a systemic change in Mercosur?

Lula has come a long way. Both he and his party have changed, moving to the social-democratic centre of the political spectrum. Lula's victory has created expectations for more justice and equity. To fulfil these he will need a well-running economy in a stable international context. When Cardoso was elected president in 1994 he rode high on a wave of sentiment created by the 'Real Plan'. Initially, many hoped that, as a social democrat, he would carry out bold reforms to address Brazil's social injustices. But both the reality of the economy, which was in need of reform, and the constraints of federal politics, in which Cardoso depended on other parties to form a coalition, forced him to pursue a path of gradual reform. Whether Lula proves to be a revolutionary or a reformer will depend on the same constellation of domestic and external restraints.

For the sake of his domestic agenda, Lula will probably strive for a stable external environment. In Brazil's foreign policy no immediate marked change is to be expected, for two reasons. First, Brazilian foreign policy has traditionally balanced its outlook between a 'nationalist' position and an 'internationalist' stance, with the latter prevailing under Cardoso. A shift along the spectrum to more 'nationalist' policies is not alien to the established pattern of Brazilian policy.[25] Secondly, Itamaraty forms an elite corps within the Brazilian federal administration. Ministers very often come from within its ranks, as exemplified by the appointment of Celso Amorim as Lula's new external relations minister.[26]

[25] Other recent 'nationalist' periods in Brazilian foreign policy are well described in: Amado Luiz Cerro and Clodoaldo Bueno, *História da política exterior do Brasil*, 2nd edn (Brasilia: Editora UnB, 2002) pp. 309–50 and pp. 397–426.

[26] Amorim served with Itamaraty for over 35 years and held ambassadorial positions in the UN and WTO, also serving as external relations minister during 1993–4.

Under a Lula government a shift in foreign policy emphasis could occur; however, the broad tradition of Brazilian foreign policy and the stabilizing 'Itamaraty factor' will ensure that Brazil does not stray far from its established path.

In the economy Lula intends to relaunch growth through the Brazilian domestic market, by investing in manufacturing and strengthening exports. He supports a stronger role for the state in regulation and planning, but needs to maintain budgetary and fiscal discipline, keep inflation under control and respect Brazil's international commitments. In the social field he aims at creating 10 million jobs and quadrupling the minimum wage within four years, fighting hunger and poverty, and improving education, health services and pensions. In this context, Mercosur is mentioned as the top foreign policy priority, in order to create an area of convergence in industry and agriculture, to create a common infrastructure, to integrate science and technology policies, and to create a regional development bank. In the field of foreign policy and trade relations Brazil would try to use a strengthened Mercosur to enhance its position in relation to the rest of the Americas, Europe and the world. As such, these initiatives do not imply any systemic change in Mercosur or in Brazilian foreign policy; however, divergences between official policy and practical implementation may occur. If Lula wants to make a difference in Brazil's social conditions, he will have to engage in negotiations that encourage economic growth. At all times he needs to maintain international confidence in his financial and economic policies, which will force him to maintain stability on the foreign policy front.

Outlook

Intra-Mercosur trade has fallen since 1998, with Brazilian exports to other Mercosur countries plummeting to all-time lows during 2001/2. In 2001 of total Brazilian exports, to the rest of Mercosur dropped to 10.93 per cent, down from 14.04 per cent in 2000 and 17.3 per cent in 1998. During 2002 they fell further to 5.76 per cent. By mid-2002 Brazil was exporting only 3.6 per cent to Argentina, down from 8.59 per cent in 2001 and 11.31 per cent in 2000.[27] At the same time, Brazil diversified the distribution of its exports across Asia, Africa, Latin America and the Middle East and improved its access to key markets, notably the US. This trend was facilitated by the Real devaluation from January 1999, continuing during 2002. Tensions within Mercosur increased when Cavallo, after taking office as Argentinian economics minister in 2001, started talking about a different kind of Mercosur,[28] based only on free trade and allowing members to negotiate free trade agreements with others. Cavallo hoped that the US and EU would be interested in this proposal; however, Argentina was not a US priority during US–Chile FTAA negotiations, while the EU took a principled position, favouring a common-market-based Mercosur. Diversification alleviated

[27] *Gazeta Mercantil*, 30 May 2002; *Estado de São Paulo*, 10 June, 11 June, 12 June 2002.
[28] Domingo Cavallo, *Pasión por crear* (Buenos Aires: Planeta, 2001), pp. 262–6.

the effects of Mercosur's declining fortunes for Brazil and ensured continued growth, but Brazil has nevertheless maintained strong political support for Mercosur, though economically it was not able to pull it forward.

At present Argentina is stuck in a most serious crisis, and great uncertainty exists about the presidential elections of April 2003. Candidates with different views on Mercosur are competing, rendering Mercosur's future unclear. For Mercosur it is crucial that Argentina overcomes the present crisis if it is to continue as a coherent common market. In December 2002 Lula, as Brazil's president-elect, made his first international visit to Argentina, reflecting Brazilian recognition of the severity of Mercosur's crisis and the crucial role played by Argentina. Lula made clear that he wanted to consolidate Mercosur on the basis of changes inspired by EU integration,[29] and develop Mercosur into a 'Community'-like model. In Paraguay a serious political crisis is unfolding and the country finds itself is in a delicate political situation. In Uruguay a grave economic crisis is taking place, tempting President Batlle to seek bilateral deals with Mexico and the US, thus breaking the common Mercosur front.

Against this background there are three scenarios that could develop. In a first scenario, a new Argentinian government could try to transform Mercosur into a free trade area along the lines suggested by Cavallo. This idea might find some sympathy in Uruguay. As an approach it would be suicidal for Argentinian trade, cutting it off from the Brazilian market and jeopardizing EU–Mercosur negotiations. Though apparently offering hope in the short term for suffering Argentinian sectors, this outcome would run against Brazilian geostrategic objectives. In a second scenario, Lula's government could pursue deeper Mercosur integration. This would be the best scenario for completing Mercosur's common market, as it would lead to an implementation of necessary integration measures. The price to pay would be a transfer of Brazilian economic sovereignty to Mercosur institutions, as a deepening of integration could be achieved only through strengthened regional governance.[30] This possibility would provide the best conditions for the conclusion of an EU–Mercosur agreement.

The prize of an agreement—greater access to EU agricultural markets, valued by Argentina, Uruguay and the strong Brazilian agro-business lobby[31]—would carry the price of providing greater access to Mercosur industrial and service sectors for European competitors, thus creating pressure on Brazilian companies. Though transition costs would have to be borne in all cases, in this case Brazilian industry would have to shoulder the burden in order to save Mercosur and stimulate the agriculture-based economies of Argentina and Uruguay. Through an alliance with the EU, Brazil would ensure that Mercosur as a common market was maintained, the Argentinian economy was refloated and Brazilian geopolitical

[29] 'Lula quer União Européia como modelo para Mercosur', *Folha de São Paulo*, 3 Dec. 2002.

[30] Da Motta Veiga, 'Brazil in Mercosur', pp. 25, 30.

[31] The Lula government includes Luiz Fernando Furlan as minister for development, industry and foreign trade (he is also president of the agro-industrial company SADIA and vice-president of the influential São Paulo Federation of Industry, FIESP), and Roberto Rodriguez as minister of agriculture (he is also president of the Brazilian Association of Agrobusiness).

objectives were realized. To a certain extent elements of this approach seem to have been adopted by Lula when he visited Buenos Aires, though details still have to be specified. A third scenario combines elements of the first two: a muddling through, with Mercosur steering a path between deeper integration, economic crisis and looser ties. This is what will probably happen if strong political leadership is not provided.

The European Commission has often been sensitive to using trade agreements for geostrategic motives, as external trade policy, together with development aid, form the two main areas in foreign policy where the European Commission has a strong competence. But the same can at present also be said of US strategy, where bilateral FTA negotiations are applied to reward loyal allies in the war against terrorism (Australia, Morocco, Singapore, Jordan)[32] or are used to further specific relationships (Chile, Central America). This is not too different from Brazilian policy, which uses trade agreements, for example with the Andean Community, as a means to realize geopolitical objectives in the absence of other 'hard power' options. Thus pursuing trade liberalization often underpins a broader geostrategic objective. It is certain that agriculture will be the *noyau dur*, or hard core, of final negotiations between the EU and Mercosur; but agriculture will also be the main issue of contention, the hardest nut to crack between the two. Mercosur, by exclusively focusing its attention on agriculture, risks overlooking the challenges in the industrial and services sectors for which its businesses might not yet be fully prepared. Brazilian industrial interests lobbied their government to hold back concessions following the Montevideo round, where the EU caught them off guard. However, Mercosur's singular focus on agriculture may also be intentional, as a means to deflect attention from Brazil's industrial sensitivities and prolong a negotiating process which serves Brazil's geostrategic interests so well. Unwilling or unable to progress at present, eventually, for the sake of reviving the Mercosur economies and resuscitating this political alliance, Brazil might be obliged to go ahead and strike a deal with the EU, at a cost to its own industry and to the advantage of Mercosur agriculture, in order to preserve the one instrument that has become the overall priority of Brazilian foreign policy during the past twelve years—Mercosur itself.

32 *The National Security Strategy of the United States of America*, 17 Sept. 2002, pp. 18–19.