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The EU and the US Competing for Mercosur

Trade Strategies and Political Goals

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Abstract

This dissertation explores the sources of power that the EU and US use in their relations with Mercosur. The theoretical framework is drawn from the complex interdependence theory. I analyse the EU and US trade strategies and political goals regarding the Free Trade Agreement (FTA) negotiations between the EU-Mercosur, and the US-Mercosur countries. I argue that the EU uses economic and soft power in the FTA negotiations to promote a model of interregionalism by including technical cooperation and development which enhance Mercosur project. On the contrary, the US pursue a 'trade not aid' interregional strategy based on bilateral negotiations with the purpose of reducing the influence of regional blocs in the FTA negotiations. The US strategy constrains Brazil's aspirations of regional pre-eminence, the access of new members to Mercosur, and a further integration between Mercosur and the Andean countries. Despite the different strategies, the US and the EU relations with Mercosur face the same deadlock: the protection of their agricultural sectors vis-à-vis the manufacturing industry in Mercosur. If the EU does not make its agricultural policy more flexible, its goal of being a global power and the perception of promoting a more humane governance model vis-à-vis the US is blurred.

Keywords: EU, US, Mercosur, interregionalism, trade strategies.

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1. Introduction

The academic attention given to European Union (EU) external relations beyond security issues is growing among scholars in the field of European studies and international relations. However, not much attention has been paid to EU external relations towards South America, specially from a comparative perspective i.e. EU and US external relations towards the Common Market of the South¹ (Mercosur).

The US and the EU share common views and values regarding the interdependent world i.e. the way they relate to developing countries that are democratic and have market economy as pattern of development. Even though the EU and the US share and promote similar values such as the market economy, regionalism, development and democracy, they are competing with each other to achieve their political and economic goals in the international system. In other words, they have similar power sources but they use them differently with regards to Mercosur countries.

The aim of this dissertation is to analyse the sources of power that the EU and the US use in their political and trade strategies to achieve their strategic goals in Mercosur. The main question posed in this work is: *What sources of power do the EU and the US use to pursue their trade and political goals in their relations with the Mercosur countries?*

Two secondary questions will help to analyse how both actors pursue their strategic goals in the Mercosur area and how the counterpart (Mercosur) reacts to the external influence coming from the US and the EU: *What are the EU and the US trade strategies towards Mercosur? And why do they pursue such strategies?*

The hypothesis in this project is that *the EU and the US compete for the Mercosur market, using different political and trade strategies to gain more influence on Mercosur and its member states. Therefore, the EU is challenging the power of the US in terms of trade, promoting new ways of interdependence based on economic relations between regional blocs that go beyond pure trade issues.*

After the introduction, in chapter 2, I set up a theoretical and an analytical framework to understand the problematic and the sources of power that the EU and the US use in their external relations. This chapter starts with a discussion of power using the neorealist and the dependency theory approaches. Moreover, I intend to pinpoint why these two views provide too narrow a perspective to understand the political and economic relations of the EU and the US towards Mercosur. After this, the complex interdependence theory is presented, analysed and linked with the term soft power and globalisation process. The complex interdependence theory will be used as theoretical frame for this study, therefore; an explanation of its strengths and weaknesses with regards to the case study will be included. Chapter 3 offers a

¹ Mercosur members are Brazil, Argentina, Paraguay and Uruguay. Bolivia and Chile are associate members.

view of the key issues of the EU as an international actor as well as its trade and political strategies for achieving its goals in the Mercosur. Chapter 4 provides an analysis of the US interests and strategies to pursue its goals in its relations with the Mercosur. In both chapters 3 and 4, the analysis goes beyond trade, including issues of development, aid, human rights, civil society participation, and democracy. These two chapters include the counter view of Mercosur countries in their relations with the EU and the US. Finally, the conclusion will contain an analysis of the findings of this work from a comparative perspective. This last chapter will analyse the differences and common aspects of EU and US political and economic strategies in their relations with Mercosur.

1.1 Time period of the study

The time frame for this study is 1991 and onwards. Despite the long tradition of close relations in the 60s and 70s between the EU and the Southern Cone countries, these were mainly pursued by European member states bilaterally with Latin American nation-states. In this sense, EU foreign policy goes beyond the mere sum of international interests of its member states. In addition, the accession of Spain in 1986 (the former colonial power in Latin America) to the EU encouraged the already emerging interest in pursuing deeper relations with this area of the world. Regarding the US, the relation between the US and Mercosur countries became less strategic in security issues with the end of the Cold War and more influenced by an economic rationale.

From a Latin American perspective, there was also a need to re-establish the lost relation with Europe as consequence of the predominance of military regimes until 1989-90 e.g. Uruguay and Chile with the purpose of consolidating democracy in the region. Moreover, the early 90s meant the definitive shift from an inwards to an outwards oriented economic model. The consolidation of the market economy as well as the creation of the Mercosur in 1991 enhanced the internationalisation of the Southern Cone and the goal of playing a more relevant role in the international arena either as bloc or individually.

1.2 Methodology and sources

This dissertation is a study of the political-trade strategies and sources of power that the EU and US use in their relations with Mercosur. This paper is also an analysis of EU and US political and economic foreign policies. To keep a clear structure in this work, EU and the US relationships with Mercosur will be presented in two separate chapters, and in a third one, a comparative approach will be used. But this comparative approach will be instrumental to explicitly answer the questions posed in the introduction. As this dissertation deals with US and the EU relationships with Mercosur, Mercosur's external policies are also considered in this work. This study is based on a theoretical-qualitative analysis, though empirical data is presented to support the arguments in the analysis of the EU-Mercosur and US-Mercosur

relationships. The data presented does not have further complex statistical analysis and it is mainly based on percentages and entire numbers. This data was taken from official reports of the Inter-American Development Bank (IDB) and the EU official web page.

The dissertation also assesses whether or not complex interdependence theory is a good theoretical frame for understanding the relationships of the US and the EU with Mercosur. The complex interdependence theory is an ideal type model. Therefore, it cannot be expected to explain every dimension of these relationships, although some evidence that goes towards the ideal of complex interdependence is expected.

After introducing what this dissertation is about, it is important to highlight what it is not about. Although some context of the previous developments of the relationships between the EU and Mercosur and the US and Mercosur is presented when necessary, the dissertation is not an historical chronology of these relationships.

Although the dissertation deals with regional blocs, such as the EU and Mercosur and the US, which, though a single country, seeks to achieve economic integration by creating an economic region, it does not intend to analyse the regionalisation process as such. It is assumed that regions already exist, and in the case of the US it is assumed that the US has the goal of promoting an economic region in the Americas. What matters in this dissertation is how these regions like the EU or countries like the US relate to Mercosur in political and economic terms.

A number of primary and secondary sources constitute the empirical material for this dissertation. Primary sources such as documents on EU-Mercosur relationships will be analysed. These documents are taken from the EU and Mercosur web pages. The document that established the frame for cooperation and negotiations of the free trade agreement (FTA) is a core document used in the analysis of the interregional relationship between the EU and Mercosur. Regarding the US, a number of US documents that set up the core ideas of the US economic and political policies towards Mercosur countries were taken from the web page of the State Department. However, these sources do not supply much evidence. Therefore, these primary sources will be complemented with articles and analysis of newspapers from the US and the Mercosur countries.

Secondary sources are abundant, especially books, edited books and articles in academic journals that deal either with the EU-Mercosur relationship or the US-Mercosur relationship. Although there is enough material on this area, there are not so many articles or books that compare US and the EU sources of power and trade and political strategies towards Mercosur. In fact, to the knowledge of the author of this work, there is only one article has been published so far studies this issue in depth (Grugel 2004).

Three interviews were conducted for this dissertation with the purpose of getting different views on these relationships. Two with academics and one with a former official of the Chilean Foreign Affairs Office, who specialises in issues of Mercosur. These interviews were conducted to provide more background on the subject of study and they are by no means going to be used to make generalisations on the respective EU and US relationships with Mercosur

2. Theoretical Framework for Analysing the EU and the US Competition for the Mercosur Market

Understanding EU and the US relationships with Mercosur is a complex issue. There are at least three contending theories that may explain these power relationships coherently: Neorealism, Dependency Theory, and Complex Interdependence Theory. The three of them have their strengths and weaknesses for this study. However, presenting the core pillars of each one, their explanatory power and flaws allow us to analyse why Complex Interdependence Theory, in this case, provides a better theoretical framework to study the EU's and the US' trade and political strategies towards Mercosur.

2.1 Neorealism

The neorealist theory of international politics, systematised and developed by Kenneth Waltz (1979), highlights the anarchic nature of the international system. This means that there is not a central authority to enforce rules, dictate norms and protect the international community (Lamy 2001: 185-186). The international community, in neorealist thinking, is constituted by nation-states, which are the primary actors of the international system (Waltz 1979 and Morgenthau 1985).

State survival and power position are the most important goals for each state in the international system. The distribution of power among states is uneven although they face similar challenges and tasks such as enhancing their security and defence to assure their survival in the system (Burchill 2001: 91-92).

Small states with less power capabilities seek for a way to keep and eventually enhance their relative position in the international system. Small states try to establish a system of alliances to protect themselves from the dominance and threat of larger states. Within the idea of alliance, which is an instrumental tool for states, the balance of power and absolute gains become essential elements, according to the neorealist school. The former deals with the idea that an alliance could counterbalance the threat coming from a potential enemy. The balance of power is essential to keep order and the status quo in the anarchic system and has to go along with the support of the big powers (Lamy 2001: 186). The idea of absolute gains is essential to keep the status quo of the system. Nation-states tend to cooperate with each other based on the absolute gains they can obtain from this relationship.

However, Joseph Grieco (1988) has pointed out that states also consider the relative gains that their allies can get when they cooperate. In terms of relative gains a state asks itself how much power and influence other states will get if it cooperates with them; and in terms of absolute gains the state asks itself how much it gains or loses from this relationship. Based on this calculation, states will decide whether or not to cooperate and empower international institutions.

Even though cooperation is a factor for the neorealist theory, it is mainly based on security issues and the enlargement of military capabilities to counterbalance threats from stronger powers. In this regard, economic matters, the phenomenon of regionalisation and the relationship between regional blocks or between single states in what Kagan (2004) calls the Kantian world is subordinated to security matters.²

Therefore, the neorealist approach is a one-dimensional theory that is too narrowly focused on security, neglecting the importance of other actors, such as persons, Multinational Corporations (MNCs) and Non Governmental Organisation (NGOs), and their potential influence in the international arena (Jackson and Sørensen 2003: 96). It is clear that the use of force has become counter-productive in the Kantian world, specially after the end of the Cold War. Democracies such as the Europeans, the American and the Mercosur countries have transcended their violent instincts³ and have learnt to resolve their differences peacefully, enhancing economic interdependence and the interactions of other actors (Doyle 1986).

The neorealist perspective also neglects the importance of groups at the domestic level i.e. business groups, NGOs, and trade unions. These are also power groups that can influence the foreign policies of a state like the US or governance system like the EU. For example, business oriented groups in the EU and Mercosur are pushing to get a Free Trade Agreement (FTA) while protectionist groups such as farmers and trade unions are opposing and hindering the achievement of such a FTA. This is reflected in the negotiation strategies of the EU and Mercosur, which set out to protect sensitive interests such as agricultural products for the EU, and industrial, and manufactured products for Mercosur. However the neorealist tradition does not consider the domestic level as an important variable to explain foreign policies and state behaviour in the international system.

This theoretical view thus fails to explain the globalisation process and the increasing transnational cooperation between regions in terms of trade, economic and political cooperation, aid and development. Because of its focus on state power and security, neorealism neglects the influence of domestic and transnational actors in the international system. In other words, it lacks capacity not only to explain the growing relationship between Mercosur-EU and Mercosur-US in a diversity of issues areas going from trade to cooperation, but also to analyse the growing competition between the EU and the US for the Mercosur market.

² Robert Kagan (2002) refers to the Hobbesian and a Kantian World. The former is where unstable conditions and open conflicts are seen. The latter is where stable democracies and perpetual peace are predominant

³ This does not mean that democracies do not go to war with pariah or rogue states, but that a strong moral justification is required to do so.

2.1.1 Mercantilism and hegemonic stability theory

Within the frame of neorealism, mercantilists assume that the world economy is an arena of competition among states seeking to maximise their power and relative position in the international system. In this sense, mercantilism is also a state-centric theory that conceives the international system as anarchical. Stability and order may only be achieved when a hegemon is willing to create, maintain and enforce the rules of the political and economic system (Woods 2001: 285).

A hegemonic power is thus the core pillar for the development and subsistence of a liberal world market economy. Without the existence of a hegemonic power the rules of the economic market cannot be enforced. In the hegemonic stability theory,⁴ the creation of an economic or regional bloc is a protectionist measure. States seek for an alternative to protect themselves when the hegemon is losing its power to enforce and rule the system (Gilpin 1987). If the US can be conceived as a hegemonic power, there is no hard evidence to claim its loss of power in military or economic terms. Moreover, the regionalisation process experienced in Mercosur, the EU and North Free Trade Agreement (Nafta) is neither purely based on a protectionist nor on a liberal model. Protectionism or liberalisation depends on whether or not a market or a regional bloc is vulnerable to the market, and this has to be analysed through issue-areas.

According to the neorealist interpretation of hegemonic stability theory, trade relations enhance the political, security and military capacities of states. Hegemonic powers have no incentives to liberalise trade with their actual or potential adversaries (Switky 2000:39). Good examples are the economic sanctions imposed by the US on Cuba and the non-trade-policy towards North Korea. However this is not a valid claim when one analyses the volume of trade between China and the US. This suggests that, more than a matter of sanctioning enemies and enhancing allies, there is a goal of maximisation of economic gains when a market is large enough. Even though, hegemonic stability theory has some explanatory power to understand the power of influence of the US in the Mercosur area, it overemphasises trade relations as a means to enhance a strategic alliance in terms of security and military issues. Such a strategic alliance does not exist, and Mercosur countries are not part of a security alliance involving the potential display of military capabilities. Not only does mercantilist theory neglect the existence of globalisation, but it also underestimates the importance of the influence that domestic and other transnational actors have on the international system. In this regard, hegemonic stability theory also neglects the role of domestic and transnational actors in the international system (Mansfield and Milner 1997:9). Therefore, hegemonic stability theory and mercantilism, coming from the realist tradition, provide too narrow a view on the regionalisation process and the growing interregional relations between the EU and Mercosur, and the US and Mercosur.

⁴ It is necessary to clarify that hegemonic stability theory is not the exclusive domain of realist and mercantilist theories. However the origins of this theory are in the realist and mercantilist tradition (Jackson and Sørensen 2003: 196).

2.2 Dependency theory

Dependency Theory emerged as major school of thought in Latin America in the early 1950s. However it is still relevant to explain the ongoing regionalisation process as a way to break the North-South division.

The early dependency theory took the ideas of structuralism, especially the centre-periphery thesis to analyse the causes of underdevelopment in Latin America. From a developmentalist perspective, the periphery or the south has to produce more and more raw material products for export to the centre simply to obtain the same quantity of imported manufactured products from the north. In the long term, a deterioration of the trade is expected for the raw material exporters vis-à-vis the north's production of manufactured goods (Cypher and Dietz 1997: 173, and Sunkel 1993).

Dependency theory's interpretation of the deterioration of the south in terms of trade has made dependency theory scholars differ on the ways to achieve independence or to reduce the asymmetries of power and trade from the north. Perhaps, the two most influential mainstreams of dependency theory are the Marxist approach led by Paul Baran and André Gunder Frank and the *desarrollista* (developmentalist within the system) approach led by the former Brazilian President, Fernando Henrique Cardoso and Enzo Faletto.

2.2.1 Marxist dependency theory

Marxist dependency theory argues that capitalism creates insuperable barriers for the working class. Consequently the dependency on the north has to be thought of in terms of strategic alliances between the local and the international elites. Together they rule the economic system in order to preserve their domination over the working class. This alliance between capitalist and precapitalist elites inhibits industrialisation, development and redistribution of wealth for the working class. Therefore, the only political solution to break down this pattern of dominance is a socialist revolution (Baran and Gunder Frank rephrased in Cardoso and Helwege 1992: 57).

For the Marxist view of dependency theory, globalisation and regionalisation are not new processes. They are thus only a different label for the dominance of the capitalist elite over the working class. The continuity of this system of exploitation worsens the gap between wealthy and poor, creating an environment for social unrest and potential conflict among social classes.

Neomarxist thinkers are rather pessimistic about the possibility of a revolution, because the superstructure of dominance created by the capitalist groups produces an acceptance of the model and the maintenance of the status quo. The socialisation process, determined by structural factors, makes the working class believe that market oriented economies create wealth and development not only for the elite but also for themselves. In Gramscian terms, the system is maintained not merely by coercion but also by consent (Hobden and Wyn Jones

2001: 210 & 221). Therefore, the only route to emancipation is through challenging the hegemonic power and the consequent reformulation of the superstructure that rules the contemporary social and economic relations.

The Marxist version is not a useful frame for this study. It does not provide a consistent systematisation to study and identify the key variables of what they call the superstructure of society. Moreover, Marxist dependency theory neglects regionalisation and interregional relations as current phenomena of world politics. Therefore, it does not provide a frame to study the relationship between the US and Mercosur nor the interregional relationship of Mercosur and the EU beyond the concepts of domination and emancipation. Finally, Marxist dependency theory overemphasises how things ought to be to end with the domination of the working class. Even though it describes the current situation and its constraints on achieving development, it is instrumental to explain how things ought to be in the ideal world.

2.2.2 Developmentalism from within the system

Cardoso and Faletto (1967) claimed that the Marxist school was mistaken in believing that industrialisation and capitalist development was not possible in the periphery. Even though the options for the periphery are limited because of the development of capitalism at the centre, they believe that industrialisation may be achieved by introducing protectionist barriers to reduce the Foreign Direct Investment (FDI) and MNCs, so that national industries can lead the industrialisation process. This phenomenon is known as Import Substitution Industrialisation (ISI) (Cardoso and Helwege 1992: 57).

In the industrialisation process of dependency theory, the state should play a strong role to introduce reforms such as tax and land reform in order to create a surplus of labour and a fair income distribution to create a larger internal market for the products created by the ISI.

The developmental model introduced in the late 50s was rather unsuccessful due to the internal constraints that the Latin American states still experience. Clientelism and the lack of state autonomy to introduce land and tax reform are often cited as causes for the failure of the model. Moreover, the states spent the economic resources available for industrialisation to pay for political favours rather than to produce efficient industries (Anglade and Fortin 1990).

Despite the failure of the developmentalist pattern in Latin America, this theory is still relevant to explain the difference in terms of trade between the north and the south. The regionalisation process in the south, like the one of Mercosur, is explained by this theory as a way to reduce the dependence from the north and enhance trade relations within the region in south-south terms. While dependency recognises a certain degree of industrialisation in countries like Brazil and Argentina, these industries are still vulnerable to the external pressures coming from the north. In this regard, regionalisation can reduce the influence of the north in the south. Therefore, trade barriers on third countries or blocks have to be kept to enhance the competitiveness of the different economic sectors within a regional block so that economic and development may be achieved.

This latter theory provides a good understanding of the phenomenon of regionalisation. However it is mainly focused on economic developmental strategies, neglecting the institutional constraints that impede the development process.

Even though dependency theory creates an analytical frame to explain how things are in the regionalisation process, it excessively focuses on how a region ought to be to break the north-south division. Therefore, dependency theory is not a good analytical tool for this study, since the goal of this work is to explain how the power relations are. In addition, dependency theory is an inwardly oriented theory, because it overemphasises the idea of close internal development, when Mercosur has shown growing external trade and the negotiation of a FTA with the EU.

2.3 Complex interdependence theory

Complex interdependence theory, developed by Joseph Nye and Robert Keohane (1977 & 2001), is an ideal type model of the world, and it is part of the liberal institutionalist tradition of international relations. The core question for this school is how to initiate and maintain cooperation under conditions of anarchy (Dunne 2001: 176-177). The liberal institutional theory highlights the beneficial effects of international institutions to avoid conflicts and achieve cooperation. However, international institutions do not guarantee by themselves cooperation in the anarchic international system. (Jackson and Sørensen 2003: 117). Cooperation is not automatic, but it can be achieved by enhancing liberal democracies and the free trade system.

For Robert Keohane (1989) a hegemonic power may help to set up the system of cooperation, widespread common values and even enforce them. But once international institutions operate they are no longer at the mercy of powerful states, though asymmetries between small and larger states are still present. Even in the absence of a hegemon, liberal institutionalists argue that established regimes should persist because they help to reduce the transaction costs in international negotiations (Little 2001:309, and Keohane 1984).

In order to keep cooperation, states have to share common interests such as peace, trade, human rights and market economy. According to the liberal institutionalist school, what leads to cooperation is the states' focus on absolute gains: "As long as we do well it does not matter if others do even better" (Jackson and Sørensen 2003:129).

Cooperation may be defined in terms of the interdependence of states. "Interdependence in world politics refers to situations characterised by reciprocal effects among countries or among actors in different countries" (Nye and Keohane 2001:7).

Robert Keohane and Joseph Nye (2001) propose that the study of power in international relations goes beyond hard power, specially in the area of the world where a condition of states' interdependence exists. Nevertheless, hard power is still an important aspect in international politics, specifically outside of the interdependent world where pariah and rogue states prevail.

Cooperation is thus a core element of complex interdependence theory, which has three main characteristics in relation to the condition of interstate relations. First, societies have

multiple channels that connect them either formally or informally, e.g. interstate relations, transgovernmental (NGOs and civil organisations) and transnational (MNCs). Second, the agenda of interstate relations consists of multiple issues that have no a clear hierarchy. This means that military security does not dominate the agenda at all and that different issues generate different coalitions, and systems of cooperation and competition among states. Finally, military force is not used towards other states where complex interdependence prevails. The use of military force is not a valid asset to solve trade disputes or to prevent the challenge of another state in terms of competition for a new market.

Therefore, power is dispersed and it is not an absolute domain of larger states. States have more or less power depending on the issue-area at stake. For example, Brazil is an important power in the issue areas of orange juice and coffee production, Argentina in beef and Chile in copper. However larger states like the US and the EU governance system are powerful in a broader set of issue-areas. Nevertheless, smaller states have their own power assets that may be used in the complex interdependent world.⁵

Moreover, power assets in the complex interdependence world may be increased or reduced depending on how soft power is used. Soft power is the capacity to make others do what one wants by persuasion, attraction and the seduction of ideas, culture, values and even trade, or by convincing people by argument rather than coercion⁶ (Nye 2004: 5-15).

This interpretation suggests that, despite the existence of predominant power like the US, it can be challenged by using efficient trade strategies along with soft power. Although complex interdependence theory highlights cooperation, it also states that competition among states is present in trade issues within the rules set up by international institutions. In order to be successful in this competition, soft power becomes an important asset to pursue trade strategies and to shape institutions in the interdependent world. International institutions like the World Trade Organisation (WTO) are not static at all, and they can be changed and reshaped, with the agreement of states, to create another stage of cooperation.

In this regard, Spero and Hart (2003:107) suggest that sooner or later the multilateral system institutionalised in the WTO should be reformed to address issues of legitimacy and governance. Others such as Faust (2004) suggest that the EU is already promoting an alternative frame of cooperation within the WTO called interregionalism.

Interregionalism is the interaction of two political and economic blocks and involves the institutionalisation of relations across regions (Faust 2004: 41-42). Interregionalism has a nature of cooperation and intends to bring benefits to both parties through negotiation and mutual agreement on a set of rules with the purpose of strengthening cross regional trade, political and economic cooperation and development, when one party is in the process of developing (Aggarwal and Fogarty 2004a: 5).

⁵ Neorealists underestimate the power assets of small states, because they are less powerful in military terms vis-à-vis larger states. This view is too narrow for complex interdependence theory, which tries to analyse power in other dimensions such as economic power, and soft power.

⁶ This sphere of power is not exclusive of the state, and it is also present in actors such as NGOs, social movements, economic actors, states and even terrorist groups. The sources of soft power are thus culture, music, movies, commerce and governmental policies such as aid, promotion of human rights, etc (Nye 2004)

On the other hand, the US is trying to keep the extant multilateral frame of the WTO. The US seeks to introduce a model of economic regionalisation using the frame of Nafta. This project is based on pure economic issues, excluding a possible political project like the one of the EU and, to a lesser degree, like the one of Mercosur.

Complex interdependence theory refers to regionalism as a transfer of power from the state to the region to pursue cooperation in multiple issue-areas beyond pure trade. Andrew Moravcsik⁷ (1998) suggests that states decide to pool or delegate sovereignty to intergovernmental bodies (regional bodies) in order to achieve their national economic interests and reduce their transaction costs. In a regional block, economic national interests become better articulated, represented and defended vis-à-vis powerful third countries like the US. If one follows this view, a region is formed to become more competitive in the world market and to reduce the vulnerability of the member states of such a region to the fluctuations of the market. “Vulnerability can be defined as an actor’s liability to suffer costs imposed by external events after policies have been altered” (Nye and Keohane: 2001:11). Reducing vulnerability does not mean that regional blocs are protectionist or against the market. A way to reduce the vulnerability of states is to become more competitive in the world economy by joining a region to increase the intra and extra-trade relations of a region.

Therefore, complex interdependence theory allows us to analyse the trade strategies pursued by big or small states either individually or as part of a regional block. It also provides a frame to study the influence of national or regional groups in states’ and regional block’s foreign policies. Moreover, interdependence theory also provides the possibility of analysing the power relations behind each trade strategy, and the reactions of a state or a region when they are being influenced.

Complex interdependence theory was not originally developed with a continent like Latin America in mind. The theory was thought to be applicable to the developed world among equal or nearly equal states. Therefore, complex interdependence theory conceives a certain degree of symmetrical power relations among nation-states. This presents a flaw in relation to Mercosur countries which are at an intermediate stage of development, remaining in many ways as part of the South. The respective US and the EU relationships with Mercosur keep the division North–South. However, it is no less true that Mercosur’s relations with the US and the EU are developing within the interdependent system.

This study takes the complexity of power from the interdependence theory. Power widespread by interrelated issues-areas becomes useful to analyse trade strategies and the power relations that are behind US-Mercosur and the EU-Mercosur trade relations.

⁷ He mainly thinks about the case of the EU, however, his conception on EU regionalisation may be used in more general terms.

3. The EU in Mercosur: Beyond Trade

Europe perceives itself as a different global power vis-à-vis the US, when it relates to developing countries. The EU makes distinctive policies towards the South that emphasise regional integration, human rights, civil society participation, democracy and poverty alleviation (Grugel 2004:603). These policies go along with the promotion of free market policies to achieve economic growth, and development. These policies are often interpreted as a way to strengthen and export the European project as successful pattern of integration, and to increase its position as global actor in the international system (Maxwell and Engel 2003).

The EU seeks to promote economic growth along with developmental issues and the integration process of other regions through interregional cooperation agreements and FTA talks. Interregionalism is the interaction of two political and economic blocs, and involves the institutionalisation of relations across regions from cooperation agreements to FTA beyond pure trade (Faust 2004:41-42). Following this definition, the EU is exporting its pattern of integration in order to gain access to new markets through establishing FTA talks with other regional blocs such as Mercosur.

3.1 Trade and political strategy: one big strategy

Mercosur was created in 1991 as a way for its members to become more competitive and reduce the vulnerability to the fluctuations of the global economy. However, there are also political issues to explain the creation of Mercosur, such as the maintenance of fragile democratic regimes and peace throughout the Southern Cone (Smith 2001:48). With the democratisation process and the definitive switch to market economies of the South American countries, the EU has seen Mercosur as a strategic partner that offers a new market for European products, and the consolidation of its idea of playing a stronger role in the international arena (Freres 2000:63).

The creation of Mercosur has also favoured the preference of the EU for dealing with a group of countries rather than on a bilateral basis. This has been done to reduce the costs of the negotiation process and to push Mercosur countries to stay together in the ongoing negotiations to achieve a FTA. Even though the EU and Mercosur established an Interregional Framework for Cooperation Agreement (EMIFCA) in 1995 after Mercosur became a customs union, some Mercosur countries tried to pursue parallel FTA talks with the EU.⁸ However, the EU has refused to follow parallel negotiations, because these talks could endanger the regional project of Mercosur.

⁸ These countries are Argentina and Uruguay.

The EU refusal to pursue bilateral FTA talks became a useful tool to pressure Mercosur to stay together, even when Argentina fell into a severe economic crisis in 2001 (Faust 2004:50). The EU as external force reinvigorated and, in part, helped Mercosur countries to face the economic crises and currency devaluation in Argentina and Brazil, and impede an eventual shift, especially, in Argentina, from an outward to an inward economic model. This eventual shift to a more protective economic model in Argentina would have reduced the intra-Mercosur trade⁹ even more, and it would have questioned the viability of Mercosur project among its member states.

Therefore, the EU trade strategy, based on interregional agreements, has been useful to enhance Mercosur when it was facing internal problems due to the Argentinean economic crisis. However, the EU trade strategy of promoting free trade through interregional negotiations may also be seen in the long term as part of the political and economic goals of the EU in the international system. Trade diversification and power balancing are the underpinnings of this relationship with Mercosur.

3.1.1 Trade diversification

Regarding trade diversification, the EU is an important market for Mercosur. Mercosur is highly dependant on its trade relations with the so-called North i.e. the US and the EU, although the EU economic relations with Mercosur are rather marginal. For example, Mercosur represents no more than 2.65% average of the share of EU total imports from the years 2000 to 2004 and a 2.28% average of the share of EU total exports in the same period. On the other hand, the EU represents a 25.6% average in the same years of the share of Mercosur total imports and a 22.26% average of the share of Mercosur total exports (European Commission 2005b).

Even though Mercosur is not very important market for the EU in terms of trade, it is still important for EU export oriented groups. In this regard, the EU does not want to repeat the Mexican experience of 1994, when Mexico joined Nafta. After Nafta came into force, Mexico redirected its trade flows towards the US and Canada, reducing its economic exchange with the EU. In 1991 Mexico sent 7.8% of its exports to the EU, however, this number decreased to a 3.4% in 2000, and 11.7% of the total Mexican imports were from the EU in 1992, but these decreased to an 8.5% in 2000 (Grisanti 2004: 41). Following this experience, the EU seeks to agree on a FTA with Mercosur in order to secure the extant market and prevent Mercosur from redirecting its exports to the US and reducing its imports from the EU if the Free Trade Area of the Americas (FTAA) is signed. The FTAA would temporarily mean a deterioration in the EU's trade relations with Mercosur, affecting the export and import sectors of the EU, generating losses in millions of euros.

⁹ The percentage change in the intra-Mercosur exports was 16.7% from 1999 to 2000. However, the intra-Mercosur exports decreased -14.4% from 2000 to 2001 and -32.9% from 2001 to 2002. The % change from 2002 to 2003 was 25.1%. And the estimate % change from 2003 to 2004 is 39% (IADB:2004: 5 &7)

In the Mercosur-EU relationship, there is also the idea of trade promotion between these two economic blocs. A FTA with Mercosur may also increase the trade exchange between the EU and Mercosur as the data on the current EU-Mexico FTA shows. After the EU-Mexico FTA became operational, the EU exports to Mexico grew by 5.5% and the imports from Mexico to the EU by 2.4%. Moreover, the total trade in goods between Mexico and the EU grew by 28.3% (Grisanti 2004:45).

Therefore, pursuing a trade strategy based on FTA talks is a logical step for the EU, because a FTA creates and diversifies markets for its exportations, which are mainly based on manufactured products. By promoting interregional negotiations, the EU secures the access to one bigger market rather than the four separate ones which would have been the case if the EU had conducted individual negotiations.¹⁰ In that case, the EU could have generated different trade strategies and it would have to give different concessions to every country of Mercosur, increasing its economic costs.

An important aspect of the negotiation process is the asymmetrical distribution of power between the EU and Mercosur, which favours the former. The trade indicators presented above show this asymmetry. For Mercosur, the trade with the EU in imports and exports represents more than 20% (approximate). Therefore, Mercosur will give high priority to its extra-hemispheric relations with the EU because it represents a strategic market that with a FTA may increase. However, for the EU, the trade with Mercosur in imports and exports barely represents 2.5%, which means that the EU will devote less time, attention and energy to the negotiations with Mercosur. The EU may thus enhance its relative negotiation position in the FTA, securing more issues that are strategic for it. On the other hand, this asymmetry creates a certain vulnerability in Mercosur, because it might be more willing to give concessions in sensitive issue-areas to achieve a FTA¹¹ (Smith 2001:58).

Nevertheless, the EU seeks to achieve a FTA with Mercosur for economic reasons and for political ones related to the idea of balancing power vis-à-vis the US. This strategic goal of the EU is concomitant to Brazil's interest of becoming a regional and global player.¹²

3.1.2 Balance of power

The EU strategic orientation to South America is part of its project of becoming more competitive in the world economy. To achieve this goal, the EU sooner or later has to challenge the US hegemonic role in the Southern Cone of Latin America (De Vasconcelos 2003: 39-44). This challenge should not be conceived in terms of a security conflict, but in terms of competition within the frame set up by the rules of the WTO. In economic affairs, the

¹⁰ Probably, the EU would have sought to establish negotiations with Brazil and Argentina for their size of their markets.

¹¹ However this asymmetry in the negotiations may be reduced by having a good team of negotiators in Mercosur and showing to the EU the other options of Mercosur to negotiate i.e. the US and China. Despite this asymmetry of power, the EU-Mercosur negotiations have been conducted in win-win terms rather than as a zero-sum game.

¹² Brazil is the largest country in Mercosur and receives around 80% of the total FDI of Mercosur.

US remains an important player, but the distribution of power is multipolar and the EU and Japan compete on equal terms with the US (Nye 2004:4). In fact, the EU is currently the main economic power in terms of FDI in Mercosur.

Counterbalancing the US power in economic affairs is not only about the size of the market shares in Mercosur, but also about competing to shape the institutional organisation of the world economy. This is a normative idea about how a new world order should be constructed (Faust 2004:43). Countries like Brazil, India and South Africa have become very active to make reforms in the WTO (Green 1999:31). The less developed world has tried to articulate a common position to exert pressure over the industrialised countries to make changes in the agricultural policy of the developed world and the health policy concerning pharmaceutical drugs distribution for people with HIV in the third world (Rapoza 2003).

The EU and the developing countries share the view of making changes in the WTO. However, the EU's reasons for this are internal. By using external forces the EU seek to reform key issues areas that consume most of its economic resources in subsidies. Therefore, the EU is encouraging these changes in the WTO, specially the ones dealing with the liberalisation of the agricultural sector.¹³ The EU Council and Commission seek to reform the Common Agricultural Policy (CAP), and the eventual reform in this sector in the WTO may give the EU institutions enough power to trigger the needed internal reforms. However, the EU is willing to make changes in these areas within the frame of the WTO only if the counterparts agree on a progressive tariff reduction in the areas of services and manufactures, where the EU is more competitive (Van Dijck 2002:90-91).

Not only is the EU a big market for Mercosur for exporting its primary and manufactured products,¹⁴ but it also offers an economic-political partnership and commitment to economic development. In this regard, the EU has taken a step ahead of the US, including the concept of strategic partnership in its interregional relation with Mercosur as a way to shape the international economic system. A partnership represents an idealised relationship with particular interest on the notions of equity and cooperation that transcends the power inequalities. Partnership and interregionalism seek to promote good governance, political and institutional reform, and social inclusion through breaking economic inequalities between the EU and the South (Grugel 2004:608).

In the EMIFCA and the FTA talks the partnership principle is a constitutive element in the interregional relationship between the EU and Mercosur (European Commission 1996). By using the concept of partnership and promoting the principles that fill the concept, the EU uses its soft power to promote integration and enhance its position as a global power. Whether the EU soft power is used as a functional part of the trade strategy towards Mercosur, or as a separate element to promote its identity, will not be analysed here. The point is that by using its soft power i.e. promotion of human rights, good governance, development and aid, the EU strengthens its trade strategy and power of influence towards Mercosur.

¹³ This does not mean that a full liberalisation will be pursued. In many agricultural areas some high protective barriers will be kept.

¹⁴ A 68% of Mercosur exports to the EU are raw materials and basic products and only a 32% are manufactured goods (Grisanti 2004:62).

Trade strategies, in general, are part of a broad framework of geopolitics that includes global governance, the roles of non-state actors such as NGOs, global regimes, international institutions and actors that are not directly concerned with trade. “Furthermore, trade strategies can be strengthened or weakened by developments in areas that have little or nothing to do with trade” (Tulchin 2004: 39). By using its soft power, the EU has been able to counterbalance and enhance its trade position in the Southern Cone of Latin America vis-à-vis the US power in the region. Nevertheless, the success of the EU trade strategy and its use of soft power can be constrained if the EU does not make its agricultural policy more flexible.

In addition, the success of the EU trade strategy with its use of soft power becomes blurred or ineffective if the counterpart is not willing to accept an external influence. The Mercosur countries foreign goals in this case are concordant with those of the EU. Not only do the EU and Mercosur countries share common historic and cultural links, but they also share the rivalry with the US (Smith 2001:53). Mercosur seeks in the relation and promotion of a FTA with the EU to counterbalance the US influence in the region

Mercosur countries have improved their capabilities to reduce the influence of the US in the 90s due to the growing intra and extra trade of Mercosur (Faust 2004 and Muñoz 2001). As economic growth has been achieved in the region, despite some recessive years in 2001/2002, the US wishes to form a FTAA, using the Nafta experience as a frame. This could mean the absorption of Mercosur by the FTAA and the increment of US influence in the region, because the US seeks to conduct individual negotiations with Mercosur countries rather with the bloc (Carranza 2004).¹⁵ Mercosur would like a FTAA that does not diminish its goal of economic and political integration. Moreover, the FTAA proposed by the US would reduce Brazil’s capacity of leverage in the international system. Brazil seeks to exert a stronger role in the international arena. Brazil’s goals are to get a seat in the Security Council and push along with Argentina, India and South Africa for reforming the WTO to include some issues relevant for the South. “Mercosur has gradually been turned into a ‘strategic and political platform for the larger countries within it’” (Grugel 2004:610).

In other words, the EU trade strategy of promoting an interregional agreement is not a one-dimensional strategy, it needs a counterpart that wants to be attracted or seduced by the economic and soft power. Moreover, the counterpart, in this case Mercosur, also has its own external goals, which are to reduce the US influence and enhance its relative position in the negotiation of the FTAA where the US is seen as the rule-maker.¹⁶ Therefore, the EU and Mercosur have concordant political goals and these may be achieved by enhancing their economic interdependence.

¹⁵ This issue will be analysed in detail in the next chapter.

¹⁶ Mercosur countries would like to reduce US influence rather than get rid of the US. This is not a possibility for Mercosur, because they are dependant on the trade with the US.

3.2 Multinational corporations, foreign direct investment (FDI) and interest groups

The Mercosur countries attracted considerable European investment in the 1990s. European FDI is higher than that of the US. This increment in FDI was due to the economic transformations in the Mercosur area i.e. privatisation, regionalisation and the subsequent market expansion. In the 1990s almost 30% of the total FDI flow to Mercosur was European (Grabendorf 2003:163). Nowadays it represents around 50% of all foreign direct investment in the region (Grugel 2004: 614). The economic liberalisation in service areas e.g. transport, banking, and the energy sectors, attracted mainly Spanish capitals i.e. the value of Spanish-owned banks alone is greater than that of the US.

Even though the EU's investment decreased in Mercosur due to the economic crisis in Argentina in 2001, the Spanish FDI flow to Argentina displaced the US FDI in the period 1996-2003.¹⁷ Spanish FDI flow to Brazil (16.4%) was the second largest after the US (21.7%) in the period 1996-2003 (ECLAC 2004:75). In 1998, 70% of all Spanish FDI went to South America (Nunnenkamp 2001:26). The Spanish FDI in the region explains why the Spanish Government has been one of the main promoters of the FTA with Mercosur. In fact, under the Spanish presidency of the EU, the EMIFCA cooperation frame was signed. This frame has been used as central pillar of the FTA negotiations. According to Nunnenkamp (2001) their cultural ties with Mercosur countries give the Spanish MNCs an advantage in expanding their investments in Latin America. Yet, the persistence and maintenance of Spanish FDI has shown other European MNCs that Mercosur is a potential, attractive and profitable market.

However, EU external trade policy goes beyond Spain in Latin America. Companies with German (pharmaceutical, financial and automobile sectors), English (financial sector) French (supermarkets, automobile, telecomm sectors), Italian (telecomm sector) as well as Danish (pharmaceutical sector) and Swedish (telecomm sector) investments among others indicate that Mercosur is strategically important for European investments (Grugel 2004: 615). European MNCs are important actors to promote an interregional agreement, even when an economic crisis is present. For example, the FDI numbers went down from 23.437 millions dollars to 14.541 millions dollars in the period 2000-2002 due to the economic crises and monetary devaluation in Brazil and Argentina (IDB 2004). This shows MNCs investments are obviously attracted by good economic conditions, and they will usually reduce capital investment or transfer their capital to more stable markets when an economic crisis is perceived (Spero and Hart 2003).

Economic crises are perceived as temporary for the MNCs and business groups. Hence, the economic crises in Mercosur countries were not an impediment for the European MNCs to continue lobbying the EU Commission and the respective governments to pursue FTA negotiations with Mercosur. In fact, there is an established economic forum that meets European and Mercosur business groups under the umbrella of the EU. The purpose of this forum is to conduct seminars and discussions regarding the economic exchange, benefits and limitations that a FTA between both economic blocs can create (European Commission,

¹⁷ Spanish FDI was 45.6% vis-à-vis a 17.6% of American FDI in the period 1996-2003 (ECLAC 2004:75)

2005c). Therefore, European MNCs shape and influence the EU trade strategy towards Mercosur by promoting an interregional agreement so that MNCs can enhance their relative position and increase their profits.

On the other hand, there are also European and Mercosur actors that oppose a FTA such as the farmers in the EU and industrial and manufacturing groups in Mercosur. Perhaps farmers are the ones that see the FTA with Mercosur as the biggest threat to their corporatist interests, because the main source of exports of Mercosur are raw materials and basic products (Grisanti 2004:62). Farmer groups are rather successful at making their voices heard in Brussels. Proof of this is that the CAP has not been reformed yet, although the EU Commission and the Council have sought to reform this controversial issue-area.¹⁸ The issue-area of agriculture has become the main impediment to achieve an agreement between Mercosur and the EU. The CAP explains why the EU-Mercosur decided to stop negotiations in 2004 and defer them to redefine their respective trade strategies.

However a solution has to be found to facilitate a final agreement.¹⁹ A preferential system of quotas for Mercosur products could be a hybrid solution for both parts, because it allows to Mercosur primary products to enter at a lower price to the EU but it keeps certain restrictions as a way to assure enough market to EU farmers' products. If a system like this is introduced in the interregional agreement, Mercosur will demand compensations and keep part of their already high protective measures in their own strategic areas. The industrial and manufactured areas are sensitive for the two biggest actors of Mercosur, Argentina and Brazil. These sector-groups become the main deadlock to reaching a final agreement in Mercosur (Markwald 2003).

Regarding the CAP, it is believed that Germany and Britain favour the elimination of protective measures to agriculture, but Spain and particularly France oppose their elimination (Mercopress 2005). This also shows the complexity and the paradox of power and the influence of domestic groups in shaping certain issue-areas of a government foreign policy. While Spain is one of the main promoters of a FTA with Mercosur because of its investments in Latin America, it is also the supporter of keeping protective barriers in agricultural issues. Spanish and Mercosur farmers have similar products i.e. tomatoes, avocados, beef, etc. Therefore, a progressive tariff reduction in this area would create high losses among Spanish farmers, because Mercosur have comparative advantages. Nevertheless, Spain is willing to negotiate in this issue-area, because of the eventual gains that a FTA will bring in other issue-areas where they already are the main traders in Mercosur i.e. the financial, telecomm and energy sectors.²⁰

While the MNCs and export oriented groups seek for a FTA with Mercosur, farmer groups have generated a deadlock in the negotiations along with the industrial and manufactured sectors of Mercosur. Only high level political negotiations can solve this impasse. Therefore,

¹⁸ In the previous pages it was explained why the EU support an eventual change in WTO and the progressive liberalisation of the agricultural sector. This is to create external rules that allows the EU change and reform its CAP.

¹⁹ The solution will probably not be an optimal one, because of the unwillingness to make many concessions in the sensitive areas of agriculture in the EU and Industry in Mercosur.

²⁰ This does not mean that Spain will not try to keep certain protectionist barriers that satisfy the farmers groups.

a system 4+4 will be implemented to try to save the FTA negotiations and reach a final agreement before the Commission presidency is changed.²¹ By the end of May, 2005, a technical group is planning to meet in Luxembourg during the EU-Rio Group ministerial meeting. The purpose of this meeting is to prepare the eventual 4+4 negotiation round, where four European Prime Ministers and Presidents will meet their Latin American counterparts to analyse the FTA and the sensitive issue-area of agriculture with the clear purpose of reaching a final agreement that allows a continuation of the integration scheme between both blocs. This eventual meeting shows that a FTA is an important issue for the EU, because it does not only involve trade, it also involves the success of the EU long term political project of becoming a relevant global player. The EU will be represented by: the French president, Jacques Chirac; British Prime Minister, Tony Blair; German Chancellor, Gerhard Schroeder and Spanish President, Jose Luis Rodriguez Zapatero; and the four Mercosur representatives will be, Brazilian President Lula da Silva; Argentina's Kirchner; Paraguayan President Nicanor Duarte and Uruguayan President Tabare Vázquez (Mercopress 2005).

3.3 The EU commitment to development

Mercosur's economic dependence on primary products and the imports of technology and services from the EU, Japan, and the US show that the EU-Mercosur relationship keeps the north-south division in terms of economic development (Grugel 2004).

Even though Mercosur countries have increased their GDP and attracted FDI since its creation, they remain less developed. For example, the income distribution in Latin America as a whole is the worst in the world e.g. GINI .493 vis-à-vis .469 in the Sub-Saharan Africa in the 90s (Morley 2000:18). Despite Brazil being the most industrialised country of Mercosur and receiving around 80% of Mercosur FDI, it was the country with the highest poverty index 22% in 1998 (World Bank 2005), and the worst income distribution .60 in Mercosur in the 90s (World Bank 1999). The market is thus not enough for development, though it helps to create tax revenues for the states to implement developmental policies. But Mercosur countries developmental goals are often constrained by the high levels of corruption and populism, which make the states spend their tax revenues inefficiently.

The EU in the articles 177 of the Constitution and 130 of the Maastricht Treaty states its principles and commitment to the development of the third world such as the promotion of human rights, democracy, good governance, environment protection, and market economy promotion as a way to achieve economic growth, economic development, civil society participation and cultural development (Grisanti 2004).

Following these principles, the EU-Mercosur interregional relationship includes clauses of cooperation, democracy, human rights and development. The EMIFCA includes explicit clauses to break this North-South division through enhancing economic trade and cooperation on issues such as technology transfer, civil society participation, and Mercosur institutional building (Faust 2004:44-45, and European Commission 1996)

²¹ The original date to end the negotiations of the FTA is October 2005.

In 2002, the EU approved a financial package of 48 million of Euro for achieving these developmental goals. With the eventual achievement of an integral FTA, the money transfer to development programs in Mercosur will increase (European Commission 2005b). These sums were given to support the institutionalisation of Mercosur i.e. harmonisation of macroeconomic policies, statistics, technical norms, and support to the Court of Controversy Resolution; support the economic structures of Mercosur and the development of its internal market i.e. scientific and technological cooperation, harmonisation of customs and health policies; support to civil society participation i.e. educational projects (Credit System Transfer for University studies, creation of an educational program as Erasmus) and support to minority groups e.g. ethnic groups. The amount of money given to this ambitious project is rather limited (48 million euros). However, the EU has given monetary support to the Mercosur members for internal projects that help to enhance the Mercosur integration project, such as 65.7 millions euros to Argentina, 64 millions to Brazil, 51.7 millions to Paraguay and 18.6 millions to Uruguay. In total the EU has funded Mercosur by more than 250 millions of euros (Grisanti 2004:73).²²

If one sees the developmental goals of the EU and the programs funded, one may conclude that the EU is not only transferring economic resources, but also its own experience of integration. This shows that the EU's commitment to development in a broader sense goes beyond mere rhetorical statements. As Jean Grugel suggests (2004 & 2000), the EU is a real civil power that it is not only moved by the rationale of trade diversification, but also by a stronger conviction of values of democracy and development, being the main aid donor in the world. In other words, the EU seeks to break the North-South division by promoting an integral FTA. The EU is rich in soft power assets and it uses them efficiently, which enhances its position as trade partner and political actor in the international system.

Therefore, this interregional relation may help to develop Mercosur countries. However, this interregional cooperation is not enough if it does not go along with more internal institutional and economic reforms within the member states of Mercosur such as fair income distribution, poverty reduction and the reduction of clientelism (Haggard 2000). These issues go beyond the EU prerogatives in the interregional relation, because it would mean a direct challenge to the autonomy and independence of Mercosur members. In this regard, the EU treats Mercosur members as equal partners and gives them enough space to keep their autonomy. Nevertheless, the EU promotes NGO programmes that deal with those issues in Mercosur countries.

3.3.1 The EU and development NGOs participation

Even though the EU has reduced its aid assistance to Mercosur countries, this remains an important asset of influence and development. Mercosur countries are no longer considered

²² Mercosur also benefits from other horizontal EC programmes that cover all Latin America countries: e.g. AL-INVEST (cooperation between European and Latin American companies), URB-AL (local urban development), ALFA (cooperation between higher education institutions), @LIS (alliance for information society). ALBAN (scholarships), ALURE (cooperation in the energy sector).

poor countries. The Aid Agencies consider Mercosur members as middle income countries. Therefore, the EU has reduced the funding to NGO programmes in the region. However, as we previously saw, the EU has funded programs that target economic development and enhance integration in Mercosur. “This has led to a decline in the use of aid resources for traditional social and rural development projects and a corresponding increase in the importance of technical assistance and training” (Freres 2000:75).

It is a difficult task to estimate the real number of NGOs working in the Mercosur countries that are partially or totally funded by the EU. According to the EU Commission web site on aid issues, European development NGOs in Mercosur only received 950.000 euros in 2003 to support the social dimension of the EU-Mercosur interregional relationship, but it does not show how this money was distributed (European Commission 2005a). The lack of empirical evidence in the EU official documents and web page on the numbers of NGOs and the funding given by the EU to them can be interpreted as a way to avoid conflicts with Mercosur member states. Some NGOs try to implement programmes and articulate interest groups in Mercosur countries that can eventually oppose governmental policies and interests.²³ These can be interpreted as a challenge to Mercosur governments. Following this inference, the lack of empirical evidence could be a strategic step of the EU to avoid conflict with its counterpart. If the EU publicly appears funding NGOs programs that challenge governments in some areas could reduce the EU’s leverage capacity in other strategic areas such as trade and trade negotiations.

Nevertheless, the EU Commission and moderate European civil society movements that work in the Southern Cone have held two formal dialogues to analyse the inclusion of developmental issues and their implementation in the FTA. These two meetings were held in Brussels in October 2000 and February 2002. The accredited number of delegates were 200 and they represented a broad range of groups e.g. academic institutes, development NGOs, human rights organisations, consumer groups and cultural associations (Grugel 2004:619).

Although the development NGOs do not have the same weight as the business groups in the negotiation process of the FTA, there is a growing inclusion of NGO groups to make their proposals heard before the EU Commission. Many NGOs see the achievement of a FTA as positive if it includes the promotion of welfare, human rights, and democracy (Grugel 2000)

However, other European NGOs are rather sceptical about the real achievement of welfare that a further liberalisation process may create in Mercosur countries. For example, 45 NGOs, not all of them Europeans, sent a letter to the Commissioner for Development and Humanitarian Aid with regards to water provision to the poorest sectors of civil societies in the third world. Here there is a criticism towards the free trade policy and the pressure that the EU exerts to make Mercosur liberalise the water services affecting the poorest sectors of the population (CorporateEurope 2005).

The EU promotes the participation of civil society groups in the FTA and also encourages social dialogue with NGOs to address sensitive issues for the less developed countries. Although, some NGOs could oppose the EU interests on promoting free trade as a way to

²³ It is not clear at all whether or not the EU funds more radical NGOs that work in Mercosur. The EU tries to establish public dialogues with moderate NGOs to analyse the EU-Mercosur relationship.

achieve welfare, the benefits of dialoguing with them are higher than ignoring them. The EU interaction with them are perceived as positive because it enhances the EU's soft power. By promoting civil society participation and supporting NGO programs the EU is perceived as a real civil power that seeks to break the North-South division (Grugel 2000 & Freres 2000).

In other words, the EU not only seeks to increase its economic power, but also to promote a different governance model in its relations with the developing world. Trade remains the core element in the relationship between the EU and the Mercosur, but for the EU, trade goes together with developmental issues. By mixing trade strategies and soft power, the EU is projecting itself in the international system as a civilian power. Nevertheless, if the EU and Mercosur do not give mutual concession to each other in their respective sensitive areas such as agriculture and manufacture, the achievement of the EU goal of being a different power becomes blurred.

4. The US relation with Mercosur: The FTAA

New and old regional projects have been launched and relaunched in South America. Mercosur was created in 1991, the Andean Community was re-launched in the mid 90s and, in December 2004, the South American Union was created as an effort to deepen the relations between Mercosur and the Andean Countries, but this latter regional project remains at a rhetorical level (AICO 2005)

The regionalisation process and dreams of further integration proliferate in South America. Moreover, there is also an ongoing process of interregionalisation between Mercosur and the EU. In this context, the US has sought not to be left out of the process of negotiating FTAs in its so-called backyard.

4.1 The Trade and Political Strategy²⁴

The US and the Latin American countries have pursued negotiations to establish the FTAA. This project was launched by President Clinton in 1994, after the failure of the Enterprise for the Americas Initiative (EAI) created by President George H. Bush. The FTAA negotiations were continuously postponed by elections in the US and the failure of the Clinton administration to get a fast track authorisation from the Congress to negotiate with Latin America. With President George W. Bush the dream of an integrated region of the Americas from Alaska to Tierra del Fuego revived but the war on terrorism cooled it down.

The FTAA negotiations involved 34 countries of the Americas with exception of Cuba, and it was launched in 1994, with an original deadline of January 2005. The negotiations during these years have transited from relative success in the deal of the FTAA between the US and Central American countries to a stalemate or to its “death” as Venezuelan President referred to the FTAA during the Social Forum in Porto Alegre, Brazil, with countries like Venezuela and Mercosur countries (Sojo 2005).

Although the FTAA negotiations were deferred with the South American countries for the moment, the FTAA will be established sooner or later either through bilateral or multilateral negotiations. The matter is under what conditions the FTAA will be implemented for Mercosur countries (De Vasconcelos 2003). This, to some extent, will depend on whether or not Brazil and the rest of the Mercosur countries can keep the unity to negotiate, and resist the influence and pressure of the US to negotiate bilaterally.

²⁴ The US political and trade strategy has to be analysed beyond Mercosur, including other areas of Latin America.

The US pursues a different trade strategy from the EU, since it prefers to hold negotiations bilaterally. This is a way to reduce the bargaining capacity of its counterparts and enhance its own position in the negotiations. The idea of pursuing bilateral negotiations has so far affected the Mercosur project of expansion through the inclusion of new members like Peru or Chile. Chile is an associate member, but once intended to become a full member of Mercosur. However, due to external tariff differences with Mercosur and the US invitation to get a FTA under Clinton administration, Chile has kept her status of associated and not full membership (Gudynas 2003:2). Chile achieved a FTA with the US in 2004. The same tactic of negotiating bilaterally has been used towards the other Andean countries to limit the scope of the South American Union, launched by Brazil. Therefore, the US trade strategy is based on bilateral talks with the purpose of reducing possible counterbalances coming from sub-regional projects like Mercosur. This is to keep the US predominance in the region.

The US seeks in the FTAA to regulate such issues as property rights, government procurements and global investment policy. The US thus prefers to pursue a rule-based and market access integration rather than a supranational institutional building model like the one pursued by Mercosur. On the other hand, Mercosur is promoting a more complex pattern of integration, which combines the political and economic rationales that go beyond the simple question of market access (Grugel 2004:610-611).

These two divergent patterns of integration produce a defensive reaction in Mercosur towards the US trade strategy, making the FTAA negotiations slowdown. On the contrary, the US FTAA negotiations have progressed more smoothly with Central American and some Caribbean countries. The faster progress on the negotiations with this part of Latin America can be explained by the prior existence of a general preferential system (GPS) that allows the products of these countries to enter the US market at preferential rates. Mercosur is affected by the non-tariff barriers of the US in agriculture. Although the two biggest countries of Mercosur have such GPS with the US, it has a lesser scope than that of the US and Central American and Caribbean countries. This makes Brazil and Argentina less competitive vis-à-vis other Latin American states in the agriculture sector (Lorenzo and Osimani 2005).

Central American and Caribbean countries are highly dependent on the production of few products like the one of Caribbean Community and Common Market (Caricom). The production of one or two exportable products reduces the complexity of the negotiations. However it creates a big asymmetry in the negotiations where the US is the hub, being able to assure most of its strategic issues-areas. The asymmetries in the negotiations between the US and Caricom and Central American countries are much higher than that of the US and Mercosur. Although this latter relation is not symmetrical at all, there are more issue-areas at stake that make negotiations more complex and slower, creating a sort of counterbalance in the negotiations (Erisman 2003).

This discrimination of agricultural products through the asymmetrical GPS vis-à-vis Caricom and Central American countries, in theory, becomes an incentive for Mercosur countries to negotiate the FTAA with the US (Lorenzo and Vaillant 2005:4). However, the lack of competitiveness of Mercosur in manufactured products makes the achievement of a

final compromise more difficult, because the US has better comparative advantages on this area, creating a deadlock together with agricultural issues in the FTAA negotiations.

Although the negotiations did not meet the original date, current trade indicators and statistical analysis show the eventual benefits that FTAA can create for the Latin American continent as a whole and specially for Mercosur countries even if a lowest-common denominator agreement is reached (De la Balze 2001).

4.1.1 Trade between the US and Mercosur

In an economic dimension, Latin America and Mercosur represent a way for the US to open markets, increase its exports and investments and also to assure its predominance. The promotion of the FTAA in the Southern Cone has to be analysed in terms of market creation and expansion. Gaining the benefits of opening markets in Mercosur is part of the US global strategy in the world economy (Grugel 2004).

In the early 90s, the US pushed Latin American countries to pursue liberal reforms through pressures from the IMF and the World Bank. The relative success of these reforms in Latin America has facilitated the access of US capital to the region. Moreover they have enhanced the US's goal of being the hub of the increasing open economies and the regionalisation process (Hurrell 1994). This American idea of leading the economic integration in Latin America is to counterbalance the growing economic influence of other actors such as the EU, Japan and China (Cohen, Blecker & Whitney 2003:302; and Dull 1997:176). Good examples of this competition are the ongoing FTA talks between Mercosur and the EU, and the FTA agreements of the EU with Mexico and Chile.

The current data on US-Mercosur economic relations shows that they follow a pattern similar to the economic relations between the EU and Mercosur. However, the economic exchange between the US and Mercosur is lower than that of the EU and Mercosur. From 1992 to 2001, the US trade with Mercosur has more than doubled, going from \$16.5 billion to 38.5 billion, while the EU trade with Mercosur has grown from \$25.7 billion to nearly \$43 billion (Federal Reserve Bank of Atlanta, undated). Mercosur extra-trade in imports and exports with the US is less dynamic than that of Mercosur and the EU. From 1991 to 1999, Mercosur exports to the US represented 16% (approximate) of its total exports, while the exports to the EU represented a 26.6% average in total in the same period. Regarding imports, Mercosur imports from the US represented 21% (approximate) of total imports and from the EU 25% (approximate) (Markwald 2003:74).

Mercosur is a secondary market for the US as well as for the EU. Mercosur only represents 1.6% of the share of US total imports between 1991-1995, and 2.4% of the share of US total exports in the same period (Lopes:1997, without page numbers). As in the case of the EU, there is also an asymmetry in trade volumes between the US and Mercosur. The lower volumes of trade between the US and Mercosur compared with that of Mercosur and the EU may be explained by the existence of non-tariff and tariff barriers in the US to Mercosur products, specially in the area of agriculture. In addition, other Latin American countries,

have better conditions for exporting their primary products to the US through the GPS (Lorenzo and Vaillant 2005).

Non-tariff and tariff barriers in the US as well as the US GPS with other Latin American countries constrain Mercosur-US trade relations. On the other hand, there are also protective sectors in Mercosur that impede the increase of the economic exchange between both parts. Mercosur is highly protective in the sector of manufactures. Protectionism in agriculture in the US and in manufacture in Mercosur, creates the deadlock in the FTAA negotiations and explain the low intensity of US-Mercosur trade relations.

According to Osimani (2005: 58-60) the FTAA agreement will be particularly beneficial for the Nafta and Mercosur countries. She claims this based on her statistical analysis of a trade intensity index. The import intensity index is "...the share of imports from the FTAA countries in total Mercosur imports, relative to the share of FTAA exports in total world exports". If the results are above 1, Mercosur buys more than expected from the other FTAA countries. Mexico and Canada presents an intensity that is below 1 from 1999 to 2001. The US has a trade intensity of 1.74 in 1999, 1.68 in 2000 and 1.71 in 2001. This data suggest that an agreement that facilitates Mercosur imports from Nafta would be beneficial. Therefore, the FTAA would potentially increase Nafta and US exports to Mercosur.

The export intensity index is defined as "the share of Mercosur exports to other FTAA countries in total Mercosur exports, relative to the share of imports from the other FTAA countries in total world imports" (Osimani 2005: 60). This index also suggest the potential benefits that a FTAA would bring for the US and Mercosur, increasing the Mercosur exports to the US. The FTAA has a trade intensity of 1.1 in 1999, 1.17 in 2000 and 1.22 in 2001. The highest trade intensity, regarding Mercosur buys, is for Chile, with 14.75 in 1999, 17.39 in 2000 and 18.02 in 2001, while the US has the third lowest after Canada and Mexico with a 1.00 in 1999, 1.03 in 2000 and 1.06 in 2001. The high intensity of trade with Chile is due to its associate status to Mercosur. A FTAA would increase trade intensity to a similar level as with Chile, by facilitating the access for Mercosur to the US market.

Following this data and using a pure economic rationale, a FTAA would create benefits for both the US and Mercosur. Therefore, the FTAA can be seen as a logical step for both actors. However, using the same economic logic, there are some constraints on the achievement of a compromise. The comparative advantages of Mercosur in agricultural products makes Mercosur push the US to make its agricultural policy more flexible. Mercosur thus intends to strike a compromise with the US only if the FTAA negotiation agenda includes agricultural issues. The US seeks to exclude the discussion of this issue by bringing it to the WTO talks (Doha Round) in order to negotiate this issue-area with other interested parties like the EU and Japan. Yet the WTO talks have shown only slow progress (Lorenzo and Osimani: 2005:42).

On the other hand, the protective barriers of Mercosur in sectors, where the US is more competitive, are also a problem in the FTAA negotiations. The eventual liberalisation of the industrial sector of petrochemicals, machinery and capital goods as well as some sectors of the automobile industry, would mean a threat to the existence of these companies in the two largest Mercosur countries, Brazil and Argentina (Vaillant and Ons 2005).

As the data presented above shows, a FTAA agreement can create good conditions for Mercosur extra-trade with the US and vice-versa. However, there are strategic issue-areas at stake for both parts that have brought the negotiations to a deadlock. In addition, the FTAA negotiations are not purely based on an economic rationale, there are also strong political connotations and intentions that could constrain or enhance the scope of the FTAA negotiations and an eventual agreement.

4.1.2 The US Political Strategy: Dividing South America?

Ruben Barbosa (2002), former Brazilian Ambassador in Washington, refers to the relationship between the US and the Southern Cone of Latin America as an economic relation. The Mercosur area is politically not relevant to the strategic interests of the US. The only country in South America that has a strategic relevance is Colombia (The Economist 2004: 63).

However, the trade relation between the US and Mercosur and the trade negotiations of the FTAA enclosed political goals and projects for the US and Mercosur, especially for Brazil which is the largest country in South America and, therefore, the natural leader of Mercosur.

As it was mentioned in the previous pages, the US has a clear goal of reconsolidating its pre-eminent power in the region vis-à-vis the growing influence of the EU and the Asian economies (Dull 1997). In addition, the US seeks to reduce the power of influence that Brazil is gaining in the region. An influential Brazil in the Southern Cone and with global presence in international institutions can reform the system of alliances in Latin America and reduce the leverage for the US to pursue its strategic goals. In order to impede the emergence and consolidation of Brazil, not only as regional power but also as a global one, the US seeks to reduce the scope of Brazilian power, keeping it within the original borders of Mercosur. However, the US policy is based on reactions towards the steps given by Brazil in the region. The pace of the FTAA is determined by the ambivalent relation of rivalry and cooperation between Brazil and the US (Schirm 2005).

The US strategy does not differ much whether the government is Democrat or Republican as the ones of President Clinton and the Presidents George H. Bush and George W. Bush respectively. The political strategy to enhance political pre-eminence and to assure the leadership in the negotiations of the FTAA is to divide Mercosur or at least to impede the inclusion of new full members. “Whenever Mercosur takes a step towards including new members, the US takes one in the opposite direction to impede it” (Gudynas 2003: 2).²⁵ The case of Chile has already been analysed in the previous pages as part of the US strategy of dividing the Southern Cone. In addition to the Chilean case, there are others that provides evidence of the US strategy. Brazil sought to achieve an agreement to include Peru into Mercosur, however, weeks after, the US announced its willingness to achieve a FTA with Peru. The consequence of this was that Peru retired its membership of the ‘Group of 20’,²⁶

²⁵ Original quote is in Spanish. Translated by the author of this work “Toda vez que se avanza un paso en ese sentido, surge una medida desde Estados Unidos que apunta en un sentido opuesto” (Gudynas 2003: 2).

²⁶ The group of 20 has been led by Brazil. The goal of this group is to articulate a common position in the WTO talks.

delayed the negotiations with Mercosur and answered positively to the US invitation (Gudynas 2003: 2). This shows that the US is still politically pre-eminent in the region when it exerts its power and the size of its market is more attractive for Southern Cone countries of Latin America than that of Brazil. It also shows that although Brazil has aspirations of being a regional power, it is far from reaching its strategic goal due to internal constraints and the lack of coherence that Mercosur shows sometimes. For example, Argentina has become rather sceptical about Brazilian aspirations in the region. Argentina does not support the Brazilian goal of getting a permanent seat at the UN Security Council. However, it does support the idea of having a permanent seat in the Security Council for South America, where the countries rotate after a fixed period of time. Moreover, Argentina has tried to delay the talks to make the South American Union real (Urrutia 2005: 2). Brazil would like to be the rule-maker of the integration process of South America but Argentina does not want to be one of the rule-takers. More than integrating new members, Mercosur needs to consolidate and deepen its internal cooperation among the current members. The eventual accession of new members like Ecuador and Peru, and others from the north like Colombia and Venezuela, rather than enhancing the Mercosur regional project and Brazilian leadership, might increase the cooperation problem (Schirm 2005).

Yet although there are inconsistencies in Mercosur that constrains Brazilian external goals, the US has also tried to deepen these differences by offering the exceptional status of ally outside NATO and military partner to Argentina in 1997. This offer reactivated the old quarrels that dominated Argentinean and Brazilian relations in the 80s. More recently, in 2001, the US tried to take advantage of the Argentinean crisis and offered FTA negotiations on a bilateral basis outside of Mercosur frame (Santander 2002: 494).

The US trade strategy is based on conducting bilateral FTA negotiations. However, behind this strategy, there are political goals that the US seek to achieve. The US behaves as a pre-eminent power and seeks to impede the emergence and consolidation of regional powers that can counterbalance its influence on the continent (Grabendorff 2003: 162). By offering bilateral negotiations to potential members of Mercosur, the US neglects the relevance of sub-regional projects in Latin America. This political strategy also constrains Brazil's project of unifying the Pacific and Atlantic side of South America through the South American Union, and a further FTA known as South American Free Trade Area (Safta) (Smith 2003, and De Vasconcellos 2003)

One of the main reasons for the US to promote the FTAA was to have access to the Brazilian Market. Brazil is the largest economy in South America and the one with the broadest internal market in both real and potential terms. From a Brazilian perspective, the attraction of getting an agreement with the FTAA is to gain access to the American market, where many Brazilian products compete in a disadvantageous position. The Brazilian and US political goals make the achievement of the FTAA difficult but not impossible.

The pace of the FTAA negotiations can be determined by the progress of the EU-Mercosur negotiations, which also were postponed. When the Mercosur-EU negotiations are retaken again,²⁷ it is probable that the US will reformulate its trade strategy accepting to negotiate

²⁷ The EU-Mercosur FTA negotiation will be retaken this year, 2005.

with Mercosur as a bloc rather than bilaterally. I believe this is a possibility, if Mercosur uses the negotiations with the EU as a counterbalance to US power. The EU-Mercosur negotiations should restart within this year. The restart and the potential achievement of a FTA between the Mercosur and the EU could trigger acceptance by the US of negotiating multilaterally with Mercosur. However, an eventual failure in the EU-Mercosur negotiations can determine the US-Mercosur relationship, and enhance the US trade strategy of negotiating bilaterally.

4.2 Multinational Corporations, Foreign Direct Investment and Interest Groups

The pace of the FTAA negotiations is also influenced by domestic groups that seek to protect or liberalise their sectors depending on whether they gain or lose with a FTA. In a two-level game analysis of international negotiations (Putnam 1998) a broader part of the American and Mercosur business community expects to benefit from a wider access to their counterpart markets. Therefore, export oriented business communities as well as MNCs would tend to support any negotiations that seek to establish a FTA (De Souza 2003: 198).

In this regard, a business community whatever its orientation protective or opening market becomes important “domestic” actors in the formulation of state foreign policies. The agriculture sector in Brazil is one of the sectors that made Brazil go further in the FTAA to assure a better deal for its products. Brazil wants changes in the FTAA regarding agriculture because agriculture represents around 25% of its GDP. Brazil is the least dependent country of all Latin America on the US market and has also no preferential arrangement at stake to protect with the US. Therefore, opening the US agricultural market to Mercosur traders is a major goal (Hornbeck 2004: 5).

Regarding the US, American MNCs have played an important role in the consolidation of the market economy and in promoting the FTAA in Latin America. Whatever the pros and cons of the MNCs, they have increased the dependence of Mercosur on FDI as source of job creation, tax revenues, training and technology transfer. American MNCs exert pressure to make Mercosur liberalise its services, manufactures and industrial areas (Dull 1997).

The support (or not support) for a FTA is determined by comparative advantages. Economic sectors with comparative advantages will lobby to agree on a FTA only if their sector can get access to the market of the counterpart. And the inefficient sectors of the economy will lobby to keep protective measures that secure their subsistence at the national level. Regarding the US-Mercosur relationship, the US farmer lobby groups have generated strong opposition at the domestic level to impede the inclusion of agriculture issue-area on the FTAA. In addition, the US Congress introduced protective measures for its steel industry and subsidies for agriculture producers in 2002. The lobby exerted by farmer groups, so far, has been effective, because the issue has been excluded in order to wait for the negotiations of the Doha round. The US does not want to give concessions that go beyond what will be agreed on the WTO (The Economist 2004: 52).

On the other hand, the survival of the Mercosur industries of petrochemicals, services, finance and some areas of the automobile industry are at stake with the FTAA (Vaillant and Ons 2005: 152). Looking at both sides of the US and Mercosur, the optimal solution but very unlikely for the non-competitive sectors would be to keep the status quo and not reach an agreement. A second best option will be to establish a system of quotas and a slower liberalisation through the years to make national industries adjust to the competition of the world economy.

The Nafta experience shows that despite export oriented interest groups seeking to remove barriers of the markets, the most probable outcome will be an agreement at the lowest common denominator. Within Nafta, the US still keeps some agricultural restrictions and continue using antidumping measures to protect their less competitive issue-areas. This is also present in the Mexican and Canadian cases. Mexico keeps some barriers on manufactures products and Canada on agriculture (Schott 2002: 8). Therefore, an agreement like the one of Nafta is the one that the US promotes because it keeps certain restrictions for key economic sectors where the parties are less competitive.

The American companies are the second main investor in Mercosur after the European MNCs. Therefore, with a FTAA the flows of capital through portfolio and foreign investment would tend to increase. Latin America and the Caribbean were the sites of almost 20% of US FDI in 1999. If Brazil and Argentina are taken individually the FDI numbers are rather poor in 1990 the US FDI was 3.3% in Brazil and 0.6% in Argentina, and in 1999 was 3.1% and 1.3% respectively of US total FDI investment in the world (Henwood 2000: 53). In absolute numbers, in 1990 US FDI in Brazil and Argentina was \$17 billion, and by 2001 US firms held \$50.5 billion (Schott 2002: 8). If a FTAA agreement is reached a further liberalisation and privatisation process could take place in Latin America. Most of the FDI in Mercosur was in the early 90s when the member-states implemented shock policies and privatised most of the public companies. However, Brazil has not pursued a path of deeper privatisation of key industries in the area of energy, and other basic services as Argentina and Uruguay did. For some US officials dealing with Latin America issues, the FTAA could create a second wave of privatisation that would help to reduce the problems of unemployment and corruption of the large states (Reich 2002: 15).²⁸

As in the EU-Mercosur case, domestic and transnational actors shape governmental policies to promote or impede the achievement of FTAA that enhance or threat their respective sectoral interests. Yet although these actors are able to influence the foreign policies of their governments, they do not completely determine them. However, the deadlock of the FTAA is due to interests of the most vulnerable areas of the economies, but a non-agreement is not a possibility for the respective parts, though the negotiations are delayed. The negotiations between the Brazil and the US will soon be retaken but the point is how much each party can achieve in the negotiations to enhance the competitive and protect the less competitive areas of their economies. An intermediate solution is the one established at the Nafta where an agreement was achieved at the lowest common denominator.

²⁸ These rhetorical statements are often used by US officials to promote the benefits of the FTAA for the Latin American countries.

4.3 Development Goals of the US Trade Strategy towards Mercosur

I excluded the issue of soft power as part of the US political and trade strategy throughout the chapter, because I believe its scope is limited and blurred. The US promotes and seeks to spread the values of democracy, human rights and its culture. In fact, in the drafts of the FTAA, these values are often included as core elements of the relation between the US and the Latin American countries. However, the US strategy of promoting a FTAA on a bilateral basis regarding the Mercosur countries constrains the Mercosur project. Bilateral negotiations create division within Mercosur and reduce its capacity to attract new full members. This rather than a product of US soft power actually reduces US soft power. Having soft power assets does not mean that they will be used correctly (Nye 2004). I do not deny that bilateral negotiations can enhance US soft power in other countries like Central American countries, where regional projects are not paramount to government policies.

The US FTAA model seeks to consolidate the fragile democratic regimes in Mercosur and create wealth in the societies of these countries as well as the rest of the continent. However, the achievement of development for the US strategy is through strengthening the economic market (Masi and Wise 2005: 314). The US approach can be summarised in the phrase “trade not aid”, a formula that inspired the first project of integration of President George H. Bush. This pattern was also followed by President Clinton and deepened by President George W. Bush. Despite the rhetorical commitment to development throughout the three last American governments, the promotion of the FTAA has not come along with substantial flows of economic aid nor significant external debt reduction or renegotiations (Carranza 2004: 65). In fact, the US economic aid to Latin America was reduced from \$1.8 billion in 1985 to \$687 million in 1996. At the same time, the EU has become the main aid donor in Latin America, with \$2.2 billion per year (Muñoz 2001: 82). In any case, the US aid is mainly concentrated in Central America and Caribbean countries, where it works rather well. Within the economic aid item, the US also includes donations to the logistic support in fighting the drug trade. For example, Brazil received \$1.5 million in equipment for fighting drug trade in 1994 (Dull 1997: 184). Regarding Mercosur, the US gave around \$19 million to Brazil and \$9 million to Paraguay in aid in 2004 (USAID, undated).²⁹ These numbers are a small percentage of the US total aid to Latin America.

There is no evidence at all of US support to NGOs programmes in Mercosur. I think this is a sensitive issue for the US. For the US, the public support to developmental NGOs can be perceived as a direct intervention in domestic politics of Mercosur countries. The US is often blamed in Latin America for seeking to destabilise governments or social movements that are not aligned with its policies.³⁰ The last cases are the one of Venezuela, where the US was accused of supporting a coup against the leftist president Hugo Chávez, and the one of Bolivia, where growing social unrest of indigenous movements and coca leaves producers

²⁹ There are no economic aid programs in the US government directed at Argentina and Uruguay.

³⁰ Although there are political episodes where the US sought to destabilise governments, however, sometimes the US is blamed to create a sense of nationalism and unity behind a President with internal problems, or for social movements to gain the sympathy of the popular classes.

overthrew President Sanchez de Losada (2003). The social movements in Bolivia have accused the US of intervention to impede that the *cocalero* leader Evo Morales runs for Presidential elections.

The US provides aid to Latin America. However, the amount of aid that goes to Mercosur countries are rather marginal. There are two reasons: first, Mercosur countries are middle income countries, and second, the US has the strong conviction that pure free trade is the way to economic and social development. For the US, the FTAA means not only economic growth but also the reduction of unemployment, and poverty. Therefore, the FTAA has a narrow approach to development. The US, rather than break the North-South division by implementing developmental programmes as complementary to trade relations, seeks to break this division by deepening free trade (Grugel 2004 and Carranza 2004). This policy constrains the US trade strategy and soft power. The market economy has not only produced macroeconomic stability and economic growth, but it has also worsened the gap between wealthy and poor in Latin America (Morley 2000). Moreover, the market economy has not showed consistency in reducing poverty indexes within Mercosur countries. Although the lack of developmental policies beyond the market economy do not jeopardise the FTAA, it does reduce US soft power in Mercosur. Because of the deadlock in the agriculture issue-area and the pure economic orientation of the FTAA, some politicians of Mercosur have stated their preference in negotiating with the EU rather than the US (Mercopress 2004).

5. Concluding Remarks: Comparing the US and the EU relations with Mercosur

The US and the EU have similar economic and political goals but, to achieve these, they pursue different trade and political strategies towards Mercosur. Mercosur also has interests at stake that to some extent help to enhance or constrain the strategies of the US and the EU. In Mercosur, Brazil is seen as the main articulator of the strategic goals of the economic bloc. The Brazilian goals of emerging as a regional power in South America, determine the US and Mercosur relationship, but not necessarily the EU-Mercosur relationship. This is because the EU is not as pre-eminent as the US in the region, although the EU competes with the US in terms of trade. Therefore, the EU seeks to establish a relation beyond Brazil, enhancing the regional project of Mercosur as a whole. However, this strategy also enhances the Brazilian position because of its size, which makes it the natural leader of Mercosur. In this regard, the EU is trying to help establishing a further institutionalisation of Mercosur by funding projects that can make Mercosur as coherent and strong as the EU integration project.

On the contrary, the US could eventually have its leverage reduced if Brazil increases its power and influence within and beyond Mercosur, for example, in the integration of the Andean Community and Mercosur through the South American Union. Therefore, if the US sees Brazil as bigger threat to its strategic interests, the US will tend to increase the pressure not only towards Brazil but also towards the other members of Mercosur, to make them support Washington's integration policies rather than Brazilian ones. The strategy to contain a further integration of Mercosur is to offer bilateral negotiations to potential members of Mercosur like Chile and Perú, and from time to time to full members of Mercosur like Argentina. The US knows that Brazil needs the Mercosur countries and the support of the Andean countries to pursue its strategic goals in the region. Without Mercosur, Brazil's political goals become less transcendent, because one of its goals is to be the articulator of Latin American integration and the voice of the developing countries of South America vis-à-vis the international community

At the moment, the US and Brazil have an ambivalent relationship which transits from rivalry to cooperation. From a rhetorical perspective, this relation is cooperative, the US is at least rhetorically trying to put the FTAA on the inter-American relations agenda as a way to achieve economic wealth. In addition, both the US and Mercosur, especially Brazil want to have access to each other's markets. There is no doubt that the US and Brazil have shown their commitment to the FTAA because of the access to their counterpart's markets. Despite the rhetoric on free trade, the US goals - and Brazilian goals - are constrained by domestic

groups that seek to exclude important issue-areas. These pressure groups have so far determined in part the pace of the economic integration between North and South America.

The rivalry between Brazil and the US is determined by political goals that both parties seek to achieve. US pre-eminence and Brazil's goals of being a regional and eventually a global power can increase the rivalry in the future.³¹ Yet the US, when it decides to operate in South America, has shown more economic and political power than Brazil to seduce and attract countries like Perú and Chile by offering access to its market. However, Brazilian goals are not only constrained by US actions that reduce Brazil's frame of action in the region, but also by the increasing opposition from Argentina to Brazil's ambitions.

In the case of the EU-Mercosur relationship, trade diversion and market expansion are the main elements. The EU pursues its relations with Mercosur beyond Brazil. The EU-Mercosur relationship is perceived by Mercosur as different to that of the US and Mercosur. However, regarding trade issues, the Mercosur-EU relationship and the US-Mercosur relationship present some similarities. In terms of trade, the EU is the main trade partner of Mercosur and the main FDI investor, while the US is the second largest. In both cases, there are notorious asymmetries in terms of trade. Mercosur is highly dependent on the US and the EU market rather than the opposite, which can eventually enhance the negotiating position of the US and the EU vis-à-vis Mercosur.

Another similarity between the EU-Mercosur and the US-Mercosur relationships is the weight of domestic actors that shape foreign policies. Both FTA negotiations have been conducted almost at the same time and have fallen into the same deadlock. The deadlock was produced in part by domestic groups seeking to exclude their issue-area from the FTA negotiations, because of their lack of comparative advantages. Perhaps the most influential lobby groups that oppose the respective FTAs are the farmers' groups in the EU and the US - and the industrial and services groups in Mercosur. This deadlock is also a proof of the similarity of economic assets that the EU and the US have in their extra-trade relations, and that the relationships EU-Mercosur and US-Mercosur keep the North-South division.

Despite the similarities with the US, the EU shows some uniqueness in its relation with Mercosur. The EU tries to break this North-South division with Mercosur by offering a FTA that goes beyond trade. This 'integral' FTA with Mercosur includes a strong commitment to achieve development of Mercosur countries and Mercosur as a regional project. The commitment to developmental goals is not merely rhetorical. The EU has transferred economic resources to enhance Mercosur institutional development e.g. educational projects, harmonisation of customs and statistics, technology transfer, etc. The EU is trying to transfer its own experience of integration to Mercosur. On the contrary, the US has reduced the level of economic aid to Mercosur countries and it has not redirected it in technology transfer to Mercosur as the EU did. The US strategy is based on the trade not aid policy. The US has the conviction that the promotion of market economies are the way to development.

In other words, the EU trade strategy is based on pure interregionalism and multilateralism, where there is the explicit recognition not only of Mercosur but also of the benefits of the creation of regions as an alternative way to shape the economic governance of the global

³¹ The intensity of the rivalry is low at the moment.

world economy. On the contrary, the US pursues a trade strategy based on bilateral negotiations that can establish a *de facto* interregional agreement where every country is connected to US rather than connected with each other. With this policy, the US seeks to contain the proliferation of other regional projects and regional leaderships where the US is not the hub. Not only does the US seek to contain the expansion of Mercosur but also the growing influence of the EU in Mercosur. An eventual FTA Mercosur-EU can reduce the trade flows between Mercosur and the US and vice-versa. As the EU and the US have similar economic resources, the EU has to offer something else to be more attractive in a region like Mercosur, where the US is economically important and politically pre-eminent. Therefore, the EU offers this integral FTA as way to access new markets. By using issue-areas that have little or nothing to do with trade, the EU enhances its global trade position. The access to each other's markets is the centre of these relationships, but within these strategies the actors involved take the opportunity to achieve an international status or consolidate either their regional and hemispheric or global position.

The foregoing analysis has explained the various sources of power that the EU and the US use in their relations with Mercosur. The EU is rich in soft power assets and these are used as part of the trade strategy. By promoting, through implementing programmes, the values of democracy, culture, human rights, social justice, development and good governance, the EU strengthens its position as an economic power. The EU perceives itself as a civilian power, and the characteristics of the Mercosur-EU relation support this perception. The EU also uses other sources of power based on absolute and relative gains. In terms of absolute gains, the EU seeks that the EU and Mercosur both get absolute gains from the relationship. In terms of relative gains, the EU tries to measure what it gets from having or not having a FTA with Mercosur vis-à-vis what the US gains or loses by having a FTAA with Mercosur. In this calculation it becomes important which FTA is agreed first. However, the power assets, political goals, and trade strategies can be constrained and hindered, as it is the case of both EU-Mercosur FTA and the FTAA, by important and powerful interest groups that are moved by a pure economic rationale. Therefore, the EU has soft power, and uses it along with economic and political power, but soft power does not have enough scope to conduct economic and political foreign relations in itself, though it helps to strengthen these two later strategies. The perception that the EU is a real civilian power can be constrained if the EU does not make its agricultural policy more flexible, because this is one of the main markets developing countries need access to end with the EU-South division.³² Hence the EU-Mercosur relationship is determined by economic issues, although there are other goals or means of power involved this relation.

³² Before finishing this dissertation, the EU has gone a step further to continue with the negotiations of the WTO. The EU proposed few days ago (La Tercera 05/05/2005) a change on how to calculate duties on farm products. This can eventually reduce the prices of the products of the developing world in the EU and US. The EU proposal was accepted by Brazil, India, and China as well as the US. This progress can make the EU and Mercosur, and the US and Mercosur retake the negotiations on the FTA.

The US trade policy involved soft power indirectly.³³ By achieving more economic interdependence through the FTAA, the Mercosur and other Latin American countries will be less tempted to go backward to authoritarian governments or to heterodox economic policies, because those countries with authoritarian governments or heterodox economic policies will be excluded from the interregional agreement.³⁴ However, regarding soft power articulated in developmental issues, the US does not seem to use it much. This is because the US believes the free market is enough on its own without soft power inducements. In this regard, the EU has a broader conception of development. The US's development strategy operates within the market while the EU's is complementary to the market. In addition, the US approach to Mercosur and especially to Brazil is dominated by the calculation of relative gains, although the idea of FTAA is that everyone wins. However, the US use of limited soft power, and its political goals towards Mercosur countries, are also hindered by economic issues. The deadlock of the FTAA negotiations is explained by the comparative advantage of Mercosur farmers, which are a threat to the US agriculture industry, and the US comparative advantages in the manufacture and services areas, which are a threat to Brazilian industries, if the FTAA include a liberalisation of these issue-areas.

Even though the FTA negotiations between the EU and Mercosur, and the US and Mercosur countries are currently stalled there is the perception that the respective FTA negotiations will be resumed. However, the eventual FTAs are not expected to be based on a full liberalisation of the most sensitive issue-areas. The most probable outcome is that, in both negotiations, the FTAs will be at a lowest common denominator as Nafta and the FTAs of the EU with Mexico and Chile shows. However, the US project is seen as more difficult to achieve because there are more actors in than the EU-Mercosur negotiation, and the bilateral negotiations increase the time taken up by the FTAA negotiations. In Latin America, at the moment, there are growing political problems between the US and Venezuela, and high political instability in Ecuador which has made the President resign, as well as the problems of Colombia. These political problems could slow down a final agreement between the US and Latin American countries if the FTAA negotiations are retaken. On the other hand, in the EU-Mercosur relationship, Mercosur countries have political and economic stability that makes it more feasible to reach an agreement in less time. However, the progress of the US's negotiations with Brazil and the rest of Mercosur can be determined by the progress of the EU-Mercosur negotiations and vice-versa. Therefore, the EU and the US compete and will continue competing for privileged access to the Mercosur market.

To conclude, the EU and the US respective models of *pure* and *de facto* interregionalism have to be studied more deeply. There is a lack of empirical studies on the issue of interregional relations, though theoretical approaches are emerging to analyse these phenomena. However, there is a lack of studies from a comparative perspective on the patterns of interregionalism that the US and the EU promote, and how these actors relate to the developing world. Comparing these two different actors can help to analyse and test the self-

³³ I do not deny in most Latin American countries, especially, in the upper classes people feel attracted by the US soft power e.g. movies, culture, language, fast food, and the american dream. These issues can eventually play a role in the US-Latin America relationship.

³⁴ Keeping democratic regimes is also a factor in the EU-Mercosur FTA negotiations

proclaimed uniqueness of the EU in conducting its international relations. Moreover, there is the possibility that interregional relations become more important in trade negotiations and that interregional agreements become either an alternative or a complement to multilateral institutions like the WTO, depending on whether this can cope with the issues of legitimacy and governance. Therefore, this dissertation is a preliminary study of these issues, which will be returned to in the future to analyse why the US and the EU pursue different models of interregional integration and why their policies regarding Mercosur differ.

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A) Interviews:

1. (04/04/2005, via e-mail) with Chilean former Official of the Foreign Affairs Office, Specialist in Mercosur. The interviewed was possible under the condition of anonymity.
2. (11/04/2005, Copenhagen) with Vanessa Saenz Prytz, PhD[©] from the Copenhagen Business School, field of studies: Brazilian Economic Foreign Policy.
3. (28/04/2005, Bochum, Germany) with Prof. Dr. Stefan Schirm, Chair of International Relations, Department of Political Science, Ruhr-Universität Bochum.