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The Interregional Association Agreement between the European Union and Mercosur: Is the Timing Right?

Pablo Gómez Leahy



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By Pablo Gómez Leahy

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European Political and Administrative Studies/
Études Politiques et Administratives
Dijver 11, B-8000 Brugge, Belgium
www.coleurope.eu/pol

About the author

Pablo Gómez Leahy was an MA student in the EU Political and Administrative Studies department at the College of Europe in 2015. He also holds a BA in European Studies from Maynooth University, Ireland, with a one-year Erasmus at Université d'Aix-Marseille, Aix-en-Provence, France. This paper is based on his Master's thesis at the College of Europe (Falcone and Borsellino Promotion).

Contact Details: pablo.gomez@coleurope.eu

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Dijver 11, B-8000 Bruges, Belgium | Tel. +32 (0) 50 477 281 | Fax +32 (0) 50 477 280
email michele.chang@coleurope.eu | website www.coleurope.eu/pol

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Abstract

The European Union (EU) and Mercosur talks have been stalled since discussions were resumed in 2000. Recurring protectionist and institutional obstacles have slowed down negotiations. The financial crisis, however, has resulted in low domestic demand in the EU. This has made the interregional association agreement (IAA) with Mercosur more attractive. The loss of the Generalized Scheme of Preference (GSP) status and the lack of a Free Trade Agreement (FTA) with the EU have both disadvantaged Mercosur. A further window of opportunity is opening up in Mercosur. In Brazil, there have been cries for a change in government. In Argentina, presidential elections will take place in October 2015 and will assuredly bring an end to *Kirchnerismo*. A change in leadership in both countries is expected to make agreement more likely. Protectionist policies are not expected to remain as high if there is change in government. This will provide the EU with an opportunity to advance the negotiations and conclude the IAA.

Introduction

The EU Mercosur relationship is nearly as old as Mercosur itself. 1992 saw the EU and Mercosur conclude their first agreement.¹ The EU and Mercosur achieved further integration at the Madrid European Council in December 1995 with the signing of an Interregional Framework Cooperation Agreement.² This agreement, however, was intended to serve only as a “foundation” for a more comprehensive agreement.³

In 2000, negotiations for the Interregional Association Agreement (IAA) began, but did not run as smoothly this time around. The trade chapter was the most complicated. Agriculture was the biggest obstacle for the EU, while for Mercosur it was manufacturing and services. An agreement could not be reached and negotiations ended in 2004.⁴

Meanwhile, however, the EU concluded many Free Trade Agreements (FTAs). The EU/Mexico FTA came into force in 2000 and the EU/Chile Association Agreement in 2002.⁵ In 2012, the EU successfully concluded a comprehensive trade agreement with Colombia and Peru.⁶ In 2014, Ecuador signed up to the same agreement.⁷ Mercosur, due to its own internal obstacles, was unable to do so.

Negotiations were reinitiated in May 2010 at the Madrid European Union and Latin America and Caribbean (EU-LAC) summit, where both regions expressed their commitment to “an ambitious and balanced agreement”.⁸ It has been jointly estimated by the European Commission and Brazil’s Ministry of Development, Industry and Foreign Trade, that the

I would like to express my sincere gratitude to Professor Michele Chang for the continuous support and immense patience, as well as to my parents, José and Una, for supporting me through a long year in Bruges.

¹ European Commission, *Interinstitutional Cooperation Agreement between the Mercosur Council and the European Commission*, 29 May 1992, retrieved on 30 March 2015, http://europa.eu/rapid/press-release_MEMO-94-62_en.htm

² Council of the European Union, ‘Interregional Framework Cooperation Agreement, 19 March 1995’, *the European Union*, L69, 19/03/1995.

³ A. Hardacre, *The Rise and Fall of Interregionalism in EU External Relations*, Dordrech, Republic of Letters Publishing BV, 2010, p. 189.

⁴ *Ibid.*

⁵ European Commission, *The EU’s bilateral trade and investment agreements – 0*, COM (2013), Brussels, 3 December 2013 p. 5-6.

⁶ European Commission, *Andean Community*, retrieved 31 March 2015, <http://ec.europa.eu/trade/policy/countries-and-regions/regions/andean-community/>

⁷ European Commission, *The EU’s bilateral trade and investment agreements – where are we?*, *loc. cit.*

⁸ Council of the European Union, *IV EU-Mercosur Summit Joint Communiqué*, Madrid, 17 May 2010.

agreement would provide €9 billion in gains, €4.5 billion for each side.⁹ Five years later, however, there has not yet been an agreement, despite the fact that there have been nine rounds of negotiations, and despite the continued affirmation of intent to conclude the agreement.¹⁰

The research question will be the following: which factors, if any, can make conclusion of the IAA more likely this time around? To answer this question, I will first of all examine the interests that both blocs have in concluding the agreement, as well as the obstacles which stood and continue to stand in the way of said agreement. The paper will then look at domestic politics in both Brazil and Argentina to show that a political window of opportunity is opening up. The hypothesis will thus be as follows: the chances of the IAA being concluded in the near future are higher given the transformations that will occur in both Brazil and Argentina.

For the purpose of the paper, I will define “Free Trade Agreement” as an agreement in which both parties agree to trade freely with one another without imposing tariffs and “Interregional Association Agreement” as an “international agreement that the European Union has concluded with third... blocs with the aim of setting up an all-embracing framework to conduct bilateral relations”.¹¹

1. European Union Interest in the IAA

Economically speaking, Mercosur is less important to the EU than vice-versa. This was reiterated by an official of the European Commission, who described the IAA as being an “opportunity” for the EU and a “need” for Mercosur.¹²

Mercosur is an important trade partner for the EU in manufactured goods. The export of services is also quite significant. In 2012, EU exports to Mercosur in this area

⁹ M. Wigell, *Seal the deal or lose Brazil*, The Finish Institute of International Affairs (FIIA), March 2015, retrieved 21 April 2015, file:///C:/Users/HP/Downloads/bp171%20(1).pdf

¹⁰ Council of the European Union, *Santiago Declaration*, Santiago de Chile, 27 January 2013, p. 6.

¹¹ European External Action Service, *Association Agreements*, retrieved 31 March 2015, <http://eeas.europa.eu/association/>

¹² Interview with an Official, DG Trade, European Commission, Brussels, 08 April 2015. (Interview A)

amounted to €18.5 billion.¹³ The EU has a clear comparative advantage in these areas. An FTA would therefore undoubtedly benefit these sectors, increase exports and provide jobs.

The EU enjoyed a balance of trade surpluses in both goods and services in 2010, 2011 and 2012, with the exception of goods in 2011.¹⁴ More generally, they also show increased trade flows. The financial crisis, by the same token, has also increased the EU's interest in the IAA. Financial crises lead to "inadequate domestic demands" and this in turn creates an economic need to find new markets abroad in order to grow.¹⁵

Government procurement, an area that has traditionally been sheltered from competition, is of increasing interest to the EU. Its ambition to have a standard-setting role in the global political economy is evident here. Common standards were first introduced into the General Agreement on Tariffs and Trade (GATT) in the form of an Agreement on Government Procurement (GPA) at the 1979 Tokyo Round. Further agreement came during the Uruguay Round, 1986-1994, resulting in an expansion of the GPA to include not only services, but also additional government entities.¹⁶ However, as it is only a "plurilateral" agreement, not all World Trade Organisation (WTO) members have signed up to it,¹⁷ hence the EU's interest in agreeing common standards with Mercosur. Government procurement is regarded as an area of "significant untapped potential for EU exporters", as at present companies face notable "discrimination practices" from many of the EU's trading partner.¹⁸ These contracts amount to roughly €1000 billion a year of world trade flows.¹⁹ Government

¹³ Eurostat, *Trade in goods, by main world traders*, retrieved 1 April 2015, <http://ec.europa.eu/eurostat/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tet00018&language=en>

¹⁴ European Commission, DG Trade, *Trade: Countries and Regions: Mercosur*, retrieved 4 April 2015, Available at <http://ec.europa.eu/trade/policy/countries-and-regions/regions/mercosur/>

¹⁵ Interview with Pierre Sauv , Director, External Programs and Academic Partnerships, World Trade Institute, Bruges, 14 April 2015. (Interview D)

¹⁶ C. Kirkpatrick and C. George, *Trade Sustainability Impact Assessment (SIA) of the Association Agreement Under Negotiation Between the European Community and Mercosur*, Institute for Development Policy and Management (IDPM), Revised March 2009, p. 83, retrieved 05 April 2015, http://trade.ec.europa.eu/doclib/docs/2009/april/tradoc_142921.pdf

¹⁷ World Trade Organisation, *Agreement on Government Procurement*, retrieved 5 April 2015, https://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm

¹⁸ Kirkpatrick and George, *op. cit.*, p. 83.

¹⁹ *Ibid.*

procurement is therefore of paramount importance to the EU. Its exclusion would be a deal-breaker.²⁰

Consolidating its market share in Mercosur is also important.²¹ The EU is Mercosur's most important trade partner. The EU already has, therefore, a strong presence in the region and it is in its interest to consolidate and build on this presence. The agreement would do this by encouraging further political and economic cooperation.

What adds some sense of urgency to the EU in these negotiations is the need to counteract US and Chinese influence in the region. Mercosur's relationship with the US, similar to its relationship with the EU, is one of dependence.²² Therefore, changes in Mercosur-US relations inevitably affect those it has with the EU. Its relationship with China is also becoming more relevant and as such also merits analysis.

The EU traditionally feared a pan-American bloc emerging which would be able to play a standard-setting role in the world economy.²³ This is highlighted by the increase in EU engagement with Mercosur that resulted from the US-led Free Trade Area of the Americas (FTAA) process. In June 2001, the EU made a unilateral offer to Mercosur in an attempt to quicken proceedings.²⁴ The EU feared that the FTAA would have had what Alan Hardacre calls a "Mexico effect", whereby the US would gain a larger market share at the expense of the EU.²⁵ However, this process, which would have created an area of free trade encompassing both North and South America, with the exception of Cuba, lost its momentum in 2005 as the Mercosur countries and Venezuela, at the time not a member, opposed it.

Given that this process failed in 2005, rivalry from the US is not as strong as it was. However, it is still present. The US is Mercosur's third most important trade partner.²⁶

²⁰ Interview with an Official, DG Trade, European Commission, Brussels, 08 April 2015. (Interview B)

²¹ *Ibid.*

²² G. M. Genna, 'Economic size and the changing international political economy of the trade: The development of western hemispheric FTAs', *International Politics*, vol. 47, no. 6, 2010, p. 649

²³ S. Santander, 'The European Partnership with Mercosur: A Relationship Based on Strategic and Neo-liberal Principles', *Journal of European Integration*, vol. 27, no. 3p. 298.

²⁴ A. Hardacre, *op. cit.*, p. 213.

²⁵ *Ibid.*

²⁶ Commission of the European Communities, DG Trade, *Mercosur, Trade with World*, retrieved 9 April 2015, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111832.pdf

Moreover, Jeb Bush, Governor of Florida and Republican presidential hopeful, has stated his interest in reviving the FTAA process.²⁷ This, of course, does not pose an immediate threat to the EU's interests in the Southern Cone, but it could in the future.

China poses a more immediate threat to the EU's presence in the region. China has been growing at an alarming rate. In 2013, it grew 7.7%.²⁸ This level of growth has led to a commodities boom, which has subsequently enabled Mercosur to increase its share of exports to the country. China is Mercosur's largest export destination.²⁹ The "adoption" of new protectionist measures by both the EU and the US facilitated this diversion of exports to China.³⁰ Chinese exports to Mercosur have also increased, although they were still behind those of the EU in 2013. China is moreover interested in establishing a "free trade zone" with Mercosur.³¹

If these trends result in China gaining a larger market share in Mercosur, the bloc will not be as pressured into signing an IAA with the EU.³² This will give it leverage in future negotiations with the EU, thus making conclusion of the IAA less likely. If the EU fails to close the deal now, it will have to make more concessions in the future, making it less likely that it will have the necessary domestic support to ratify the agreement. It is therefore essential that the EU makes a sufficient offer to Mercosur sooner rather than later.

2. Mercosur Interest in the IAA

The loss of the Generalised Scheme of Preference (GSP) status is a major factor pushing Mercosur into concluding the IAA. This scheme allows developing countries to pay fewer duties on their exports. As of January 2014 onwards, however, Brazil, Argentina, and Uruguay stopped benefitting from GSP as they are now classified as high or upper-middle

²⁷ S. Lester, 'Jeb Bush Revives the FTAA', *International Economic Law and Policy Blog*, 18 February 2015, retrieved 19 April 2015, <http://worldtradelaw.typepad.com/ielpblog/2015/02/jeb-bush-revives-the-ftaa.html>

²⁸ The World Bank, International Development Association, *GDP Growth (Annual Data)*, retrieved 20 April 2015, <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>

²⁹ Commission of the European Communities, DG Trade, *Mercosur, Trade with World*, retrieved 9 April 2015, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111832.pdf

³⁰ E. Cardoso and M. Holland, OECD, Development Centre, *South America for the Chinese? A Trade-Based Analysis*, Paris, OECD, 2010, cited in O'Connor, *loc. cit.*

³¹ J. Klonsky, S. Hanson and B. Lee, 'Mercosur: South America's Fractitious Trade Bloc', *Council on Foreign Relations*, 31 July 2012.

³² Genna, *op. cit.*, p. 652.

income countries by the World Bank.³³ Paraguay still benefits from the scheme. Failure to reach an agreement with the EU means that it will have to compete with other exporting countries that do benefit from GSP status, as well as those that have already concluded have FTAs. This means it is facing competition from virtually every rival in the region, except Cuba.

Given that the EU is Mercosur's first trading partner, concluding the IAA would undoubtedly benefit its export sector. This will, of course, only be the case if the EU opens its markets to agricultural products. Exports in this area to the EU make up the largest proportion of all Mercosur exports. In 2013, agriculture amounted to 43% of total exports to the EU, while raw materials came in second place at 28%.³⁴ It is actually quite impressive that Mercosur, in light of the import tariffs, is able to export so much of its agricultural produce to the EU. Should this protectionism be relaxed as part of the IAA, Mercosur would be able to reach more of its economic "potential" in this area.³⁵

FDI from the EU is also of significant importance to Mercosur. In 2012, it amounted to €280 billion.³⁶ Given that the EU is its main supplier of FDI, it is undoubtedly in its interest to consolidate these investments by concluding the IAA. Increased investment between the two regions would have added benefits. It would facilitate the transfer of technology and the exchange of knowledge.³⁷ This is something that is of particular interest to countries of Mercosur as they seek to develop their economies. FDI flows from the EU, however, are uneven. The only European country that contributes a significant amount of its FDI to Latin America relative to other regions is Spain. This accounted for 30% of Spain's investment stock during 2006-2011.³⁸ Spanish firms moreover supply nearly

³³ 'Mercosur members, except Paraguay, de-listed from EU import preference scheme', *MercoPress*, 31 October 2012.

³⁴ European Commission, *Mercosur*, retrieved 31 March 2015, <http://ec.europa.eu/trade/policy/countries-and-regions/regions/mercosur/>

³⁵ K. Gerber, 'The Interregional Association Agreement between the European Union and Mercosur: Stalled or Broken Down', Master's Thesis, College of Europe, Bruges, 2007, p. 27.

³⁶ European Commission, *Mercosur*, *loc. cit.*

³⁷ W. Greiner, *Die Interregionale Assoziierung zwischen der Europäischen Union und dem Mercosur: Ein Modell für die Kooperation zwischen mehreren Freihandelszonen im Rahmen der Welthandelsordnung*, Frankfurt am Main: Peter Lang, 2004, p. 152 and IRELA, *Relaciones económicas entre el Mercosur y la UE: perspectivas para la nueva década*, IRELA, Madrid, 1999, pp. 16-17, cited in Gerber, p. 13.

³⁸ S. Gratiús, *Europe and Latin America: In Need of a New Paradigm*, Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE), February 2013, p.5, retrieved 11 April 2015, http://fride.org/download/WP_116_Europe_and_Latin_America.pdf

half of the FDI in the region emanating from Europe.³⁹ Even though Spanish firms continue to prioritize Mercosur for investment, new markets are becoming more and more interesting to them.⁴⁰ The financial crisis is moreover negatively affecting Spanish investments in the region. In 2013, FDI from Spain was much lower than in previous years.⁴¹ In the longer term, this could lead to sustained reductions in Spanish FDI.

Concluding the IAA with the EU would help to reverse this trend. There can be no doubt that it would lead to increased FDI from the EU. It is no coincidence that Brazil and Mexico, the two countries that have strategic partnerships with the EU, soak up the vast majority of EU FDI in Latin America. Concluding the IAA would not only help to consolidate FDI inflows from countries such as Spain, it would also incentivise other European countries to invest more in the region.

Mercosur also has strategic aims in these negotiations concerning its own legitimisation as a viable economic entity. Its viability as a regional entity is constantly being questioned.⁴² For this reason it engages in political dialogue as a way to legitimate itself as a global actor.⁴³ Failure to conclude the IAA with the EU this time around will put its viability into question once again. This scenario is unacceptable to many policy-makers in Mercosur's most important country, Brazil, who are keen on agreeing more FTAs. One example is former development minister, Luiz Fernando Furlan. According to him, Brazil would benefit from leaving the bloc and signing bilateral agreements.⁴⁴ The only reason why Brazil has not left the bloc is that it continues to value Mercosur. Yet if Brazil is to play a leadership role in the region via Mercosur, it is absolutely essential that it has FTAs with

³⁹ *Ibid.*

⁴⁰ J. C. Martínez Lázaro and I. Galo (eds), *2014: Panorama de Inversión Española en Latinoamérica*, Inversión Española (IE), p. 3, retrieved 11 April 2015, http://www.crones.es/pdf/VII_Informe_Inversion_Espanola_Latam_2014.pdf

⁴¹ A. Bárcena et al, UN, ECLAC, *Foreign Direct Investment in Latin America and the Caribbean*, Santiago, UN, 2014, p. 31.

⁴² For example, 'Mercosur RIP?', *The Economist*, 14 July 2012, and 'Crece Alianza del Pacífico tras fracaso de Mercosur', *El País*, 20 June 2014.

⁴³ B. Ruiz and A. R. Puntigliano, 'The European Union and the making of South American Regionalism', in Lombaerde, Philippe and Michael Schulz (eds.), *EU and World Regionalism*. London, Ashgate, 2009, p. 108

⁴⁴ 'Former Brazilian minister blames Argentina for the lack of EU/Mercosur trade accord', *MercoPress*, 20 November 2014.

the world's main economies. Concluding the IAA with the EU would dispel a lot of the criticism about its credibility and would keep the bloc together.

3. Why has an agreement not been reached yet?

In spite of the aforementioned reasons which seem to render the IAA of interest to both regions, agreement has not yet been reached.

3.1. Protectionism

From the EU side, we can identify protection of agriculture as the main obstacle to an agreement. Aggarwal and Fogarty contend that the strategies of the EU are determined by the interests of specific interest groups.⁴⁵ In the case of its relations with Mercosur, we can consider that agricultural interests play a role.

According to the Argentine Embassy, access to agricultural markets remain too restrictive,⁴⁶ while on the other hand an interview with a European Commission official highlighted the Commission's somewhat misplaced belief that access to these markets is no longer such. Despite being a "sensitive" area which the EU does not want to see fully liberalised, it is nonetheless willing to gradually open up parts of the sector through "quotas".⁴⁷ It is hard to know yet if this is the case, however. The most recent CAP reforms took place in 2013 and are thus only in their infancy. They mainly entailed a change in the direct payments regime and to a lesser degree the ending of quotas.⁴⁸ The reforms cannot hurt, but they certainly do not provide for a significant opening up of EU agricultural markets to Mercosur in the future. The main hurdle remains the lack of progress achieved during the Doha Round.⁴⁹

What is clear is that protectionist tendencies are strong due to the strength of agricultural interests. Agricultural interests are well-engrained at Member State level and have always been well represented. At the EU level, the interests of farmers are represented by the Committee of Professional European Agricultural Organisations (COPA) and by the

⁴⁵ V. Aggarwal and E. Fogarty (eds), *EU Trade Strategies: Between Regionalism and Globalism*, Basingstoke, Palgrave, 2004, p. 7, cited in Hardacre, *op. cit.*, p. 207.

⁴⁶ Interview with Mr. José María Arbilla, Minister, Chief of the Economic and Trade section, Argentine Embassy to the European Union, Brussels. (Interview C)

⁴⁷ Interview with an Official, DG Trade, European Commission, Brussels, 08 April 2015. (Interview A)

⁴⁸ 'CAP 2014-2020: A long road to reform', *EurActiv*, 4 July 2013.

⁴⁹ Interview with Pierre Sauvé, Director, External Programs and Academic Partnerships, World Trade Institute, Bruges, 14 April 2015. (Interview D)

General Confederation of Agricultural Cooperatives (COGECA). Farmers' interests continue to have strong platforms, at both national and supranational level, from which they oppose a liberalisation of agriculture. This base allowed agricultural interests to oppose the agreement during the period 2000-2004 and from the beginning of the negotiations in 2010.⁵⁰ The recent reforms of the CAP are, however, indicative of a weakening of the agricultural lobby. This could enable the EU to make a more ambitious market-access offer to Mercosur.

From the Mercosur side, we can identify the protection of both the manufacturing and services sectors as the main obstacles. In Brazil, protection of the manufacturing sector from international competition has been the norm over the years. Consensus existed for this from both business elites and civil servants.⁵¹ In an age when most countries are removing barriers to trade, Brazil is increasing them. It has an applied customs tariff of 13.5% and is seen by the EU as one of the countries that has the most trade-restrictive measures.⁵²

In Argentina, trade-restricting policies are also the norm. So much so in fact that the EU challenged Argentina's import licensing regime in the WTO in 2012.⁵³ Some of these restrictive policies include the non-automatic issuing of import licenses and tough pre-approval requirements. The lack of transparency in their issuance is another factor which further exemplifies Argentina's protectionism.⁵⁴

Lowering trade restrictions remains incomplete, which shows how much of an obstacle this has been in these negotiations.

⁵⁰ 'Farmers oppose relaunch of EU-Mercosur trade talks', *EurActive*, 18 May 2010.

⁵¹ P. L. Kegel and M. Amal, *Mercosur and its Current Relationship to the European Union: Prospects and Challenges in a Changing World*, Centre for European Integration Studies (ZEI), 2012, p. 21, retrieved 28 March 2015, http://www.zei.uni-bonn.de/dateien/discussion-paper/dp_c209_kegel_amal.pdf

⁵² European Commission, *Countries and Regions: Brazil*, retrieved 15 April 2015, <http://ec.europa.eu/trade/policy/countries-and-regions/countries/brazil/>

⁵³ A. Rebossio, 'Denuncia contra Argentina ante la OMC por prácticas proteccionistas', *El País*, 30 March 2012.

⁵⁴ European Commission, *Countries and Regions: Argentina*, retrieved 15 April 2015, <http://ec.europa.eu/trade/policy/countries-and-regions/countries/argentina/>

3.2. Institutional Obstacles

Both regions face substantial obstacles in relation to their institutional structures. First of all, neither is a sovereign state.

From the EU perspective, getting a negotiating mandate in a Council of, at the time, fifteen Member States to enter into negotiations in the first place proved difficult. The initial mandate that the Commission received met with serious “reservations” concerning agriculture, notably from France and Ireland.⁵⁵ These reservations were to mark the subsequent 15 years of stalemate in the negotiations. Its mandate is therefore inflexible.

There are also many veto players. The EU faces more obstacles in this regard. This can, however, increase its leverage in the negotiations.⁵⁶ This potential block allows it to attempt to exclude areas in which it has defensive interests, such as agriculture, and include areas in which it has offensive interests, such as government procurement on the basis that it needs to satisfy these different sectors. Yet Mercosur, by relying solely on intergovernmental decision-making, also gains leverage, hence the stalemate.

The EU must have unanimous support in the Council to ratify the agreement. Furthermore, the European Parliament (EP), thanks to the increased powers it received with the Treaty of Lisbon, has to give its consent to international trade agreements. The EP could potentially cause the agreement to collapse, as it did with the Anti-Counterfeiting Trade Agreement (ACTA) in 2012. Domestic interests at the Member State level that are well mobilized will be able to influence their MEPs in rejecting or in giving their consent to an agreement.

Mercosur, on the other hand, does not have as many veto players. It has only 5 Member States and no parliament with supranational powers. Nevertheless, it still needs the unanimous consent of these members to conclude the agreement. The main obstacle in this regard is Mercosur’s “insistence on strict intergovernmentalism”.⁵⁷ This logic makes it tough for the countries to even come up with joint proposals. The EU at least has the ability

⁵⁵A. Hardacre, *op. cit.*, 190.

⁵⁶ R. Putnam, ‘Diplomacy and domestic politics: the logic of two-level games’, *International Organisation*, vol. 43, no. 3, 1988, p. 448.

⁵⁷ M. Doctor, ‘Interregionalism’s impact on regional integration in developing countries: the case of Mercosur’, *Journal of European Public Policy*, 2015, p. 14.

to negotiate somewhat independently of its members once it has received a mandate. This obstacle will, for Mercosur, continue to be relevant in the foreseeable future given Brazil's reluctance to cede sovereignty.⁵⁸

4. What has changed to make the conclusion of the IAA more likely?

4.1. Changes in Brazil's Domestic Politics

The changes occurring in Brazilian domestic politics at the time of writing have game-changing potential for EU-Mercosur relations.

In an age where trade liberalisation has been the norm, Brazil has continued to favour its domestic market. Protectionist policies have been implemented over the last decade by both *Partido dos Trabalhadores* (PT) presidents "Lula" da Silva and Dilma Rousseff. Lula became president in 2003. He was re-elected in 2006 and stayed on until 2011. Under his leadership, Brazil has become a lot more protectionist. He reintroduced what were called "strategic development plans", for instance, to privilege specific domestic industries in certain sectors of the economy through financial support and protection against competitive imports.⁵⁹ These policies have distorted trade. This is now being felt more acutely as the commodities boom has ended and it can no longer rely on exports to China.⁶⁰

Rousseff, who won the 2010 elections, has continued her predecessor's policies. Import tariffs have increased. In 2012, for example, a tariff increase of 25% was applied to an extra one hundred goods emanating from outside Mercosur.⁶¹ In addition to mere import protection, Rousseff has been expanding the role of the state, thus making many local industries increasingly dependent on government spending,⁶² which is unsustainable in the longer-term. The assumption on the part of many Brazilian policy-makers was that Brazil

⁵⁸ L. Gomez-Mera, *Power and Regionalism in Latin America: The Politics of MERCOSUR*, Notre Dame, OH: University of Notre Dame Press, 2013, p. 197, cited in Doctor, *loc cit*.

⁵⁹ R. Camargo Mendes, *Trade: Brazil's New Protectionist Agenda*, Americas Quarterly, retrieved 21/04/2015, <http://www.americasquarterly.org/node/3288>

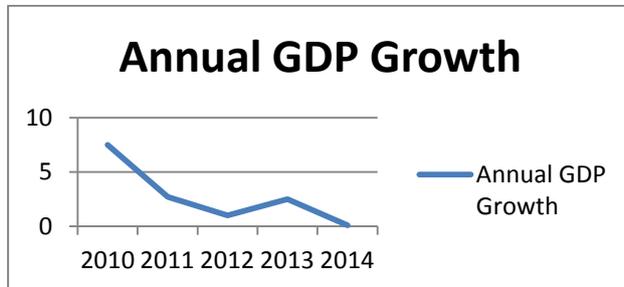
⁶⁰ Interview with Pierre Sauv , Director, External Programs and Academic Partnerships, World Trade Institute, Bruges, 14 April 2015. (Interview D)

⁶¹ 'Brazil applies 25% tariff increase on 100 imported goods; another 100 list in the making', *MercoPress*, 5 September 2012.

⁶² Camargo Mendes, *loc. cit*.

had a sufficiently large internal market, which would be able to allow for some protectionism without actually damaging economic growth.⁶³

Figure 1: Annual GDP Growth in Brazil



Source: Authors elaboration. This graph takes the figures for annual GDP growth in 2010, 2011, 2012 and 2013 from the World Bank <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG> and 2014 figures from Focus Economics <http://www.focus-economics.com/countries/brazil>

This has not been the case. The figures for annual GDP shown in figure 1 demonstrate this. There has been a marked reduction in growth in Brazil since 2010. It therefore makes economic sense to look for new opportunities abroad by concluding the IAA.

In spite of Rousseff's protectionist proclivities, some analysts are confident that she will embrace a more trade-oriented stance vis-à-vis the EU as a way of encouraging Brazilian companies to export, as there is significant potential for growth in this area. Only 13% of Brazil's GDP is made up exports.⁶⁴ She has already made changes to her cabinet, which is a sign that she is not completely ignoring Brazil's economic woes. She unveiled a new economic team committed to improving Brazil's economic performance soon after her re-election in October 2014.⁶⁵

These low figures for economic growth are moreover causing reverberations in Brazil's domestic politics, which will push Rousseff into changing her policies regardless.

⁶³ T. Ridout, *Brazil Looks Outward, Cautiously*, The German Marshall Fund of the United States, retrieved 21/04/15, <http://blog.gmfus.org/2014/02/18/brazil-looks-outward-cautiously/>

⁶⁴ M. Wigell, *loc. cit.*

⁶⁵ Brésil: Rousseff nomme une équipe économique taillée pour l'austerité', *La Libre Belgique*, 27 November 2014.

This has led to the emergence of increased sectoral interests that are favourable to more open economic policies that will improve the country's economic growth. Traditionally, the extremely competitive agricultural sector was the main group pushing for free trade.⁶⁶ Nowadays, however, manufacturing lobby groups are also calling for FTAs with the EU. Conclusion of the IAA would give them improved access to cheap inputs and give them greater access to technology.⁶⁷ Brazil's most important industrial lobby, *the Federação das Indústrias do Estado de São Paulo* (FIESP) in 2013 called for a conclusion.⁶⁸

A deteriorating economic environment will combine with emerging trade initiatives to expose the vulnerabilities of the country's current trade policy. As a result, adjustments are likely... Brazil's proclivity toward protectionism is expected to unwind.⁶⁹

Brazil is now an upper-middle income country. The middle class grew in recent years and now accounts for 52% of Brazil's population.⁷⁰ A lot of people in this category, however, are seen as "vulnerable" as many of them have "precarious incomes and unstable employment".⁷¹ This will be an important factor in changing Brazilian policy from one of protectionism to one based somewhat more on the principles of open trade. In addition to not being conducive to economic growth, protectionist policies are driving up inflation and in this way affecting the spending-power of the newly emerged middle class.⁷² This will increase Rousseff's reluctance to implement protectionist measures which are seen as increasing the cost-of-living. Such measures would not have the support of this socio-economic category which was, after all, "torn between" voting for Rousseff or Aécio Neves, the more pro-business candidate.⁷³ Rousseff will not want to lose these votes. This, as a result, will lead to an easing of Brazil's protectionist policies.

⁶⁶ J.A. de Castro Neves, *Brazil's Slow and Uncertain Shift from Protectionism to Free Trade*, Inter-American Dialogue, p. 1, retrieved 22 April 2015, http://www.thedialogue.org/uploads/CastroNeves_Trade.pdf.

⁶⁷ M. Wigell, *op. cit.*, p. 5.

⁶⁸ 'Brazil's main manufacturing lobby calls for urgent resumption of talks with EU', *MercoPress*, 26 September 2013.

⁶⁹ Castro Neves, *op. cit.*, p. 3.

⁷⁰ M. Pezzini, Director, OECD, Development Centre, *An emerging middle class*, Paris, OECD, 2012.

⁷¹ *Ibid.*

⁷² Castro Neves, *op. cit.*, p. 8.

⁷³ E. Buchanan, 'Brazil: Growing clamour President Rousseff's Petrobras impeachment as 2m sign petition', *International Business Times*, 17 February 2015.

Rousseff is moreover in an extremely weak position politically. She was just barely re-elected as president in October 2014. She won only 51.4% of the vote in the second round, while Neves received 48.5%.⁷⁴ This would indicate that large swathes of Brazil's population are dissatisfied with her management of the economy.

Domestic dissatisfaction with her leadership has moreover grown in recent months as a result of the scandal involving Petrobras, a state-controlled oil company of which she was chairwoman during 2003-2010, the period in which the corrupt practices that are now coming to light took place. The affair involved cases of money laundering and bribery in which both directors of domestic construction companies and PT politicians were implicated. The sheer scale of the scandal has had huge domestic repercussions. There have been massive protests in over 160 cities and many have called for Rousseff's impeachment.⁷⁵

Legally speaking, Rousseff has avoided implication. She is nonetheless highly vulnerable politically. A motion of censure is more likely now than it was before. However, this process is quite complicated. It requires the approval of the President of Congress as well as a two thirds majority in both houses.⁷⁶ Yet, even if it this scenario is not particularly likely, the mere fact that such a course of action is being talked about is indicative of her tenuous grip on power.

If elections were to be called, she would lose them, especially given her abysmal approval rating of 13% in March 2015.⁷⁷ Neves, who narrowly missed out on being elected president in October 2014, vowed to open Mercosur if he were elected.⁷⁸ Marina Silva, a presidential candidate who reached the top of the polls in the mid stages of the campaign,

⁷⁴ S. Romero, 'Brazil Stays With Rousseff as President After Turbulent Campaign', *The New York Times*, 26 October 2014.

⁷⁵ J. Watts, 'Brazil in crisis mode as ruling party sees public trust rapidly dissolving', *The Guardian*, 17 March 2015.

⁷⁶ Buchanan, *loc. cit.*

⁷⁷ R. Colitt and A. Galvao, 'Brazil's Rousseff Pushes Anti-Graft Bills as Her Approval Sinks', *BloombergBusiness*, 18 March 2015, retrieved 25 April 2015, <http://www.bloomberg.com/news/articles/2015-03-18/rousseff-approval-rating-sinks-as-brazil-economy-faces-recession>

⁷⁸ Neves pledges deep reform of Mercosur and opening to the world, if he wins', *MercoPress*, 13 October 2014.

also affirmed her intention to seek a trade deal with the EU.⁷⁹ A change in leadership would undoubtedly increase the chances of the negotiations succeeding.

Failing that, it is expected that the economic slowdown and popular discontent with current policies will make the IAA with the EU more attractive to the current leadership. Furthermore, agricultural interest groups, now reinforced by the manufacturing sector, will be putting huge pressure on Rousseff into concluding the agreement.

4.2. Changes in Argentina's Domestic Politics

The late Néstor Kirchner of the Peronist party, the *Partido Judicialista*, was elected in 2003. He ruled the country until 2007, when he stepped aside for his wife Cristina Fernández de Kirchner. She was elected that year and again in 2011. In 2011, Kirchner was re-elected with 54% of the vote, while her nearest adversary, received 17%.⁸⁰ In spite of the strong support, economic woes are increasing and will contribute to changing the future direction of Argentina's economic policies.

Economically speaking, the years following the 2001 default have been characterized by protectionism. This has prevented Mercosur from concluding FTAs with its trading partners. These measures, the government argues, have helped it to protect domestic industries.⁸¹ Detractors, however, claim that these steps isolate Argentina from global markets and leave it "vulnerable to retaliatory policies from its key trading partners".⁸² Argentina has already been affected negatively by failing to conclude FTAs with the world's most important economies. This has been exacerbated by the loss of GSP. Its interventionist policies have also alienated it internationally and frightened investors. In 2012, for instance, it nationalized YPF, a subsidiary of Repsol, a Spanish energy company.⁸³

Opposition leaders see these policies as damaging to Argentina's interests and are turning away from them. They are calling for economic policies that will improve relations with its trading partners. Both Sergio Massa of the *Frente Renovador* and Mauricio Macri of

⁷⁹ J. Leahy, 'Silva to seek trade deals for Brazil', *MercoPress*, 24 September 2014.

⁸⁰ A. Barrionuevo, 'Kirchner Achieves an Easy Victory in Argentina Presidential Election', *New York Times*, 23 October 2011.

⁸¹ M. Rogers, 'Made in Argentina: Is the Rise in Protectionism Justified?', *The Argentina Independent*, 11 October 2011.

⁸² M. Rogers, *loc cit*.

⁸³ F. Peregil, 'Argentina expropia a Repsol su filial YPF', *El País*, 17 April 2012.

the *Propuesta Republicana* party, the two main opposing presidential candidates, have signed a joint document in which they promise to bring Argentina closer to the EU and the US.⁸⁴ Moreover, the “*oficialista*”, the candidate of the party that is currently in power, Daniel Scioli, is also believed to favour a similar shift in policy.⁸⁵

Economic weaknesses are also to be found in Kirchner’s search for partners in China and Russia. Critics warn of the “asymmetrical nature of the relationship” with China.⁸⁶ Her visit to Russia ended with the signing of a “strategic partnership” in the areas of oil and gas.⁸⁷ This supposed trade dependence on the two countries will provide opposition candidates with more fuel to add to their campaigns.

The most purely economic factor that will change the political landscape in Argentina is cost of living. “Inflation of as much as 40% is the biggest economic challenge Argentina faces,” according to Massa.⁸⁸ Inflationary problems will be one of the main economic arguments that opposition candidates will use to win the presidential election in October 2015.

These economic challenges will weaken the government. The opposition candidates will be in a strong position to win the elections and implement new economic policies. There will therefore be a new window of opportunity as Argentine negotiators, who will be now more in favour of concluding the IAA with the EU, will no longer be dragging their feet.

The Kirchner years have moreover been plagued with allegations of corruption and authoritarianism.⁸⁹ Recently, in 2014, Kirchner’s vice-president, Amado Boudou, was charged with accepting a bribe amounting to a 70% share in Ciccone, a firm that enjoys

⁸⁴ C. Cué, ‘Argentina se prepara para un giro en política exterior’, *El País*, 17 April 2015.

⁸⁵ *Ibid.*

⁸⁶ F. Fraysinnet, ‘Argentina Moves Towards Marriage of Convenience with China’, *Inter Press Service*, 23 February 2015, retrieved on 25 April 2015, <http://www.ipsnews.net/2015/02/argentina-moves-towards-marriage-of-convenience-with-china/>

⁸⁷ T. Parfitt and H. Alexander, ‘Cristina Kirchner and Vladimir Putin cuddle up over oil and bitter feelings for Britain’, *The Telegraph*, 23 April 2015.

⁸⁸ D. Cancel, ‘Argentina Economy Can’t Take 40% Inflation: Massa’, *Bloomberg Business*, 7 March 2015, retrieved on 25 April 2015, <http://www.bloomberg.com/news/articles/2015-03-07/argentina-economy-can-t-take-40-percent-inflation-massa>

⁸⁹ U. Goñi, ‘Cristina Fernández de Kirchner: is the fairytale ending for Argentina’s new Evita?’, *The Guardian*, 21 February 2015.

huge profit-making contracts from the Argentine government for printing Pesos.⁹⁰ Indicative of Argentina's authoritarianism is the Nisman Affair. Alberto Nisman, an Argentine prosecutor, was murdered days after he claimed that President Kirchner and her foreign minister Hector Timmerman had attempted to protect Iranian officials from implication in the 1994 Buenos Aires bombing of a Jewish centre which killed eighty-five people.⁹¹ He had accused her of cutting a deal with Iran to secure oil.⁹² He was found dead the day before he was to present his 289-page report to the parliament. It is impossible to know if his murder was planned by the government. Nevertheless, the fact that such a prominent opposition figure was murdered at all is indicative of the unstable domestic political landscape. This has the potential, albeit unlikely, to bring the government down before the end of her mandate.⁹³ Kirchner still has an approval rating of 29.8%.⁹⁴ However, it is her disapproval rating of 63.5% which is significant.⁹⁵ This affair will, at the very least, contribute to the domestic dissatisfaction with her leadership and make it less likely that she will be re-elected.

The Argentine constitution moreover only allows for two terms in office. Kirchner will not be able to run again, unless the constitution is amended. However, her party does not have the requisite two-thirds majority in the lower house to do this. Her party will therefore lose its emblematic leader. A change in leadership will make conclusion of the IAA easier, given her administration's tendency to slow down negotiations.⁹⁶

Pressure from Brazil will also play a role in forcing the new leadership into not hindering the agreement. Argentine economic policy is tied to Brazil's. Argentina has traditionally enjoyed the "lucrative" Brazilian market for manufactured goods, something it fears

⁹⁰ U. Goñi, 'Argentinian vice-president Amado Boudou to testify in corruption case', *The Guardian*, 8 June 2014.

⁹¹ K. Zraik, 'The Mysterious Death of Alberto Nisman', *New York Times*, 20 February 2015.

⁹² U. Goñi, 'Alberto Nisman's death highlights failures of Argentinian investigation', *The Guardian*, 20 January 2015.

⁹³ Goñi, 'Cristina Fernández de Kirchner: is the fairytale ending for Argentina's new Evita?', *loc. Cit.*

⁹⁴ H. Bronstein, 'Popularidad de presidenta argentina Cristina Fernández cae tras muerte de fiscal: encuesta', *Reuters*, 23 February 2015.

⁹⁵ *Ibid.*

⁹⁶ C. Meacham, *Surprised? We May Finally See an EU-Mercosur Trade Agreement*, Centre for Strategic and International Studies(CSIS), retrieved 25 April 2015, <http://csis.org/publication/surprised-we-may-finally-see-eu-mercosur-trade-agreement>

losing.⁹⁷ It also fears Brazil concluding its own FTA with the EU. If Brazil and the EU conclude an FTA, not only will Argentina lose out to EU competition for its manufactured products, but it will also lose out on agricultural exports to the EU as it will become cheaper for Brazilian farmers in relative terms.

Conclusion

This paper is hopeful that the IAA will be concluded in the coming years. Much has changed in recent times to make agreement more likely. During the initial period, 2000-2004, the cost of no agreement was low to both countries. Nowadays, the cost of no agreement is higher, particularly for Mercosur.

The EU's strategy of concluding FTAs has disadvantaged Mercosur and left it on the margins of the international trade. The loss of GSP status has moreover increased its export costs and its need for an agreement. Failure to conclude the IAA with the EU risks further commercial isolation.

The EU's interest in the agreement has increased, albeit not as dramatically as Mercosur's. It is still more of an 'opportunity' for the EU than a 'need'. The financial crisis has resulted in weak domestic demand, which may pressurise the EU into looking for export markets. Concluding the IAA with Mercosur would give it access to one of the world's most important emerging markets. This would strongly benefit its manufacturing and services sectors, not only through increased trade flows, but also through government procurement possibilities. Furthermore, rivalry from China in the regions is increasing rapidly, thus threatening the EU's market share there. The threat of increased US rivalry in the region is also something that could affect negotiations in the coming years.

The journey ahead is also seen in a positive light because of the domestic political changes that will occur in Mercosur's two most important economies. In Brazil, President Rousseff will have to change her protectionist policies in response to domestic demands emanating from business sectors and middle classes, if she can hold on to power that is. In Argentina, President Kirchner will be vacating the *Casa Rosada* in November 2015 and

⁹⁷ 'EU hopeful the free trade accord with Mercosur will be reached next year', *MercoPress*, 19 September 2014.

will not be running again. The leading candidates to succeed her are all in favour of improved relations with the EU.

These political transformations in both Brazil and Argentina will facilitate a more free-trade-friendly agenda on the part of Mercosur. This will create the window of opportunity that is needed. The ball will be in the EU's court once these changes occur in Brazil and Argentina. The timing is undoubtedly right, or at the very least about to be right, for the IAA between the EU and Mercosur.

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