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IMPLICATIONS OF THE EU-MERCOSUR NEGOTIATIONS



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- The EU seems to be dragging its feet in the negotiations for a free trade agreement with Mercosur. It urgently needs to revive the process.
- The time is now ripe for reaching a deal. Mercosur is ready for the exchange of market offers, reflecting the fact that Brazil wants to speed up the negotiations.
- The broader geostrategic implications of an EU-Mercosur agreement have been neglected in the European debate. Not only would an agreement help the EU revive its presence and influence in South America, but it would also strengthen Brazil's stake in the liberal world order.
- If the EU fails to act, Mercosur will likely turn elsewhere and become a more difficult partner to negotiate with.
- Any hopes the EU may currently have of Brazil breaking free from the Mercosur format to negotiate a separate deal are misplaced. Despite the pressure on Brazil to open up for more trade, it is unlikely to want to risk its position as a regional leader by negotiating alone with the EU.

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Introduction

Since 1999, the European Union has been engaged in negotiations over a free trade agreement with Mercosur, the South American regional organization comprising Argentina, Brazil, Paraguay, Uruguay and Venezuela.¹ The negotiation process has been difficult and was already suspended in 2004 without an agreement. Negotiations were then re-launched in 2010, but have stalled since 2012 because the two parties have not been able to set a date for the exchange of market access offers. The main obstacle has been Mercosur, where Argentina in particular has been dragging its feet for fear of losing the profitable Brazilian market to more competitive products from the EU, and where the temporary suspension of Paraguay from Mercosur caused turmoil.²

Now the tables have turned. In August 2014, the Mercosur countries agreed on a joint negotiation position and Mercosur has since then been ready to exchange offers aimed at completing a trade deal with the EU, according to diplomatic sources. However, the EU is now dragging its feet and has been unable to commit to a date for the presentation of market access offers referring to goods, services and their establishment, and public procurement. The negotiations aim at a comprehensive trade agreement involving the liberalization of trade in goods and services, improved access to public procurement, and the improvement of rules concerning public procurement, intellectual property, customs and trade facilitation, and technical barriers to trade.³

Calculations done by the European Commission, and the Brazilian Ministry of Development, Industry and Foreign Trade, estimate annual trade gains of €9 billion, or €4.5 billion per side from an EU-Mercosur free trade agreement. That would provide a major economic boost on both sides of the Atlantic just

at the time when both the EU and Mercosur desperately need to reactivate their economies. But for whatever reason, be it the current focus on the Transatlantic Trade and Investment Partnership (TTIP) talks with the US or simply having lost faith in the parties' commitment to the negotiations, the European Commission seems to have put the EU-Mercosur negotiations on the back burner, seeing little urgency for moving forward. That could yet prove to be a mistake.

Right now is a far more critical time for the EU-Mercosur negotiations than most European policymakers seem to realize. Europe's presence in South America is rapidly being displaced by China.⁴ Not only does this translate into lost economic opportunities, but it also has major geostrategic implications for the EU. Brazil, by far the most important Mercosur country and a potentially useful ally for the EU in global governance, has in recent years been strengthening its ties with the other BRICS countries.⁵

This "southern turn" under the Workers' Party-led government has been criticized by the opposition, who would like to see Brazil concentrate more on relations with its traditional partners in the North, and more broadly with the OECD countries. This division extends to the current government, where the new economic team would like to see Brazil moving closer to the OECD, whereas parts of the Workers' Party are pushing in the other direction. As things stand now, Brazil is ambivalent about its future direction, whether it should open up its economy and integrate more fully into the Western-led liberal world order, or continue down a neo-mercantilist path and focus on tightening its BRICS relations.

The EU-Mercosur negotiations play a major role in unlocking this ambivalence. An agreement would help set Brazil on a liberal reformist path by changing the structural basis for its international

1 Venezuela is excluded from the negotiations and will thus not be part of a possible agreement.

2 This paper is based on interviews conducted in 2014 with policymakers and experts in Brasília, Brussels, Helsinki, London and Washington DC.

3 For details, see the website of the European Commission: <http://ec.europa.eu/trade/policy/countries-and-regions/regions/mercosur/>.

4 E.g. European Parliamentary Research Service, "EU-Latin America relations", Briefing, 26 March 2014, accessed March 4, 2015, [http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/140763/LDM_BRI\(2014\)140763_REV2_EN.pdf](http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/140763/LDM_BRI(2014)140763_REV2_EN.pdf).

5 E.g. see José Vicente de Sá Pimentel, ed. (2013), *Brazil, BRICS and the international agenda*. Brasília: FUNAG.

economic insertion from an inward-oriented towards an outward-oriented growth model. That would also make Brazil's current foreign policy strategy of "soft balancing" against the Western powers increasingly redundant.⁶

By making use of the leverage provided by the other BRICS, Brazil has sought to relax current liberal norms and rules governing international economic relations so as to free domestic neo-protectionist policies from international constraints. By helping to put Brazil on a liberalizing path, the logic of that foreign policy strategy would no longer apply.

Once on that path, the natural next step for Brazil would be to open up for similar free trade agreements with Australia, Canada, Japan and the US. An EU-Mercosur agreement would thus not only strengthen ties between the EU and Brazil, it would also help strengthen Brazil's overall stake in the Western-led liberal world order.

Incidentally, in January, Brazil took over the presidency of Mercosur for a six-month period and is preparing what diplomatic sources describe as a "last push" for an agreement with the EU. If it fails, the alternative will not be a unilateral turn by Brazil towards the EU, as some EU policymakers seem to bet on. On the contrary, in the event that the EU-Mercosur path looks like a dead end, Brazil is likely to pivot more sharply towards the BRICS. This would not only hasten the loosening of the EU's influence and presence in South America, but have repercussions for the Western-dominated liberal world order that the BRICS is challenging. Unfortunately, these big geopolitical implications of the EU-Mercosur negotiations seem to have been lost on Europe's policymakers.

A window of opportunity...

The fact that Mercosur is now ready for the exchange of offers reflects the fact that Brazil wants to speed up negotiations with the EU for a free trade

agreement.⁷ Having previously been reluctant to pressure Argentina to stop prolonging the negotiations, Brazil became much more forceful in 2014, according to diplomats. That marks a real change, signalling a renewed Brazilian urgency over the negotiations. This can be attributed to three things.

First, Brazil's economic growth has ground to a halt.⁸ As a result, the country is on the lookout for new growth opportunities. Despite her protectionist instincts, President Dilma Rousseff has come to the conclusion that Brazil needs more trade, as indicated by the change of her economic team to a more market-friendly and trade-oriented one. Brazil's exports are equivalent to only 13 per cent of GDP and very few Brazilian companies export.⁹ An EU-Mercosur free trade agreement would provide a boost for Brazilian exports, much more so than any prospective agreements with other emerging countries. That is why during the past year President Rousseff has committed herself to seeing through the EU-Mercosur negotiations as a matter of high priority. Her new economic team has also set itself the task of pursuing a programme of liberal economic reforms, and an EU-Mercosur agreement would provide a way to legitimize and "lock in" these reforms.

Secondly, and coupled with the above, Brazil's private sector stands more united than ever before in its support of an EU-Mercosur agreement. While the agricultural sector has always been in favour of a deal with the EU, Brazil's manufacturers have in the past been less inclined to lobby for it. Now, the manufacturing sectors are almost exclusively behind

6 For a discussion of Brazil's strategy of soft balancing as part of the BRICS initiative, see Daniel Flandes, "O Brasil na iniciativa BRIC: soft balancing numa ordem global em mudança", *Revista Brasileira de Política Internacional*, Vol. 53, No. 1.

7 Mercopress, "Brazil committed to advance with EU/Mercosur trade negotiations", 22 November 2014, accessed March 4, 2015, <http://en.mercopress.com/2014/11/22/brazil-committed-to-advance-with-eu-mercosur-trade-negotiations>.

8 According to the Economist Intelligence Unit, the estimate for real GDP growth in 2014 was 0.1 per cent. In 2015, the estimate is for real GDP growth to be negative (-0.5 percent). <http://country.eiu.com/article.aspx?articleid=1922846776&Country=Brazil&topic=Economy&subtopic=Forecast&subsubtopic=Forecast+summary>.

9 See Otaviano Canuto, Cornelius Fleischhaker and Philip Schellekens, "The curious case of Brazil's closedness to trade", *Vox CEPR's Policy Portal*, January 2015, accessed February 10, 2015, <http://www.voxeu.org/article/brazil-s-closedness-trade>.

the negotiations as well, piling the pressure on the government to seal the deal. Over the past few years, Brazilian manufacturers have begun facing serious challenges to competitiveness, in large measure because of trade barriers. An EU–Mercosur trade agreement would give industries access to cheaper inputs from Europe, expand their supply chain options and help them integrate into the global value chains, giving them better access to cutting-edge technology and research resources. Indeed, as indicated by interview sources, within Brazil’s business sectors the realization that the country needs to open up in order to regain competitiveness has been quick and widespread.

Thirdly, Brazil’s political and economic elites have become increasingly concerned about their country’s geoeconomic position. Mercosur as a whole is stagnating¹⁰, with Argentina and Venezuela experiencing negative growth in combination with high inflation.¹¹ Brazilians are worried about being left out when the rest of the world moves forward in making trade deals. The launch of EU–US trade talks alerted many in Brazil to the prospect of a huge trade block to which Brazil would not belong. The EU has also recently concluded the signing of a free trade agreement with Canada, a competitor to Brazil in some important export sectors. At the same time, Chile, Peru and Mexico are participating in the talks over a Trans–Pacific Partnership, which would create another huge trade block to which Brazil would not belong. Mercosur, for its part, has only managed to sign three free trade agreements (FTAs): with Egypt, Israel, and Palestine – all of little economic significance. For Argentina, Brazil and Uruguay, the situation is made even worse by the fact that they are now being classified as upper–middle income countries and therefore no longer eligible to use the EU’s Generalised Scheme of Preferences, which has been offering trade preferences for their exports

to the EU. All this exerts pressure on Mercosur to conclude the negotiations with the EU.

Argentina may also prove to be less of a brake on the negotiations than before. The era of *Kirchnerismo* is coming to an end. In October 2015, Argentina will elect the successor to President Cristina Fernández de Kirchner. All three leading candidates are economically more market–friendly than she has been and likely to seek reforms that an EU–Mercosur agreement may help legitimize.

Argentina being shut out of international capital markets, the country is also desperate for trade that would provide it with access to foreign currency. After all, Argentina was the country that most eagerly pushed for the re–launch of the EU–Mercosur negotiations in 2010. Although the Kirchner government eventually became more hesitant, its need for trade is more pronounced than ever and the incoming government can be expected to attempt to boost trade. As for the smaller Mercosur members, Paraguay and Uruguay, they are desperate to reach an agreement with the EU.

All this suggests that the time is now ripe for the EU to continue the negotiations with Mercosur. Much depends on whether the EU is now able to reach a consensus over a joint offer, the sticking–point being the proposal for agricultural liberalization. Some EU member states, including France, Hungary and Ireland, have had problems supporting the negotiations. The European Commission has also been unwilling to engage in the exchange of market access offers, unless it is given forward guarantees that the Mercosur offer is ambitious enough. Understandably, Mercosur does not want to give any such foreknowledge as it could be used tactically by the EU when formulating its own joint offer.

... not open indefinitely

The EU should now pluck up courage and sit down at the table with Mercosur to open respective offers. A new offer will not be forthcoming before that, and the window of opportunity for making progress will not stay open indefinitely.

According to trade representatives, Mercosur has already held exploratory talks with the Eurasian Economic Union (EEU) over whether to open up free

10 Annual real aggregate GDP growth under 2% for the last three years. FDI flows to Mercosur flat or declining since 2011. For an analysis, see Juan Pablo Fuentes and Douglas Wynne, “Why Mercosur Lags the Pacific Alliance”, Moody’s Analytics, July 2014, accessed March 4, 2015, <https://www.economy.com/dismal/analysis/free/248931>.

11 TD Economics, “Latin American Outlook”, Special Report, July 2014, accessed February 10, 2015, <http://www.td.com/document/PDF/economics/special/LatinAmericanOutlook.pdf>.

trade negotiations.¹² Russia is keen on negotiations in order to lessen the impact of the sanctions regime upheld by the EU and the US. On the Mercosur side, Argentina in particular has been looking to exploit this possibility to increase its exports to Russia, now that European and US exporters have had to withdraw. Brazil remains ambivalent, as a deepening of economic relations with Russia may come at the expense of its political relations with the West. As a result, negotiations between Mercosur and the EEU will probably not open up anytime soon, although this prospect should not be written off just yet, especially if no progress is made in the EU-Mercosur negotiations.

However, Mercosur is also eyeing up the Pacific. It has recently held talks with the Pacific Alliance – an economic grouping comprising Chile, Colombia, Mexico and Peru, with Costa Rica in the process of joining – to promote an agenda of partial integration.¹³ This would also see Mercosur turn economically more towards the Asia-Pacific. The “bi-oceanic” nature of this convergence would add a strategic benefit for Mercosur in negotiating other trade deals, and lessen the urgency in reaching a deal with the EU. China’s presence in South America is also growing by the day with deepening economic relations as a result.

Indeed, Brazil’s commodity trade with Asia has become so important that it partly offsets its agricultural producers’ need for EU market access. So, while the industrial sectors have become more willing to see a successful conclusion to the EU-Mercosur negotiations, the tendency within Brazil’s agricultural sectors – originally the main lobbyists for a free trade deal – has been towards growing indifference. As Asia keeps growing while the EU

does not, that tendency may gather strength. What all this means from the perspective of the EU is that now is the time to act. If allowed to linger, Mercosur is likely to become a more difficult partner to negotiate with.

For the EU, the political gains of an EU-Mercosur agreement would be considerable. Both the EU and the US have in recent years been losing presence and influence in South America. The US is now trying to reverse this trend by committing itself more actively to regional development projects. Through its new Cuba policy, the US is paving the way for a closer relationship with the entire Latin American region. The EU, however, has so far done little to halt its slide into greater irrelevance. Brazil also increasingly looks to its BRICS partners when engaging in global affairs, at the expense of Europe. An EU-Mercosur free trade agreement would help Europe revive its relations with South America, particularly Brazil.

Indeed, the EU-Mercosur negotiations carry broad geostrategic implications. Recent years have seen international power shifting from the West to “the rest”, generating much debate about what this will mean for the global order. Analysts paint a disturbing picture of the liberal world order under siege by revisionist powers, such as China, Iran and Russia, and foresee a future without liberal internationalism. Others believe that most of the rest, as they rise, will integrate into the existing international order, transforming into “middle powers” with a stake in the liberal international system and therefore assisting in securing it against any challenges from illiberal powers.

There is hardly any teleology as to the future of the global order. It could go either way. Much hinges on rising powers such as Brazil, India, South Africa and Turkey, and whether they will assimilate into the liberal order or decide to challenge it. These countries are regional heavyweights and therefore in a position to influence their broader regional environments, adding to the repercussions of their actions. While there is no automation as to how they will swing, the West may, through its own actions, help or hinder them from integrating into the liberal global order.

In this respect, trade agreements can be of major importance. An EU-Mercosur agreement would

12 While Mercosur has issued no official statement concerning these talks, apparently, a memorandum of understanding has also now been signed. See Buenos Aires Herald, “Mercosur signs MOU with Eurasian Economic Union”, November 26, 2014. Accessed March 4, 2015, <http://buenosairesherald.com/article/175675/mercotur-signs-mou-with-eurasian-economic-union>.

13 Mercopress, “Pacific Alliance and Mercosur agree to continue discussions in Chile”, November 3, 2014. Accessed, February 10, 2015, <http://en.mercopress.com/2014/11/03/pacific-alliance-and-mercotur-agree-to-continue-discussions-in-chile>.

help put Brazil on a path to liberalization, changing the structural basis of its economic policy. As a result, Brazil would have less incentive to push for a reform of international institutions by which it has sought to open up the policy space for its current state interventionist policies. By contrast, without an agreement, Brazil will most probably continue down a path of neo-mercantilism instead, and seek the leverage provided by its BRICS partners in reforming international institutions so as to relax the current liberal norms and rules governing economic relations.

Brazil unlikely to break off from Mercosur

For the EU, the main attraction of the EU-Mercosur negotiations lies in increasing access to Brazil's internal market, and the political gains to be achieved from partnering more closely with Brazil. Indeed, some European policymakers have been pinning their hopes on Brazil breaking off from Mercosur and pushing for its own trade deal with the EU. Given Argentina's increasing protectionism in recent years, the European Commission is sceptical about the possibility of reaching a deal that would be comprehensive enough if it includes Argentina.

The EU should not fool itself into thinking that Brazil would be prepared to start bilateral negotiations. The signal from inside the Brazilian government, floating the possibility of Brazil engaging in separate negotiations without Mercosur, has been part of a tactic intended to put pressure on Argentina in the internal negotiations for Mercosur's joint proposal. It is not an option that President Rousseff has been contemplating realistically.

Under the current rules, Mercosur members cannot negotiate separate bilateral trade deals. Brazil deciding to go ahead on its own in negotiations with the EU would effectively mean the end of Mercosur. That is not something that the current Brazilian government is prepared to risk. It remains committed to Mercosur, which has formed the main avenue for its own regional engagement and for managing relations with its neighbourhood. The EU would therefore be well advised not to count on Brazil breaking off from Mercosur anytime soon. Instead, the EU now needs to get its act together and revive the negotiations with Mercosur, so as to prevent Brazil from turning elsewhere.

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