

## ARTÍCULOS Y NOTAS DE PRENSA

[2014](#) | [2013](#) | [2012](#) | [2011](#) | [2010](#) | [2009](#) | [2008](#) | [2007](#) | [2006](#) | [2005](#) | [2004](#) | [2003](#) | [2002](#) | [2001](#) | [2000](#) | [1999](#) | [1998](#) | [1997](#) | [1996](#) | [1995](#) | [1994](#) | [1993](#) | [1992](#) | [1991](#) | [1990 a 1968](#) | [Todos los años](#) |

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 Much more than trade and investments: is the future Mercosur-European Union bi-regional agreement a contribution toward effective global governance?

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### 1. Some preliminary remarks about the relevance of a strategic idea

Since its origin, the idea of a bi-regional negotiation between Mercosur and the European Union has been conceived as part of a broader global strategy of both regions with strong political and economic dimensions. The main idea was to develop a building block for global governance upon the cooperation of two regions with significant links and common interests between them and, at the same time, with clear democratic values and social concerns. Promoting trade and investments was important, obviously. It was even seen as crucial, but not necessarily as the only reason to undertake such complex negotiations - nor even the main one.

With new global and regional trends shaping up the international landscape, the original idea seems to be valid, yet. Even with the deep changes that we are observing in both sides of the Atlantic, including the metamorphosis that is evolving in the European Union, as well as in the Mercosur integration processes, the idea of sharing efforts to build sustainable conditions for a regional governance that could strengthen the so required global governance efforts, is today as valid as it was more than twenty years ago.

The recent Summits that took place in Brussels, Belgium and Mendoza, Argentina, on the same dates (June 28 and 29, 2012) could be perceived on their own as the beginning of new phases – and very different processes - of this joint work to ensure a reasonable degree of regional governance, in each case according to their unique realities.

In that context, the conclusion of the bi-regional Mercosur-EU agreement should allow both regions to engage in an ambitious and equilibrated win-win common process. The result of this long-term process would be to multiply all kinds of economic and social networks between these two regions which have many interests in common, deeply rooted in the past. As such, this inter-regional connection will imply a significant contribution to the development of a more rational global order.

## 2. Conditions for a successful bi-regional negotiation

Political will and strategic vision that reflect the concrete national interests; external conditions that generate the perception of economic and political challenges, even of threats; and a network of cross-interests in the economic and social levels are some of the basic conditions that explain the origin of the integration agreements between countries and, eventually, between regions.

These are agreements that, regardless of their modalities and of the market integration techniques employed - for which there are no single models -, are subscribed voluntarily with the idea of building a permanent relation among sovereign nations. They are multidimensional in scope since at the same time they have political, economic, and even social implications due to their effect on the level of welfare and on the expectations of the respective populations.

At least, this is indicated by five decades of experiences developed not only in Europe - so far the most successful integration process in terms of sustainability and depth - even with its current well-known strong difficulties - but, also, in other regions including South America and the Mercosur regional space.

The presence or the lack of such conditions, as well as their respective weight, may account for the successes or failures in the history of integration processes.

However, it should also be noted that the above-mentioned conditions have a dynamic character and tend to change with time. This is the reason why the enthusiasm and energy present at the conclusion and signature of an integration agreement are weakened by changes in the original circumstances, as well as by the perception - in one or all of the partners, especially in the citizenship - of the actual or expected future results.

Additionally, other personal facts become relevant to explain the origin and strength of the respective agreements. Political leaders and negotiators with different interests, priorities and qualities may help to explain the founding moment of an integration process - or of an Institutionalized strategic association between these two regions - as well as the capacity to overcome changes, those other moments when inertia prevails or when the necessary drive to continue building what was originally imagined begins to wane.

The previous thought seems to apply in the case of negotiations for the establishment of a bi-regional strategic association between Mercosur and the European Union. One of its main instruments would manifest, precisely at the level of the economic and commercial integration between both regional geographic spaces, in the shape of a free trade area, as established in article XXIV of the GATT-1994.

After almost twenty years since the initial steps were taken for the advancement of a special bi-regional strategic relation, and after ten years of the inception of the formal negotiation process, in practice, the situation reached a standstill in October 2004, which has lasted until the negotiations were re-launched at the Madrid EU-LAC Summit (May 2010).

Since then, some facts and especially political pronouncement could be considered as indicators of the presence of the above-mentioned conditions (political will and strategic vision), which are necessary to create a stable strategic association with an economic integration objective, in this case between two institutionalized regional geographic spaces. It is yet to be seen if they carry the necessary weight to produce the expected results.

There are various tracks that will enable to continue building on the idea of a bi-regional Mercosur-EU association as a key component of a broader strategic alliance between Europe and Latin America.

A first course of joint action relates to the great challenges originated by deep changes that are taking place worldwide. In this sense, it is to be expected that the future biregional agenda (EU-LAC, as well as Mercosur-EU) focuses the joint work on the main issues that have a bearing on global governance. Due to the number of countries involved, the nations from both regions may play a relevant role, provided they are able to coordinate their positions in accordance with their diverse national and regional interests. A top priority, among others, is the bi-regional cooperation for the creation of conditions that guarantee peace and international security. This would imply strengthening the multilateral system, within the scope of the UN, and the yet to be confirmed effectiveness of the G20 mechanism. However, this implies, also, that both regions can play an active role to ensure the conclusion of the Doha Round, as well as to achieve a reasonable outcome from the negotiations on climate change. A third relevant issue of the bi-regional agenda relates to the role played by both regions in the fight against organized crime and the different modalities of international terrorism.

A second track relates to specific issues of the reciprocal relations and, in particular, to the idea of a bi-regional strategic partnership conceived as a gradual, long-term process that will require the conciliation of multiple diversities through variable geometry and multispeed flexible working methods and instruments. Among them, the priority is the creation of a network of multiple association agreements of a preferential nature and with a deep strategic purport. The EU has signed, already, preferential agreements with Chile, Mexico, Peru, Colombia and the Central American countries. Those are the same countries that have concluded the FTA with the United States and some of them, more recently also with China, among others.

In the specific case of the European Union and Mercosur, reaching a bi-regional agreement will not be an easy task. It will require much political determination - on this regard the signals given off two years ago in the Madrid Summit should be considered as very positive - as well as creativity in the technical level to achieve commitments that imply a reasonable balance between interests that appear quite different at times. The knots that need to be untied are well known and have been thoroughly diagnosed on both sides. Some of them were manifested in the negotiations for the Doha Round, a fact that generated links between the bi-regional and the global multi-lateral negotiations. The issue of agricultural products - including the processed ones- is not the only one. However, frequent declarations in EU member countries with strong agricultural interests indicate that, still, it is necessary to overcome many resistances – real or apparent - will be

necessary to overcome many resistances -real or apparent- in order to reach an agreement.

Furthermore, it should be noted that this is not an isolated negotiation, neither would be the preferential trade agreement that is eventually achieved. On the contrary, to understand the Mercosur-EU negotiation in its full dimension it would be necessary to link it - from the perspective of both regions and of its respective member countries - to the network of agreements being promoted by the European Union with several countries and those that could be also negotiated in the future by Mercosur.

For example, the idea of a Mercosur-China FTA has been proposed by Wen Jiabao, the Chinese Premier on his recent videoconference with Mercosur Presidents (Buenos Aires, June 25, 2012). This is not a surprising proposal. Keeping in mind the deep changes of the map of the global economic competition and the actual financial crisis, whose effects still continue to unfold, China's economic prominence will eventually grow in the world in general and in Latin America in particular. This is perceived as a great challenge by several companies doing business in the region - certainly by the European ones but, also, by those of the region itself. A sector particularly vulnerable to the effects of future Chinese competition is the automotive one, which in Mercosur has been characterized by a strong European presence. The investments and the demand for equipment and capital goods that will result from the discovery of hydrocarbon sources in the South Atlantic may be another driving force behind the interest on the European side to re-launch the negotiations with Mercosur and to conclude them, promptly.

### **3. Some specific issues**

An aspect that will require particular attention is how to approach in this bi-regional negotiations the requirement that the scope of a free trade agreement should comprise what is “substantially all the trade” (article XXIV - inc.8 of GATT-1994). It was a delicate matter in the Mercosur-EU negotiating stage that ended in 2004. It is, perhaps, the specification of such requirement - i.e., the definition of what is considered to be “substantial trade” - that may offer a key for the degree of flexibility that the commitments and instruments agreed in the bi-regional agreement may have if there is an intention of achieving a reasonable balance of the different interests at stake . Such flexibility might be even more necessary if we take into account that if the bi-regional negotiation were to be concluded soon it will happen before the eventual end of the Doha Round.

It is crucial to bear in mind that there is no legally binding definition as to what should be understood by “substantially all the trade”, to appreciate the consistency of an agreement that establishes a free trade area within the GATT rules. Qualitative and quantitative criteria may be used. In fact, several proposals have been advanced on this issue both by countries which are now members of the WTO and by experts. However, no concrete definition exists to bind those countries or customs union negotiating a free trade zone. It is also a known fact that the efficiency of the procedures established by the GATT-WTO system to ensure the consistency of the different modalities of preferential trade agreements with the commitments

in the multilateral plane is far from ideal. This is the reason why in the case of the negotiations between India and the EU some specialists argued that the concern for the requirement of what is understood as “substantially all the trade” should not be exaggerated. They even suggested that in such agreement some relevant sectors should be excluded, specifically the agricultural and the automotive sectors.

The creation of a preferential trade and economic space between different countries or regions does not necessarily need to be concluded in one stage, as would be the case if it was required for example to guarantee in a period of time the liberation of 90% of the trade of originating products. It would be possible thus to imagine such creation as a gradual long term process –i.e. more than ten years- in which the first preferential stock –that may be qualified as “significant” in a valid interpretation of the term “substantial”- is gradually increased through the application, for example, of different modalities of evolutionary clauses. Or the more sensitive sectors or products to be included in the liberation schedule could have special escape clauses.

In the case of an agreement Mercosur-EU, a gradual process of creation of a bi-regional preferential space consistent with GATT rules could be bolstered by including clauses aimed at linking the different agreements that form part of the network that the EU is creating in the region, based on the agreements signed in due time with several Latin American countries, as mentioned before.

This would enable to provide European firms and businesses networks operating in different countries -for example Mercosur plus Chile and Peru- more appropriate conditions to develop productive integration strategies. Additionally they could benefit from the reduction of duties and of any future improvements on the quality of the physical connectivity between the different markets. It would also help to articulate the preferential trade strategies with the other issues of bi-regional cooperation that were included in the action plan approved at the Madrid Summit including, among others, those pertaining innovation and technological advancement, social cohesiveness, climate change, energy and bio-diversity.

In the investment field the agreement could be also innovative. First giving priority to the idea of development of bi-regional value chains oriented toward third markets. Innovation, technical progress, small and medium size firms, should be three key elements of a strategy of bi-regional cooperation to promote production networks in some sector in which it is possible to identify common interests, especially if the global markets opportunities are taken in consideration. And second, through the introduction of innovative approaches for investment protection policies and mechanisms.

One way to do it could be to relate the access to investment protection rules –for example, those that could be included in the bi-regional agreement- to the acceptance by interested firms of the prescriptions of a code of conduct with norms related to social responsibility, among other points.

#### **4. The risks of a failure in the negotiations**

Is it possible that once that the Mercosur-EU negotiations after been re-launched after the Madrid Summit could eventually suffer more delays,

become stagnant once again or simply fail? Having in mind what happened since May 2010, all these are plausible scenarios, either because of insufficient political incentives, or the technical difficulties to untie the knots that are still pending, or because of a lack of consensus regarding new approaches to commitments and instruments that could be –as mentioned before- flexible enough and at the same time are consistent with WTO requirements.

The costs of not concluding the negotiations could be very high this time. If there is sufficient political determination and technical creativity it would be difficult for a country -or region- or sector to be willing to assume the consequences of a failure. One outcome could be that instead of a bi-regional agreement the final result is something similar to what happened with the Andean Community of Nations. Due to the inability to move forward in the joint negotiation, the EU opted to conclude agreements with two countries, Colombia and Peru, even without excluding the possibility that the other countries might be incorporated at a later date.

If this eventually happened in the case of Mercosur, it would imply a strong blow to the fundamental idea of building among its members, a common regional space with a deep strategic and political purport and to its natural consequence, which is precisely to negotiate with one single customs territory, with no harm to the flexibilities that it may have, taking advantage of the opportunities provided by article XXIV, clause 8, a, of GATT-1994. A failure in the negotiation that could not be attributed to the EU would imply a fracture within Mercosur between those countries that are willing to negotiate and those who are not, whatever the validity of the arguments used to justify this position. It is a fracture that eventually could have political implications having in mind the main strategic ideas –including the nuclear field- that lead in the 80's to the launching of the Argentina-Brazil cooperation and integration process, that was then enlarged to what is today known as Mercosur.

In a certain way, the high political costs of an eventual failure of the Mercosur-EU negotiations would indicate that the moment of truth has arrived for both the bi-regional relation, after such a prolonged “courtship”, and for Mercosur's own integration process.

## **5. Some conclusions about a possible and optimistic scenario**

It would be reasonable to imagine as a possible and probable scenario the full conclusion of a bi-regional agreement in which both parties have invested much political capital, as was reflected by the results of the Madrid Summit. But this scenario will require a lot of flexibility in the instruments that will be used. And also it will require a strong political determination on both sides of the Atlantic.

Such scenario - obviously an optimistic but possible one - would allow to creatively tackling other unresolved issues of the bi-regional relation or that involve countries from both regions, including those issues of great complexity or that have been dragging on for a long time. A biregional strategic partnership agreement such as the one being sought may contribute

a common ground and an opportunity for an imaginative approach to all those pending issues, even the most politically sensitive and complex ones.

In any case, these negotiations will entail a remarkable coordination effort both among Mercosur member countries and also among EU members, including the Commission and its various internal areas. An efficient articulation of strategic visions within each one of the countries on both sides will be required as well. One example, among others, is the diversity of interests on the European side in relation to, among other sectors, agriculture, automotive industry, capital goods and services.

Additionally their firms would benefit from the reduction of duties and any future improvements on the quality of the physical connectivity between the different markets. It would also help to articulate the preferential trade strategies with the other issues of bi-regional cooperation that were included in the action plan approved at the Madrid Summit including, among others, those pertaining innovation and technological advancement, social cohesiveness, climate change, energy and bio-diversity.

It would be a scenario that could imply a positive contribution to the more difficult task of assuring a reasonable level of global governance, through the gradual construction of positive cases of regional and inter-regional governance.

Perhaps this would be the most important contribution of an eventual EU-Mercosur bi-regional agreement to the idea of building the conditions for a more stable global order, even if it doesn't comply, at least in its first period of implementation, with all the requirements of text book definitions about what ought to be a free trade area or with a more orthodox interpretation of the ambiguous article XXIV of GATT-1994.

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