Global Positioning of the European Union and MERCOSUR: Towards a New Model of Inter-regional Cooperation

Annual Lecture of the Mercosur Chair
Institut d’Etudes Politiques - Paris, France
April 4, 2002

The Annual Lecture of the Mercosur Chair at the Institut d’Etudes Politiques de Paris is a distinguished opportunity to reflect on where we are and where we are going in the relations between Latin America and the Caribbean (LAC) and the European Union (EU). Having been invited by a prestigious institution which has hosted eminent development scholars such as Bela Balassa or Albert Hirschmann, it is natural to look at those relations in the light of the current development challenges that my region faces nowadays. And I will look at them through the prism of regional integration. This is because a vocation for regional integration has been a central strategic tool in the global economic and geopolitical projection of both European and Latin American countries, and at the same time it constitutes one of the most important expressions of the cultural affinity that link our continents.

Since the end of World War II, the successful construction of closer ties among European countries through a sustained process of increasingly deeper regional integration has inspired many political leaders in the developing world, and in particular in LAC, which historically has had many episodes of trying to “get together”.

During the last decade our region witnessed an unprecedented interest in regional integration. Unlike the old early Post-War vintage of regional integration initiatives which was inward-looking, there has emerged what some call a New Regionalism that is an integral part of a structural reform process designed to make our economies more open, more market-based, more socially equitable, more democratic and more internationally competitive in a globalizing world economy. Mercosur has been a prominent example of this new wave of regional integration agreements.

Meanwhile, the 1990s witnessed the EU expanding its regional web, including more comprehensive approaches to Latin American countries. This process permitted the Rio Summit in 1999 to go one step further and establish a strategic partnership. This Summit brought 48 countries from the European Union and Latin America and the Caribbean together for the first time and an Action Plan was agreed on in order to increase cooperation in the political, economic and cultural fields. All participants are now actively pursuing initiatives to implement this plan which is to be re-examined at the upcoming Madrid Summit in May.

One of the most striking features of the New Regionalism is the sharply growing disposition of developing countries to enter into reciprocal agreements with industrialized countries. This interest in our region extends primarily to the EU and North America. The EU has always encouraged the strengthening of regional integration in Latin America and the Caribbean and has actively supported Mercosur and other subregional initiatives from their very conception. In the case of Mercosur, the most significant result of the Rio Summit was the launch of formal negotiations “aiming at bilateral, gradual and reciprocal
trade liberalization, without excluding any sector and in accordance with the WTO** between the EU and Mercosur (and Chile). This would serve as a centerpiece that would pave the way for a comprehensive Interregional Association Agreement.

Steps ahead of this Interregional Association process has been the Free Trade Area of the Americas (FTAA) that was launched at the Miami Summit in 1994. The FTAA is undoubtedly the most ambitious collective initiative in the history of the Western Hemisphere and has already generated important positive externalities for the development of our borrowing countries and the strengthening of the multilateral system. The goal of the process is to achieve a “balanced and comprehensive agreement” with negotiations being concluded no later than December 2004, while entry into force will be sought no later than December, 2005. The negotiation has advanced steadily and now is entering into the critical, and very difficult, final stage of product and sectoral level discussions of reciprocal liberalization.

For our borrowing countries it is of vital importance to maintain balanced free trade and investment relations with all major trading partners and to actively support the progress of the multilateral trading system. After the approval of the WTO’s comprehensive Doha Development Agenda, Latin American and Caribbean countries must ensure that all preferential trade negotiations steadily advance at comparable rhythms and are complementary to the multilateral trading system. This will be good for us and will be good for the entire world.

The Inter-American Development Bank (IDB) has been committed to the support of regional integration initiatives since its foundation. This commitment has been eloquently stated by the first President of the Bank, Felipe Herrera, who declared in 1961: “Seremos el Banco de la Integración”. Nowadays, along with actions in the fields of social development, modernization of the state and competitiveness, the support of regional integration is one of the four pillars of the New Corporate Strategy of the Bank to promote the reduction of poverty and the sustainable development of the region.

The last decade witnessed the emergence of a passionate debate on the vices and virtues of globalization and regionalism. Perhaps the most exciting feature of this debate is the prominent role assumed by civil society organizations. Since its establishment, the IDB has been a pioneer in working with civil society organizations based inside and outside Latin American and the Caribbean.

In this regard, it is important to point out that through the Integration and Regional Programs Department and our Special Office for Europe, the IDB has been supporting and co-financing the Mercosur Chair of Sciences-Po in cooperation with the European Commission and additional support has come from the Ministries of Foreign Affairs of France and Brazil. I believe that the work accomplished by the Mercosur Chair is an excellent example of a constructive mechanism which allows elements of civil society to channel opinion in a disciplined way to trade negotiators. Over the last two years, the Chair’s Working Group on EU-Mercosur negotiations has been an effective instrument to transmit new ideas from an eminent and diversified group of experts to the officials in charge of the E.U-Mercosur initiative, as well as private sector players. Indeed, I think that this constructive interaction generated by the Mercosur Chair’s Working Group could be a model for cooperation with civil society in other regional initiatives.
It is therefore a great honor to be here today to share with you my views on:

- some of the historical antecedents of regionalism in Latin America and the Caribbean;
- the characteristics of the New Regionalism that emerged in Latin American and the Caribbean in the nineties;
- an emerging second stage of the New Regionalism as we enter the 21st Century;
- the strategic relevance of the relations between Latin America and the European Union in the context of the New Regionalism;
- the particular challenges that the Mercosur and the European Commission are facing in order to conclude the first ever reciprocal free trade agreement between two customs unions;
- the role that the Inter-American Development Bank may have in supporting stronger relations between the EU and Latin America and the Caribbean.

I. Integration in the Post War Development of Latin America and the Caribbean

To understand the contemporary New Regionalism it is useful to establish a backdrop of what preceded it.

Latin America and the Caribbean led the way in the emergence of import substitution industrialization (ISI) development strategies that dominated early Post War development policy and theory. In Latin America this approach had its seeds in some mutations of liberal economic policy at the turn of the 19th Century, but gained full expression in the Great Depression when private markets and international trade and finance collapsed and governments throughout the world dramatically raised protectionist barriers. In the face of these developments Latin America also raised its barriers and the state undertook a much more direct role in the economy in order to stimulate investment and growth in these difficult times.

By all accounts our region faired relatively well by the ISI strategy. During the Great Depression the region managed to avoid sharp falls in output; indeed, Carlos Diaz-Alejandro once commented about the contrast between the humming sound of economic activity in Sao Paulo and the quite desperation of New York. As we moved into the early Post-War period Latin America was at the forefront of economic growth in the developing world. Moreover, the mainstream development economics theory of the era — Prebisch/CEPAL, Singer, Nurske, Perroux, Rosenstein-Rodan, etc. — in their own way gave logical form to the practice of ISI.

The Post-War arguments for an ISI strategy developed out of some prevailing assumptions, many of which had deep roots in the experience of the Great Depression. Some of these were:

- Pessimism about the secular external terms of trade for commodity exporters
- Skepticism about the entrepreneurial vocation of the private sector
- Faith in the effectiveness of public enterprise
- Fear of dependence on foreign firms and their extraction of exploitative rents
- Marginal interest in the GATT and the multilateral trading system
On the basis of this the central tenet of the development strategy was to promote infant industries behind high levels of external protection; promote state economic planning with a leading role for public enterprises in strategic sectors; restrictions of foreign direct investment (FDI), especially in extractive industries, and minor participation in the GATT, as reflected by the fact that only 8 Latin American and Caribbean countries were members during the 1950s, rising to just 11 by the end of the 1960s.

While the world economy began to rebuild itself in the early post war period with gradual processes of liberalization and recovering flows of international trade and finance, Latin America's growth performance began to flag. But the development model, perhaps victim of its own success, was not fundamentally questioned. Rather the prevailing diagnosis of the time was that the small domestic markets had exhausted possibilities for efficient ISI and needed a larger market environment to achieve the efficiencies of economies of scale, especially in heavy industries which were at the core of this strategic approach.

In the development debate regional integration emerged as one of the potential strategic tools for strengthening ISI. CEPAL was instrumental in bringing regional integration to the consideration of policy makers. While grossly simplifying, the approach aimed to eliminate trade and investment barriers among partner countries, maintain, or even raise, protection against third parties, extend planning and state intervention to a regional level, regulate foreign direct investment and support this all with a collective institutional architecture where the emerging European integration project was a clear point of reference.

The overarching goal of this early episode for regional economic integration was an eventual creation of a Latin American Common Market. The primary initiatives were the Central American Common Market and the Latin American Free Trade Area (LAFTA), which some members hoped would evolve into a common market. Later, in the late 1960s, the Andean countries, in part due to the desire to accelerate this latter objective, formed what was called the Andean Group. Meanwhile the emerging independent states of the English speaking Caribbean States formed a free trade area in 1968 that deepened to a common market project in the early 1970s.

The results of these early initiatives in regional economic integration were generally limited in terms of regional tariff liberalization and trade and investment, with Central America being something of an exception for awhile. While there were many reasons for this, some of the key obstacles were;

- **Vocation for National Protection.** The opening up of a regional market was handicapped by the vocation for national protection which was inherent in the model. Hence liberalization was generally carried out by a laborious “positive lists” approach with results of limited scope. In effect the strategic tool of regional integration was undermined by the very model it was designed to rescue.
- **State-Private Sector Tension.** This reflected on the one hand extensive state intervention in market decisions and on the other the protectionist habits of the private sector. The tension was further aggravated by the top heavy regional institutions that some of the agreements engendered.
- **Macroeconomic Instability.** The ISI model was inherently unbalanced and prone to aggravate macroeconomic instabilities arising from unstable commodity prices and financial flows.
• **Distribution of Benefits.** Trade balances were very uneven among partners and this created serious political tensions in the agreements.

• **Infrastructure.** Sparse regional infrastructure was a limiting factor for growth of regional trade.

• **Authoritarian governments.** The period was dominated by authoritarian governments that stimulated national rivalries, border conflicts and restrictions on the flow of goods, people and development of regional infrastructure.

• **US Skepticism.** In this era the U.S government was not comfortable with regional approaches, as its main focus was the multilateral system. Moreover, its articulation with the countries and regional cooperation was more motivated by the cold war politics than commercial interests.

II. **Globalization and the New Regionalism**

The last decade of the XX Century witnessed the parallel and intertwined forces of globalization and regionalization strongly at work. Rather than being contradictory, these processes are two complementary manifestations of modern capitalist development. Indeed, the features that have been characterizing both globalization and regionalization emerge from the autonomous technological transformations of private market development and from policy implemented by governments to regulate the insertion of their national economies into the world economy. In this latter category formal regional integration initiatives have had a primary role. And Latin America and the Caribbean have been at the forefront of these regional processes.

a. The New Regionalism

Regional integration occurs naturally, albeit very unevenly, during the course of the development of private markets. “Natural” market integration is a process characterized by progressive convergence of economic and social parameters between locals and regions, and by increasing degrees of interdependence. But regional integration also can be driven by policy-induced regional cooperation, or regionalism. Reciprocal preferential trade agreements are very often the point of departure for formal regional integration.

In our region, integration initiatives go back to the very early days of independence, spurred by the integrationist philosophy of *libertadores*, such as Simon Bolivar. But as we saw earlier, attempts at economic integration gained a strong foothold only in the early Post War period and sustained success was limited. Moreover, the onset of the debt crisis in the early 1980s was a death blow for the flagging ISI approach to development and the integration schemes that were introduced to support it.

While the seeds of change were evident in the 1970s, once again crisis was the handmaiden of a major shift in Latin America and the Caribbean’s development paradigm. The region’s economic collapse of the 1980s was localized as the world economy continued to expand and world markets remained open. Moreover, by then there had developed clear demonstration effects in the OECD area and Asia of the growth potential arising from opening and exports to the world economy and exports. Under pressure of a prolonged economic collapse and a shifting policy consensus, the region embarked on another historic venture involving major structural economic reform to open economies through reduction of tariff barriers, deregulation and privatization of
markets and a primary focus on monetary and fiscal discipline. Parallel to this, and integral to the reforms, was a general process of democratization.

Initially regional integration seemed to lose its luster in Latin America and the Caribbean. However, a wave of New Regionalism became quite evident in the 1990s. Indeed, the period witnessed the emergence of more than twenty free trade area or common market projects. The overarching defining difference between the New Regionalism and earlier Post-War experiences is the policy environment. In effect, the New Regionalism is inserted into a framework of policy reform that promotes open and competitive private market-based economies in a modern democratic institutional setting. Indeed, the New Regionalism is an extension of that very structural reform process that got underway in the mid-1980s.

Perhaps the most dramatic change in character was the gradual shift during the 1990s from the traditional intra-regional focus for integration (“South-South”) to growing interest in inter-regional (“North-South”) agreements, which link up commercially with industrialized countries in reciprocal free trade, often in conjunction with ambitious functional cooperation programs. This is something that would have been politically inconceivable before the new policy framework.

This trend is seen in Mexico joining NAFTA with the US and Canada; Canadian free trade areas with Costa Rica and Chile; Chilean negotiations for a free trade area with the US; EU FTA/Cooperation agreements with Mexico and South Africa and on-going negotiations with MERCOSUR, Chile and the CARICOM countries; the Western Hemisphere’s Summit Process and Free Trade Area of the Americas (FTAA) negotiations; APEC; and Japan’s recent FTA with Singapore.

Growing and mutually beneficial economic interdependence among partners typically induces demands for additional regional economic cooperation to exploit more fully the advantages of a maturing regional market. Moreover, demands for non-economic and even political cooperation arise from the social externalities generated by closer economic ties. There is the contemporary example of Western Europe, where growing interdependence through trade has served to drive forward a political agenda among certain partners of the agreement for very deep integration and broad-based cooperation. Latin American and Caribbean new integration initiatives are still in their initial phase. There are, however, no doubts that continuous political commitment and the growing level of trade interdependence would contribute to the deepening of the integration commitments in the region.

b. The Objectives of the New Regionalism

**Strengthening Structural Economic Reforms.** The overarching motive of the New Regionalism is to create a strategic national tool to reinforce the structural economic reform process in a period of highly competitive globalization. Countries now value a greater participation in the globalizing world economy as it is seen as a way to stimulate investment and growth. Regional integration is viewed as an additional policy tool to complement and strengthen national reform processes. The clearest link to the structural reform process is enhancement of commitments to trade liberalization, which has been a central feature of many developing countries’ development strategy. In effect, regional economic integration has become the third tier of a three tier process, with the first two being unilateral and multilateral opening. Moreover, the regional opening is facilitated by
political economy considerations: full reciprocity, locking in the reform through binding rules-based commitments, and the possibility of signaling liberalizing commitments to the private sector, especially when it is not feasible to pursue unilateral or multilateral opening. The three tiers have certainly worked in tandem to mutually reinforce each other in the case of MERCOSUR. Meanwhile, regional trade agreements, especially those with deep objectives, or the so-called “second generation” free trade areas which go beyond traditional market access in goods, encourage structural modernization of institutions directly through the disciplines they introduce, and indirectly through the increased demands brought about through regional competition.

**Economic Transformation.** While liberalization and increased participation in a globalizing world economy is viewed as instrumental to modernizing the region, countries face serious vulnerabilities arising from, among many other things, a narrow export base and insufficient competitiveness of much of the private sector’s export supply. Reciprocal opening, guarantees of market access, preferences, etc. of a regional scheme can provide new opportunities for export and diversification to compete in a global economy. Regional markets also serve as an outlet to an important array of products like textiles, dairy goods, meat, food processing, etc., which confront very high levels of international protection. However, while the New Regionalism is designed to create trade, it builds on longer term strategic considerations arising from imperfect and incomplete markets at home and abroad. In effect, dynamic transformation effects are sought through the catalyst provided by access to a secure enlarged market, more specific information flows and defined market competition and identifiable export opportunities, all of which can induce investment, greater specialization via economies of scale, product differentiation, increased productivity, competitiveness, employment and growth. In the process, regional integration also can contribute to completing markets in labor, finance, technology, etc.

**Attraction of Foreign Direct Investment (FDI).** There is nowadays a worldwide competition in developing countries to attract FDI for its potential contribution in areas of export networks, technological and know-how spillovers, and institutional modernization. A regional agreement, through the creation of a larger liberalized rules-based regional market, can serve to distinguish member countries and help them compete for, and attract FDI. Moreover, FDI tends to cluster, so initial success in this area can lead to more.

**Geopolitics.** A group of like-minded countries can use their regional scheme to, among other things, establish a regional safety network for fragile democracies, promote disarmament and peace among neighbors, and enhance bargaining power in international fora.

**Functional Regional Cooperation.** The New Regionalism also reflects itself in increased interest in functional regional cooperation in economic, social and political areas to deal with externalities arising from increasing interdependencies in regional and world markets. Development of regional infrastructure, business facilitation, control of natural disasters and regional security are some of the principal emerging areas of regional cooperation in Latin America and the Caribbean.

Finally, by examining its central characteristics, it can be seen then that the New Regionalism has turned the Old Regionalism “on its head”:
• It is outward rather than inward looking.
• While not immune from macroeconomic instability, our economies— and hence regional initiatives— are clearly much more resilient than in the past.
• Liberalization of regional trade (above all in goods) has been relatively quick and universal.
• Market forces predominate and regional institutions tend to be more scaled down.
• The private sector is expected by governments to be the principal economic actor.
• There is a welcome mat for FDI.
• There is a democratic setting and relative peace on borders.
• Beginning with NAFTA, the US become a convert to regionalism and with some tentativeness began to look South for commercial partners with the launch of the FTAA.
• Countries are increasingly eager to link up with industrialized countries—something that would have been inconceivable as late as the 1980s—as they view this as a way to further foster the objectives outlined above.
• All but one IDB borrowing country are active members of the WTO.

III. The New Regionalism in the 21st Century

The New Regionalism is continuing to evolve and new challenges must be addressed.

First, we are witnessing demands for a new generation of reforms. The policy reforms since the mid-1980s have been impressive. However, it is clear that there is a need to “reform the reforms”. The economies, while more resilient, are still prone to serious macroeconomic vulnerability. The first generation of reforms also have not successfully addressed inequality and poverty, generating some popular backlash to open economies and globalization. Corruption and crime are increasing sources of social tension and democratic institutions remain fragile. Hence more attention must be given to institutional development, public and private finance, labor market and social policy reforms as well as the optimal sequencing issues regarding new policy reforms and the reinforcement of older ones. Meanwhile, good governance and democratic participation continues to be a priority area of development.

Second, the movement to a second generation of policy reforms will demand that regional integration provide support through more extensive introduction of second generation regional disciplines. Most intra-Latin American and Caribbean regional integration faces the challenges of pushing their regional liberalization beyond goods to trade in services; introducing common disciplines to trade and investment related domestic policies; completing customs unions in schemes with deep objectives, exploring ways to promote economic stability through financial and macroeconomic coordination and pursuing intensified regional cooperation, or the production of regional public goods, in emerging areas such as transparency, the environment, technology, promotion of regional production chains and social protection.

Third, the formerly unquestioned European leadership in regional integration will be increasingly challenged by aggressive US regionalism on a global scale and of a different philosophical tone in terms of modalities and architecture. Japan also seems to be awakening to the strategic possibilities of regionalism. Hence, in the future, as developing countries deepen their interest in linking up with the industrialized countries,
they may very well have choices that will help determine the future map of commercial and geopolitical relations in a globalizing economy.

Fourth, the tentative approach of the US administration to regionalism with Latin America and the Caribbean during the 1990s has evolved under the Bush administration into a clear and vocal strategic priority that is being led by trade and investment issues.

Fifth, the intensity of regionalism should increase and expand into new areas of cooperation. Given the continued vulnerability to the uncertainties of globalisation, developing countries will search more aggressively for a strong anchor for their economic, political and social reforms by entering into regional agreements with industrialized countries.

Sixth, as North-South integration moves forward the survival of subregional and bilateral agreements that lack economic relevancy and political commitment will be at risk.

Seventh, there will be much more interaction between the multilateral system and regionalism as there is an increasing perception that regional integration will be a growing part of the globalizing world economy, that there are functional links between the two, and that there are serious risks if the two systems drift apart.

Eighth, the credibility and effectiveness of the multilateral system will depend on it finally advancing seriously in significantly reducing protection and trade distorting practices on those products for which developing countries have a clear comparative advantage.

Ninth, the increasing interest and participation of developing countries in the multilateral system and in integrating with developed market economies will place heavy burdens on donors and development banks to ensure the capacity building necessary for sustainable agreements and socially efficient adjustments.

Tenth, civil society will demand increasing interaction with trade and integration processes and this will in turn create demands for more effective, disciplined institutional channels of communication.

Finally, the success of the second generation of reforms and the regional initiatives meant to support them will also depend on reforming the international financial architecture so that it is less prone to abrupt surges and retreats of capital flows, particularly of a short term nature.

IV. Current trends in EU-LAC initiatives

Despite the historical and cultural links between Europe and Latin America and the Caribbean, in the early post-War decades the formal cooperation initiatives between the two regions were, with the exception of the ACP countries, somewhat low-profile and mainly focused on individual countries rather than on the whole region or sub-regions within it. This trend resulted from the relative importance of former colonies in the definition of the European development cooperation policy, but also from the lack of unity of the Latin American region itself.

However, during the 1980s, the Central American crisis and the effective European response through the achievements of the San José dialogue; the entry of Spain and
Portugal in the European Community and the subsequent shift of the attention toward their former colonies; and the mandate to raise the profile of European external policies established in the Single European Act (1987) and in the Maastricht Treaty (1992) all prompted the emergence of a renewed concerted interregional engagement.

During the 1990s the interregional agenda notably expanded as culmination of these developments. The network of contacts setup to address the issues related to the Central American crisis were institutionalized in the meetings of European and Rio Group foreign ministers. The political commitment was also matched by an increase in European aid resources. Indeed, throughout the past decade the EU has been by far the most important source of Official Development Assistance (ODA) to the region, providing over US$ 25 billion since 1990 and accounting for almost 50% of total bilateral ODA received by LAC.

Perhaps the most striking feature of trans-Atlantic relations during the 1990s was the marked European preference for supporting regional integration and the greater emphasis placed on “economic cooperation” beyond traditional “development cooperation”. This trend was a direct consequence of Europe's preference for dealing with groups of countries rather than on a purely individual basis. In this framework, the support for the private sector through trade promotion, training and technical assistance schemes, and direct contacts between firms were defined as the key priorities of the new cooperation instruments, such as ECIP, AL-INVEST, ALURE, etc.

However, the fundamental change in the nature of the relations between the two regions is clearly connected with the emergence of the New Regionalism in Latin America and the Caribbean. The EU responded to this new trend by adopting a “differentiated” search for reciprocity in inter-regional economic agreements with the most advanced Latin American and Caribbean countries or regions. This trend is observed generally in all agreements linking the EU with LAC, such as the reform of the GSP or the new Cotonou agreement with Caribbean countries, and more explicitly in the free trade talks with Mexico, the Mercosur and Chile.

It also is important to highlight that negotiations for a reciprocal trade agreement are part of a more comprehensive approach aiming at sustainable development, macroeconomic stability, poverty alleviation and the consolidation of democracy and good governance. Indeed, we see that political dialogue, cooperation and trade are linked in a single undertaking packaged in the negotiation of Interregional Association Agreements with Mercosur and Chile. This potentially creates a “trade and cooperation nexus” which is quite unique to the European approach to strengthening links with developing areas and could, if it delivers on its promise for a really integrated initiative, emerge as a model for the North-South dimension of the New Regionalism.

Notwithstanding its many initiatives and generosity in development aid and cooperation, there is a sense in some circles of Latin America and the Caribbean that the EU is mostly focused on internal matters as well as Eastern Europe and hence is not all that enthusiastic about tightening relations, particularly trade relations, with our region. This contrasts with a US thrust in Latin America and the Caribbean that does strongly emphasize trade and investment—our region’s primary interest—and which can act as an eventual effective “hanger” on which to drape regulatory and institutional arrangements favorable to US business interests as well as geopolitical initiatives.
Perhaps where this perception is strongest is ironically in the area where the EU has its strongest presence: Mercosur.

V. The Mercosur-European Union process

Mercosur has received support from the European Commission (EC) since its foundation. In 1992, one year after its creation, the EC signed an Inter-institutional Agreement with Mercosur to provide technical and institutional support to the fledging structures of the common market project. At present, the EU-Mercosur relationship is based on an Interregional Framework Cooperation Agreement signed in December 1995 between the EC and its Member States and Mercosur and its Party States. This entered into force on 1 July 1999, although provisional application already took hold from 1996 onwards. This Framework Agreement consists of three main elements: political dialogue, cooperation and trade issues.

The main objective of the 1995 Framework Agreement is to prepare the conditions for an Interregional Association Agreement between the EU and Mercosur, which should include the liberalization of trade in goods and services, aiming at free trade, in conformity with WTO rules, as well as an enhanced form of cooperation and a strengthened political dialogue. In July 1998, after three years of preparatory work between the Commission and the Mercosur governments, the Commission was able to put forward to EU Member States a proposal for a negotiating mandate that was approved. On this basis the Heads of State and Government of the European Union and Mercosur were able, at their Summit Meeting on June 1999 in Rio de Janeiro, to formally launch negotiations.

The negotiations started in November 1999 in Brussels, when Mercosur and EU negotiators presented to their ministers a document on the structure, methodology and calendar for the negotiations. In the first four rounds of the first phase of the negotiations the Parties agreed on selected issues regarding the political and cooperation dialogues, exchanged preliminary information on tariffs barriers and as well as proposals for the reduction of non-tariffs barriers.

Trade talks entered the second phase in July 2001 with negotiations on tariffs and services. The results of the last two rounds were positive, as the detailed stage of the negotiation process effectively got underway. In fact, both sides set up an initial and fruitful clarification of the respective tariff offers through the exchange of negotiating texts for goods, services and government procurement. Notwithstanding this progress, doubts linger among some about the intentions of the EU to finalize a comprehensive agreement on market access, which is at the very heart of objectives of the Mercosur countries.

The next Round is an occasion to advance in the technical issues related to the negotiations. Meanwhile, the Summit to be held in Madrid next month will be an opportunity to reconfirm the political commitment for a rapid conclusion of this historic free trade agreement between two customs unions.
a. The Prospects for an Interregional Association

The prospects for inter-regional association can be explored through the review of the trade and investment flows between the two regions during the last decade.

For the EU Mercosur is a relatively minor trading partner: it represents 3% of extra-EU trade. In contrast, the EU is Mercosur’s main trading partner, accounting for 27% of total external trade. However, the Mercosur countries are the most important commercial partners of the EU in Latin America and the Caribbean, accounting for almost 50% of EU trade with LAC.

In the last decade, inter-regional trade increased at an average pace of 8.2%, outstripping the growth of world trade (5.9%). The growth of trade flows benefited the EU more than the Mercosur. In fact, EU exports to Mercosur increased by almost 15% annually, while the exports to the world increased by only 5%. Meanwhile, EU imports from Mercosur only increased by 3% annually compared to an annual average increase of extra-EU imports of nearly 5%. The asymmetric dynamic of trade flows explains the accumulation in the Mercosur of trade deficits with the EU after 1994.

Moreover, the asymmetry of trade relations is also manifest at the qualitative level. The sectoral composition of trade flows indicates that Mercosur countries export more natural resources-based products to the EU than to the world, while they import relatively more industrial products from the EU than from the world. Indeed, this structure of international specialization characterized by the export of low value-added products and the import of products with high technological content has worsened during the 1990s.

Given the above-mentioned transformation of the global economy in the last decades, trade relations must be analyzed along with the trend of foreign direct investment (FDI). In the last decade Mercosur has progressively become an important destination of FDI directed toward emerging markets. In 2000 the Mercosur countries represented 59% of FDI directed toward Latin America and the Caribbean.

For Mercosur countries the trade agreement with the EU is an opportunity for securing market access in its major export market and for balancing the trade deficit through the increase of agriculture-related exports and the diversification of manufactured exports. It also will be an important stimulus to European foreign investment and institutional modernization.

For the EU it is an opportunity to consolidate its commercial presence in a big external emerging market. It must be remembered that competitive success in a globalizing world economy requires global positioning; hence market share in important corners of the world such as the Southern Cone cannot be overlooked, especially given the competitive advantage that the EU already has in terms of its still strong cultural affinities with this geographic area. An agreement also will ensure a more stable regulatory framework for direct investment, intellectual property protection and dispute settlement, Free trade with Mercosur would additionally open new business perspectives, in particular those related with private and public procurement emerging from the subregion’s renewed interest in the development of regional infrastructure. Finally, the umbrella of a comprehensive free trade agreement also should serve as a beacon that will broaden the geographic distribution of European investors in Mercosur.
As mentioned earlier, the EU-Mercosur process is paralleled by the negotiation of the Free Trade Area of the Americas. North America has not lost sight of the instrumental role of free trade areas in its global positioning. The Southern Cone is clearly in its strategic sights as a primary target when negotiating the FTAA. Since the FTAA negotiations are firmly on track, from the European standpoint the Mercosur-EU process would be the best, if not the only, instrument to avoid potentially severe loss of market shares.

From the Mercosur standpoint these two inter-continental processes are highly complementary. Mercosur countries are “global traders” that present a geographically diversified trade pattern and would therefore benefit both from multilateral and balanced North-South preferential opening.

In fact, as shown by the simulations realized by our Integration and Regional Programs Department, the parallel entry into force of the FTAA and of the EU-Mercosur free trade area would produce sizable welfare gains for all the participants, a clear “win-win” option. Moreover, this dual track strategy of free trade would help Mercosur countries to diversify the sectoral pattern of their exports and to balance the political economy pressures for trade protection and discrimination.

The wide scope of the EU-Mercosur Association agreement could bring to Mercosur some additional assets to sustain the path toward deeper integration. First, skills and technologies useful for better capturing the opportunities offered by a regional market might accompany the development of European FDI flows. Second, a focused and effective political dialogue accompanied by targeted cooperation initiatives could usefully transfer to Mercosur the valuable “technology of integration” accumulated in Europe over the decades; for example, compensation mechanisms, the regulatory reforms needed for deeper integration and even roadmaps for macroeconomic coordination and monetary union. Finally, as mentioned above, the EU-Mercosur process could become a worldwide example of innovative North-South relations through a trade-cooperation nexus underpinned by a legally subscribed single undertaking.

b. The Challenges Ahead for Greater Interregional Cooperation

Another novelty of the EU-Mercosur negotiation is the emphasis placed on the bloc to bloc format for negotiation and hence on the very notion of an interregional agreement itself. In fact this negotiation format may bring valuable systemic effects, as it will provide an effective instrument for the rationalization of complex plurilateral international trade and trade-related negotiations. However, it also requires a sufficient degree of coordination achieved by each bloc prior to the interregional negotiation.

Mercosur is a recent regional integration agreement among emerging markets, the logic of which has been questioned by problems of its member countries arising from turmoil in their links with international financial markets and a slowdown of the international economy. The apparent fragility of the Mercosur, the temporary waivers to certain integration provisions and internal disputes have also cast some doubts on political will and the ability of Mercosur to negotiate a bloc to bloc trade agreement. However, rather than being signals of a flawed project, the difficulties of Mercosur should to be seen as a growth crisis in which a further deepening of integration processes can help provide some relief.
The logic underpinning Mercosur is strongly related to the natural pull of geography, culture and commercial interdependencies, coupled with common interests in finding a regional platform to compete in a globalizing world economy, creating a security network for peace and democracy in the Southern Cone and developing a stronger geopolitical profile, in particular through the organization of a solid and credible bloc for international negotiations. Mercosur also is aware of the urgency of consolidating a rules-based system which is absolutely essential to organizing a functional economic space that encourages the trade, investment, financial and technological flows that are needed to respond to the challenges of globalization. Therefore there are many real economic and strategic factors that encourage Mercosur countries to link national interests to regional cooperation and help make sense of the sometimes heard phrase that Mercosur is a destiny rather than an option.

It is certainly true that in the last few months Mercosur has generated some unsettling news, such as the adoption of temporary waivers to the common external tariff and an increase of effective protection; the introduction into the WTO of an interregional antidumping case; the appearance of restrictive trade measures to respond to the effects of the devaluation of the Argentine Peso; and the fall of intra-regional trade flows. However, on the other hand there are other signals which show that Mercosur is a high priority for member countries and that the current crisis may be a window of opportunity to strengthen the integration process. This can be seen in the clear expressions by partners of political solidarity with the new Argentinean government, in the initiatives between Central Banks to adopt a payments agreement that would help sustain intra-regional trade flows and in the recent publicly stated proposal of the Brazilian government to implement a commercial “peace” agreement with regional neighbors. Finally, it is particularly important to highlight the adoption of the Olivos Protocol that strengthens the dispute settlement mechanism of the Mercosur.

As a trade partner, the E.U is not without its own challenges. For example, recently the EU has been confronting the difficult trade-offs involved in adapting one of its historically most important integration instruments—the Common Agricultural Policy—to the strategic requirements of expansion to the East and more broadly of global positioning and pursuit of new markets abroad through interregional and multilateral trade negotiations.

These examples, referring both to the Mercosur and to the EU, demonstrate that regional integration agreements are dynamic entities that evolve over time and face the continuous challenge of adjusting to the global contest for market position and to the unpredictable winds of the evolution of the world economy, all in a way compatible with the interests of member states. I am confident that Mercosur and the EU will be able to overcome the technical, political and institutional difficulties associated with the complex negotiation of this interregional association agreement, provided that both regions maintain sufficient political will to conclude their mandates. As mentioned earlier, the Madrid Summit would certainly be an appropriate platform to reiterate that commitment.

c. Dealing With the Argentinean Crisis

Last but not least, it is certain that the deepening of Mercosur and a successful interregional agreement with the EU depends on a recovery of the Argentine economy.
There is no doubt that most of the onus lies on Argentina itself. It needs to complete a coherent and sustainable macroeconomic framework, in particular through a disciplined budget that rationalizes the relationship between central and provincial government income/expenses. It also needs to restore faith in the banking system and investor confidence, as well as deal with the rapid spread of poverty at home. Not unrelated, at the international level the country must obtain a debt restructing that sets up a new realistic payments schedule, and finish negotiating a package with the IMF.

But Mercosur also has an essential role to play. Argentine recovery would be assisted through a concerted initiative to renew the deepening of Mercosur. A first step is to respect the peace agreement, avoid backpedaling on the regional market opening, use transparent contingent mechanisms to deal with market disruptions and of course deploy dispute settlement. Further market opening in services could also promote recovery in the region. Meanwhile, launch of a project for a common Mercosur currency would open possibilities for Monetary Cooperation with Argentina that does not exist today. And, to be credible, all these initiatives must embark on a more solid regional institutional setting than Mercosur has today.

The Argentine government has made important strides forward under dramatically adverse circumstances. But it certainly can be helped along through proactive engagement by its regional partners and the international community. The EU is a major protagonist in this regard due to its importance as a market for Argentine exports and strong investor presence. Significantly advancing towards a comprehensive EU-Mercosur trade agreement clearly would be a positive signal for an eventual Argentine recovery and consolidation of the subregional initiative.

VI. The role of the IDB

As mentioned earlier, supporting regional integration has been a cornerstone of the Bank since its founding. However, in the context of the New Regionalism the demands for support have expanded exponentially and the prospects for success have never been better.

The Bank is supporting regional integration in all its dimensions, including promoting complementary links with the multilateral system.

I feel that the EU has much to offer Latin America and the Caribbean and vice-versa. This is particularly true in the area of trade and integration partnerships. The EU is more than just a commercial market for Latin America and the Caribbean. Rather it is also a beachhead for ideas and practices that have been functional to socially sustainable development. Development models cannot be transferred wholesale to other realities. But in searching for its own formula for development, Latin America and the Caribbean can learn from other experiences, of which the European one is rich in lessons, and particularly in the area of regional integration where it has no peers. Meanwhile, in the global competition for market shares and geopolitical influence, the EU cannot afford to overlook preserving and deepening relationships with our region where it already has natural cultural and historical ties and a significant presence.

The vast majority of EU members are active shareholders in the Inter-American Development Bank. Nevertheless we have been working to further enhance interaction between the Bank and Europe. We are on the verge of signing an MOU with the
European Commission to promote cooperation in a number of areas: democracy and human rights, social equity and poverty reduction, regional integration and information technology.

In the area of regional integration, our Integration and Regional Programs Department already has been actively collaborating with the Commission on regional activities in CARICOM and this Department along with our Special Office in Europe, located here in Paris, is exploring other ways to work together on regional and trade issues. The Bank furthermore stands ready to work with the EU and its Commission in supporting the follow-up of mandates emerging from the Madrid Summit. The Bank already has an extensive experience in supporting broad-based regional initiatives, as seen by our active supportive role in the Plans of Action emerging from the Western Hemisphere Summit Process as well as that of the South American Heads of State Summit Process and the Puebla-Panama Plan. We would be glad to consider a similar role in the EU-LAC process.

Finally, we are very satisfied with our collaboration with Sciences-Po’s Chair Mercosur as it has helped to spread through civil society and governments a better understanding of the possibilities, problems and potential solutions leading to stronger trade and cooperation news between the EU and Mercosur. Thank you and it’s been a great pleasure to present this Lecture at your Annual Meeting.