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*The European Union's Trade Policy towards MERCOSUR*

by

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**Abstract**

Interregional relations between the European Union and MERCOSUR reflect a general trend of governments and firms to institutionalise their relations not only within but also across regions. As the global liberalization process within the WTO has been stagnating in recent years, transregional strategies have become attractive as next-best strategies. Against this background, the following analysis focuses on the institutional development of EU-MERCOSUR relations and the driving forces behind this development from a European perspective. This, because shedding some light on the political economy of relations between two of the most ambitious integration mechanisms of the 1990s should deepen our understanding of the forces shaping the growing importance of transregional and interregional trade relations. Rather than trying to explain the course of EU-MERCOSUR relations by one dominant hypothesis, I make an appeal for a multi-causal framework, highlighting three aspects of particular importance from a bottom up perspective. Firstly, one can observe that the interplay of economic interest groups has strongly influenced the course of interregional institutionalisation between the EU and MERCOSUR. ) Secondly, political actors have not acted as mere agents of private interest but also have followed their own political agendas. Thirdly, the European Union's interregional trade strategy towards MERCOSUR has not been independent of the international context.

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## The European Union's Trade Policy towards MERCOSUR

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## 1. Introduction

The countries of Latin America and those of the European Union share a long tradition of intensive economic, political and cultural relations. Driven by the political crisis in Central America and the debt problems of the Latin American subcontinent, since the late 1970s political relations have been increasingly accompanied by a transregional political dialogue between the European Community and Latin American cooperation and concertation mechanisms. The creation of MERCOSUR in 1991 favoured the EU's preference for dealing with groups of countries rather than on a purely bilateral basis. Parallel to increasing economic interaction between the EU and MERCOSUR, political actors of both mechanisms started to build the necessary institutional framework for negotiating encompassing trade liberalization between the two integration schemes.<sup>1</sup> Within this context, a major step toward the beginning of official trade negotiations occurred in December 1995. On the same day, when MERCOSUR officially converted itself from a free trade area to a customs union, the European Commission (EC), EU member states and MERCOSUR members – Brazil, Argentina, Uruguay, and Paraguay – signed the *EU-MERCOSUR Interregional Framework for Cooperation Agreement* (EMIFCA). EMIFCA functions as a framework agreement for an *Interregional Association Agreement*. This interregional association agreement shall include all aspects of trade liberalization as well as strengthened forms of political dialogue and cooperation. Four years later, in 1999, the EC finally obtained authorization from member states to start official negotiations on tariff liberalization. Once this process was initiated, during their 2002 Madrid summit governments of both mechanisms again reasserted their commitment to successfully concluding such an agreement. Yet, both sides still confront major obstacles, especially with regard to liberalization in the agro-industrial sector.

Interregional relations between the European Union and MERCOSUR reflect a general trend of governments and firms to institutionalise their relations not only within but also across regions. As the global liberalization process within the WTO has been stagnating in recent years, transregional strategies have become attractive as next-best strategies. Against this background, the following analysis focuses on the institutional development of EU-MERCOSUR relations and the driving forces behind this development from a European perspective. This, because shedding some light on the political economy of relations between two of the most ambitious integration mechanisms of the 1990s should deepen our understanding of the forces shaping the growing importance of transregional and interregional trade relations. Rather than trying to explain the course of EU-MERCOSUR relations by one dominant hypothesis, I make an appeal for a multi-causal framework, highlighting three aspects of particular importance from a bottom up perspective.

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<sup>1</sup> For an introduction to EU-MERCOSUR relations see Bulmer-Thomas 2000, Müller-Brandeck-Bocquet 2000, Inter-American Development Bank 2002.

1) Firstly, one can observe that the interplay of economic interest groups has strongly influenced the course of interregional institutionalisation between the EU and MERCOSUR. Even if a trade agreement creates an overall benefit for both mechanisms, economic gains and losses will be distributed unequally among economic actors. As such, potential winners and losers have attempted to influence the course of negotiations in order to serve their particular interests. From a European perspective, trade liberalization would be costly for the agro-industrial sector because of Brazil and Argentina's high competitiveness in some of the most protected branches of the EU. By contrast, the steady upsurge of investment and exports from Europe to the Southern Cone of the Americas has increased the interest of more advanced and internationally competitive industrial sectors for deeper institutionalisation of economic relations. This conflict among the interests of pro-free trade industries and the agricultural sector has shaped the course of interregional institutionalisation.

2) Secondly, political actors have not acted as mere agents of private interest but also have followed their own political agendas. Therefore, the interplay among private interests has to be nested into a broader power game within the institutional framework of the EU, the European Commission and the European Council being the major players. In general, the EC has been more in favour of increasing trade liberalization than the Council. This because an *interregional association agreement* not only offers a vast array of bureaucratic opportunities for the EC but also gives it a leverage for pushing its reform agenda with respect to the internal development of the European Union. Furthermore, protectionist interests in general have found a better reception within the Council as this body is not only sceptical about enhancing the EC's responsibilities but also responds much more strongly to protectionist groups with electoral influence.

3) Thirdly, the European Union's interregional trade strategy towards MERCOSUR has not been independent of the international context. Rather than treating private and political actors as the only relevant players, the EU as a collective actor is also firmly embedded in an international context that demands collective action towards collective challenges. Therefore, the EU's trade strategy towards MERCOSUR can also be interpreted as a response to growing American influence in the Cono Sur area. Contesting US dominance in economic affairs, however, is not only about the size of market shares in MERCOSUR. By promoting its ideas of regionalism and interregional relations, the EU is also engaged in a competition about the institutional organization of economic cooperation within a globalizing world economy. Thus, the political interest of the European Union in building a deeply institutionalised relationship with MERCOSUR and helping MERCOSUR to augment its coherency is closely connected to the EU's normative ideas of how a new world order should be constructed.

In order to fully develop these arguments about the driving factors of the EU's trade strategy towards MERCOSUR, the following analysis is organized as follows: To provide an empirical basis, in chapter two I will present a description of the institutional development and the economic relations between the EU and MERCOSUR. Based on the given empirical information, chapter three then concentrates on exploring the intra-EU bargaining process among private and public actors and connects these internal processes with the influences stemming from the international context.

## **2 An Overview of EU-MERCOSUR Relations**

### **2.1 The Process of Interregional Institutionalisation**

With the creation of MERCOSUR in 1991, the new democracies of Cono Sur - with the exception of Chile - started an ambitious integration scheme. Member countries have been not only aiming at the establishment of a free trade area but also at the creation of a common market. During the first half of the 1990s, MERCOSUR was the most promising integration scheme of the developing world. Yet, a less favourable environment confronted the successful installation of a free trade area and the political willingness to go one step further by establishing a customs union during the second half of the past decade. The Tequila effect of 1995, the Asian Crisis, the devaluation in Brazil and the fierce recession in Argentina confronted the ambitious timetable with several internal and external challenges. Yet, despite these rising difficulties, most international observers still perceive MERCOSUR as a viable strategy to strengthen economic development and political cooperation in the Southern Cone (Müller-Brandeck-Bocquet 2000: 566). In general, such a perception also has been shared by the European political and administrative elite dealing with the external affairs of the European Union. Consequently, even if transregional relations with North America and the task of integrating some of the transition economies in Eastern Europe have remained on top of the EU's foreign economic policy agenda, the EU continues to favour and support the integration process in the Southern Cone. Notwithstanding the current difficulties of MERCOSUR, the development of institutional linkages with MERCOSUR has led to a unique form of interregional institutionalisation (Ayllón 2000).

Only three days after signing the Asunción Treaty, foreign ministers of the MERCOSUR member-states visited the European Commission, resulting in the first signals of a future interregional cooperation agreement (Schulz 1997:99). Already less than one year after the establishment of MERCOSUR, the European Commission signed an Inter-Institutional Agreement in order to provide technical and financial support for institution building in MERCOSUR. Even if this kind of coopera-

tion agreement did not aim at trade liberalization, it already demonstrated the willingness of the EU to commit itself to concrete interregional institution building.

In 1994, the European Council decided to strengthen the institutional linkages with MERCOSUR and asked the Commission to provide an analysis of the feasibility of further transregional institutionalization. In December 1994, based on this analysis, the Council, the EC and MERCOSUR governments agreed to negotiate an interregional framework agreement. Such a framework agreement was to define and structure the relevant policy-fields of future interregional institutionalisation. The main idea was to build the institutional platform for an Interregional Association Agreement. After two rounds of negotiations in Brussels and Montevideo, the Commission presented a proposal to the European Council containing the framework agreement (EMIFCA). EMIFCA, signed in 1995 by the Council's members and the four presidents of MERCOSUR member states, on the one hand, underlined the EU's continued political commitment to fostering regional integration in the Southern Cone. Besides strengthening technical assistance and political dialogue, on the other hand, EMIFCA was a new undertaking, since it formally included the interests of both mechanisms in beginning serious talks on encompassing trade liberalization. EMIFCA's core function therefore has consisted of setting out the institutional framework for negotiating an Interregional Association, including liberalization of all trade in goods and services in conformity with WTO rules.

EMIFCA is not only about conventional trade in goods. It has focused on investment, property rights, liberalization in services and also has included several aspects of purely political cooperation. Consequently, EMIFCA has to be considered as a mixed agreement, which required ratification by the European Parliament as well as by each member parliament. This ratification process lasted almost four years, so that EMIFCA acquired formal status as an interregional agreement only in July 1999. Parallel to the parliamentary process of ratification, the European Commission needed to obtain a negotiation mandate for officially starting negotiations on trade liberalization. Between 1995 and 1998, both blocks interchanged several trade studies and concluded an agreement on statistical cooperation in 1997. Additionally, the EC began to informally negotiate possible courses of official trade negotiations with MERCOSUR members. In July 1998, the EC finally presented a proposal for a negotiation mandate to the Council, accompanied by an impact study analysing the possible consequences of trade liberalization with MERCOSUR. Finally, in September 1999, the European Council officially gave the negotiation mandate to the EC. The Council's decision was based on a political compromise reached by the EU ministers in Luxemburg in June of the same year, followed by a declaration by the heads of state of both integration mechanisms during the Rio Summit one week later.

Yet, the directive contained major deviations from the original proposal, which are to be interpreted as signs of conflict among EU member states about the course

of EU-MERCOSUR relations. Firstly, the mandate allowed the EC to start negotiations on tariffs only from July 2001, meanwhile holding a dialogue about tariffs, services and agriculture. Additionally, the directive enabled the EC to start official negotiations on all trade issues connected with non-tariff barriers already in 1999 (Bulmer-Thomas 2000: 2). Secondly, the directive stipulated that trade negotiations may only be concluded after the end of the next WTO round. Linking the success of a trade agreement to progress at the WTO level has also been interpreted as a sign of heterogeneous interests within the Council. A third point regarded by some authors as a barrier for serious liberalization (Müller-Brandeck-Bocquet 2000: 569) is that even the term "free trade area" was deleted from the final text of the directive. However, as MERCOSUR and European member states are committed to WTO conformity, article 24 of the GATT implies that a preferential agreement between both blocks must include all sectors and more than 90 percent of all products (Bulmer Thomas 2000:1).

Official trade negotiations between both mechanisms started in November 1999 in Madrid. At this initial stage, the *Cooperation Council of EMIFCA* tried to define the structure, methods and timetable for further negotiations, and furthermore, created a *Biregional Negotiations Committee*. Additionally, a *Subcommittee on Cooperation* was established encompassing senior officials from the EC and the MERCOSUR members. While the above mentioned groups have been responsible for all issues involved in EMIFCA, the *Biregional Negotiation Committee* has been given the right to establish working groups responsible for working on the "technical" issues of economic liberalization.<sup>2</sup> With regard to the method of negotiation, the *Cooperation Council of EMIFCA* decided to commit itself to the principle of "Single Undertaking", meaning that negotiations on one topic may only be concluded when there is agreement in all policy-fields involved in EMIFCA (Maukisch 2001: 71).

After the negotiating mandate was finally approved and priority decisions were made about the structure, method and timetable of further negotiations, several negotiation rounds took place between 2000 and 2002. While until July 2001 negotiations were restricted to the area of non-tariff barriers, the major issues in this period were about setting up the specific technical groups, identifying non-tariff obstacles and exchanging the technical data of trade and investment. As the path of negotia-

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<sup>2</sup> The *Cooperation Council of EMIFCA* consists of members of the European Council, the EC, the Council of MERCOSUR and the MERCOSUR Group. The *Biregional Negotiations Committee* consists of Council members, members of the EC's general directorates of Commerce and Foreign Relations and the foreign ministers of MERCOSUR. Furthermore, three technical groups were created: a) the technical group for trade in goods and tariffs, b) the technical group for services and intellectual property rights, c) the technical group for competition and regulated markets (Inter-American Development Bank 2002: 43). Regarding the timetable of negotiations, the different parties agreed that the *Biregional Negotiation Committee* and the *Subcommittee on Cooperation* should meet at least twice a year and that meetings should be prepared by the working groups, whose members were asked to create a network of political and societal interest groups.

tions was slow, many observers remained sceptical that the EU would present a concrete proposal in July 2001. Much to the surprise of these sceptical voices, on the fifth round of negotiation in July 2001, the EC formally offered a concrete negotiation proposal on how to reduce trade barriers with regard to sectors of different sensitivity. Even this proposal included more than 90% of all products and had several interesting aspects relating to the reduction of quantitative restrictions in the agricultural sector, MERCOSUR members qualified it as unacceptable because it did not offer a substantial removal of trade barriers in the agro-industrial sectors (Benecke 2001). MERCOSUR's counter-proposal in October 2001, however, included less than 40% of all traded goods, thus being unacceptable to the EU. Despite of these quarrels, both mechanisms were able to improve their proposals by the end of 2002, the MERCOSUR offer being only slightly under the 90% margin.

Taken together, the course of EU-MERCOSUR institutionalisation allows a division of the process into five stages. The *first* stage covers the period from 1992-1994, with the agreement on technical assistance to foster the integration process in the Cono Sur area. The *second* stage can be located in the period from 1994-1995, when the EU decided to commit itself to the establishment of EMIFCA. This step was a major shift in a qualitative sense, since EMIFCA had been aiming at an Inter-regional Association containing institutionalisation in several important policy-fields including substantial trade liberalization. The *third* stage was the process of ratification and political bargaining around a negotiation directive for the EC. This process took almost four years, reflecting conflicts among actors involved in the European decision-making process. The *fourth* stage began in September 1999, when the EC obtained formal authorization for trade negotiations, and lasted until 2001. This period was characterized by formal activity but rather slow progress in substance regarding trade negotiations. A *fifth* stage began in 2001, when both mechanisms began to present official proposals on tariff reductions. While the second proposals presented at the end of 2002 have undoubtedly improved, there is still no consensus on the most sensitive issues. In summary, there can be no doubt that the progress of trade negotiations has been very slow, with the sensitive agro-industrial issues still unresolved. However, there also can be no doubt that this process has been progressive in the sense that an evolution from non-trade cooperation to serious and formalized bargaining is observable.

## 2.2 Economic Relations between the EU and MERCOSUR

As the evolution of trade and investment flows between two regions should have an impact on the preferences of economic and political actors, it is necessary to highlight the dynamics of EU-MERCOSUR economic relations. With regard to trade

flows, recent analysis has distinguished several points of interest.<sup>3</sup> The most striking aspect has been a substantial increase in trade in the 1990s followed by a period of only modest increase, due to the economic difficulties of the MERCOSUR economies. Between 1990 and 1998, the relative growth of interregional trade exceeded EU trade growth rates with all other regions and almost doubled the growth rate of global trade expansion. In the late 1990s, the EU was the most important trading partner for MERCOSUR. For the European Union, even if the relative importance of MERCOSUR as a trading partner has been very modest, it is remarkable that the relative importance of MERCOSUR almost doubled during the 1990s, exceeding its 1980 level, when neither Eastern Europe nor the Asia-Pacific were as attractive alternatives for expanding EU trade as they are today. The evolution of total trade between both regions during the 1990s was highly favourable for the European Union. While during most of the eighties, MERCOSUR countries had a surplus with the EU, the 1990s were characterized by a rising deficit in MERCOSUR countries until the macroeconomic problems in Argentina and Brazil caused a decline in the growth rates of EU exports, thereby diminishing substantially the EU's trade surplus with MERCOSUR.

Growth of Trade Flows: EU and MERCOSUR				
	to/from MERCOSUR	to/from EU	to/from Extra Region	to/from World
MERCOSUR				
Exports	16,9	4,0	4,9	6,4
Imports	16,4	13,6	11,5	12,3
European Union				
Exports	13,0	5,8	7,0	6,1
Imports	3,4	5,4	7,0	5,9
Source: Giordano 2003: 13				

The trade structure of EU-MERCOSUR commerce shows a rather typical pattern of North-South relations, in which low value-added products have characterized MERCOSUR exports. MERCOSUR has mainly exported raw materials and commodities from the agro-industrial sectors, amounting to more than 50% percent of total EU imports from MERCOSUR.<sup>4</sup> In contrast, EU exports to MERCOSUR have been more concentrated in technology intensive manufactured goods. Intra-industrial trade is still low.<sup>5</sup> With regard to the service sector, transregional trade has

<sup>3</sup> The following arguments are based on studies by IRELA 1999b; Estevadeordal/Krivonos 2000; Rozo 2001, Inter-American Development Bank 2002; Giordano 2003.

<sup>4</sup> The main imports within the agricultural and food sector in the late 1990s were coffee, soybeans, oil cake, fruit juices, non-manufactured tobacco, and meat (Estevadeordal/Krivonos 2000: 4). From 1998 onwards, MERCOSUR became the EU's most important extra-regional source of agricultural products, exceeding NAFTA's exports in this sector (Bouzas 2000: 8).

<sup>5</sup> There is, however, a remarkable difference between the EU's trade with Argentina, Paraguay and Uruguay on the one hand, and Brazil on the other hand, the latter revealing a much higher percentage of intra-industrial trade.

also been characterized by a surplus on the part of the EU, but despite dynamic growth rates, EU service exports to Mercosur represent only a marginal amount of EU's worldwide exports in services.<sup>6</sup>

The existing trade structure is closely linked to the protectionist measures of both mechanisms, which have revealed a clear divide with regard to each region's comparative advantages (Bouzas/Svarzman 2000; Estevadeordal/Krivosos 2000). Besides facing strong tariff and quantitative barriers in the agro-industrial sector and with regard to semi-finished manufactured products, MERCOSUR economies have also been facing serious non-tariff barriers, such as phytosanitary standards and antidumping measures.<sup>7</sup> In contrast, even if MERCOSUR members have been liberalizing trade, protectionist measures are still concentrated in the manufacturing sector and consist mainly of tariff barriers (IRELA 1999b; Bouzas/Svarzman 2000). The government of Brazil, by far the most important economy of MERCOSUR, appears to be especially interested in a rather slow liberalization process, since otherwise its large industrial sector would have to pay the highest cost of trade liberalization.

Against this background, increasing interregional market access through trade liberalization is expected to foster trade in those sectors in which the respective economies have comparative advantages. As Estevadeordal/Krivosos (2000:4) have observed, in the case of the EU, these advantages are located in sectors such as chemicals, plastic products, machinery and transport equipment. MERCOSUR economies would profit in the agricultural and fisheries sectors, foods, leather products, mining and, in the case of Brazil, additionally in rubber, iron and steel manufacturing. Even if the dynamic effects of transregional trade liberalization might lead to a higher degree of competitiveness in some manufacturing sectors in MERCOSUR, agricultural exports will keep their predominant role and the composition of trade is unlikely to change dramatically.

As in the case of trade, European direct investment in MERCOSUR had been gaining strong momentum during the 1990s, when MERCOSUR was one of the most attractive areas for FDI in the developing world.<sup>8</sup> The increase in European FDI to MERCOSUR during the 1990s was mainly due to the economic reforms within MERCOSUR countries and the specific integration efforts of MERCOSUR (Nunnenkamp 1997, IDB 2002). During the first half of the 1990s, in comparison to

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<sup>6</sup> EU-MERCOSUR trade in communications, IT and financial services has been growing at a higher speed than overall trade in services, but the relative importance of these sectors for the EU is still very modest. However, the growing participation of European firms in the tertiary sector makes service liberalization an important issue in EU-MERCOSUR negotiations (IRELA 1999: 15).

<sup>7</sup> Additionally, important export products from Brazil and Argentina have suffered from preferential agreements and reduced quantitative barriers that the EU has given to the ACP countries, Switzerland, several countries from Eastern Europe, Australia and New Zealand (Bouzas/Svarzman 2000: 15; Giordano 2003).

<sup>8</sup> From 1990-99, MERCOSUR accumulated an FDI inflow of 104.45 billion US-\$ compared with 78.42 in the case of ASEAN and 67.18 in Mexico. For an in-depth analysis of FDI flows to MERCOSUR during the nineties see Chudnovsky/López 2000.

Brazil, Argentina experienced a huge inflow of European FDI due to the neoliberal policies of the Menem government. The situation changed in the second half of the 1990s when FDI in Brazil became significantly stronger than in Argentina because of the government's successful attempts at implementing privatisation and deregulation programs. As Nunnenkamp (1999: 174) notes:

"it was mainly Brazil that suffered a seriously impaired attractiveness in the early 1990s. Brazil's share recovered precisely when it joined its neighbours in implementing economic policy reforms related to macroeconomic stabilization and structural adjustment."

With regard to the composition and the source of European FDI, major changes took place during the 1990s. While, traditionally, European FDI was concentrated in the secondary sector, in the 1990s, flows of European FDI were largely concentrated in the services sector (IDB 2002: 25).<sup>9</sup> FDI in financial services, telecommunications, infrastructure and energy was mainly linked to privatisation programmes in the MERCOSUR countries and materialized in mergers and acquisitions. In this context, traditional European investor countries lost relative weight, while especially Spain, and to some extent Portugal, the Netherlands and France gained relative weight.<sup>10</sup>

Besides domestic reforms, the integration scheme of MERCOSUR had an impact on European FDI. As MERCOSUR has primarily been fostering intra-regional economic relations, the internal speed of trade liberalization within MERCOSUR has differed greatly with its external tariffs. The consequence of this discriminatory construction has been that investors in MERCOSUR during the 1990s have mainly been applying market-seeking strategies. Thus, this trend differs notably from investment activities in Mexico, where NAFTA allowed foreign investors to pursue efficiency seeking strategies oriented towards the establishment of global production and distribution networks (Mortimore 2000). In contrast, production systems in MERCOSUR have still largely been confined to the subregion (Nunnenkamp 2001:19). Thus, European FDI in MERCOSUR has been primarily oriented toward overcoming market barriers instead of making use of special MERCOSUR advantages with regard to more globally oriented production networks. On the one hand, this development can lead to the conclusion that European investors in MERCOSUR would only profit from trade liberalization in a limited way, since the connection with global production networks is relatively restricted. On the other hand, one might expect that with the large market experience many European companies have in the Cono Sur, they probably foresee the possibility of changing their strategies from market-seeking to efficiency-seeking in the case of transregional trade liberalization. Especially in some service sectors and in the automobile,

<sup>9</sup> In contrast, US FDI in MERCOSUR was less dynamic. Instead, newly acquired US assets have tended to go to the assembly of manufactures in Central America in order to allow American companies to compete more favourably in the US domestic market against Asian imports.

<sup>10</sup> As Nunnenkamp (2000: 12) assumes, "it was largely due to Spanish FDI that the sectoral composition of FDI in MERCOSUR countries shifted towards the service sector."

chemical and petrochemical industries with a relatively high degree of intra-industrial trade, European firms have shown clear signs of interest in interregional trade liberalization. As these companies perceive the limitations of the Cono Sur markets and are confronted with global or European restructuring of their own industries, they are interested in increasing their efficiency-seeking investments in MERCOSUR. Such a change, however, requires trade liberalization as a prerequisite to steer forthcoming FDI towards more globally oriented production networks.

### 2.3 Characterizing EU-MERCOSUR Regime-Building

Against the given background on EU-MERCOSUR relations, it seems clear, that institutionalising those relations has to be considered as one of the few cases of pure interregionalism. Interregionalism unlike transregionalism is not only about crafting agreements between several countries of at least two regions but instead binds at least two customs unions from different regions. This characterization seems to be appropriate, even if MERCOSUR's customs union is still far from being fully implemented. Besides increasing trade conflicts within MERCOSUR during the last years, MERCOSUR governments have not reversed their aim of going on with the implementation of a customs union. The successful conclusion of an interregional free trade agreement could even foster the full implementation of a customs union, since such an agreement would require MERCOSUR members to implement a common tariff structure according to the timetable of interregional trade liberalization. Besides being minilateral and geographically dispersed, the process of EU-MERCOSUR trade liberalization has to be classified as a liberally oriented attempt at creating an encompassing trade regime. In contrast to sector-specific liberalization, negotiations between the EU and MERCOSUR aim at trade liberalisation on a broad product basis according to article 24 of the GATT. With regard to the strength of EU-MERCOSUR institutionalisation, the process has aimed at creating a strong and highly institutionalised international regime. While the organizational structure of EU-MERCOSUR relations does not include a secretariat, it still has to be considered as relatively strong because of its well-defined working structure in all relevant policy-issues included in EMIFCA. Compared to other cases of interregionalism or transregionalism, the negotiation process is committed to create a set of strong and binding rules. With respect to trade liberalization, the creation of an interregional association agreement between both mechanisms would not only constrain actors' behaviour but also include mechanisms of dispute settlement. Furthermore, the issue scope EU-MERCOSUR regime-building is broad. Not only do negotiations focus on encompassing trade liberalization including modern issues such as competition policy, government procurement, intellectual property right and liberalization in

services. Additionally, an interregional association agreement would also comprise a broader array of topics, political dialogue and aid being of especial importance. As it is an outspoken strategy of the European Union to foster regional cooperation and integration between developing countries, there is also a strong developmental focus of the EU's posture towards MERCOSUR. In fact, the intraregional threats to MERCOSUR's coherency in the last years have been counterbalanced to some extent by its external agenda; especially the need to find a common position with regard to the EU's posture, who made it clear, that it was not willing to negotiate on a bilateral basis with single MERCOSUR countries. Consequently, with the exception of some minor issues in the area of non-tariff trade barriers, the EU's commercial treatment of MERCOSUR has been characterized by a high degree of uniformity, meaning that all MERCOSUR member countries receive similar treatment.

### 3 Private Interests, Intra-European Politics and the International Context

#### 3.1 The Impact of Free-Trade-Oriented and Protectionist Interests

The specific development of transregional economic relations between the EU and MERCOSUR offers strong evidence that the slow course of interregional trade institutionalisation between both mechanisms in part can be traced back to conflicts among economic interest groups.<sup>11</sup> According to such a perspective, interest groups have lobbied for an "insider status" in the decision making process, thus becoming part of the governance structure hereby increasing their influence on the policy-process (Streeck/Schmitter 1991; Kohler-Koch 1996).

*Therefore, a first causal mechanism, explaining the EU's trade strategy towards MERCOSUR should be related to the interplay among economic actors.*

As attempts at advancing the global trading regime have been thwarted in recent years, internationally competitive actors continue to struggle for interregional liberalization as a second-best strategy. They hope to take advantage of their own competitive position by penetrating previously closed international markets. By contrast, sectors, which rely on the EU's protection, notably agriculture, lobby against an interregional agreement with MERCOSUR and its highly competitive agro-industrial branches. Instead, they prefer selected bilateral agreements with small countries such as Chile or countries with less sector competitiveness such as Mexico.<sup>12</sup> Bilateral agreements allow these protected sectors to maximize the asymme-

<sup>11</sup> For a general argument on the influence of interest groups in the course of liberalization see Frieden 1991, Keohane/Milner 1996.

<sup>12</sup> The successfully concluded negotiations with Chile include liberalization in agriculture, yet Chile's agro-industrial sector differs in size and product scope from those of Argentina and Brazil making it easier to achieve an agreement. In the case of the EU-Mexico Free Trade Agreement excludes sev-

tries in the Union's bargaining power vis-à-vis smaller countries, thereby shielding their rents. The disagreements surrounding EU-MERCOSUR negotiations have reflected a separation between economic interests in favour of trade liberalization with MERCOSUR and protectionist agro-industrial interest groups (Sanchez Bajo 1999: 932).

Between 1991 and 1993, the issue of negotiating a trade agreement was not on the EU-MERCOSUR agenda. Consequently, lobbying was relatively limited. It started only in 1994, when the EU decided to commit itself to the establishment of EMIFCA. The European Farmers Federation (COPA) and national farmers associations recommended the Council and the EC not to commit them to the issue any longer. Lobbying against an agreement intensified after the signing of EMIFCA in 1995 and concentrated especially on the Commission's request for a negotiation mandate. The major argument of agricultural interest groups against such a mandate had been that an engagement in concrete negotiations would have overloaded the EU agenda with respect to the pending reform of the Common Agricultural Policy (CAP), the issue of expanding the EU to the east and the fiscal discipline imposed by the monetary union (IRELA 1998: 3). This lobbying against a trade agreement with MERCOSUR has been persistent, sustaining the argument that potential losers, such as the agro-industrial sectors and some traditional industries, have been among those with the greatest reservations.

In contrast, more globally oriented European industries as well as the services sector would be among the profiteers of an agreement with MERCOSUR. Trade liberalization would provide those industries with better market access and enable them to reorient their investment strategies within MERCOSUR toward more globally integrated chains of production. Since the late 1990s, those pro-free trade actors have started to develop collective action capacities in order to push the EU toward interregional trade liberalization. The strongest evidence of such endeavours has been the creation of the MERCOSUR Europe Business Forum (MEBF) in 1999. As a result of an initiative by the then president of the Federation of German Industries, the MEBF, similar to the Transatlantic Business Dialogue, has aimed at pronouncing business interests involved in EU-MERCOSUR relations.<sup>13</sup> The motivation to create the MEBF was to join important, pro-free trade oriented business leaders instead of business federations with rather mixed motives regarding trade liberalization. As such, MEBF was strongly in favour of giving a negotiation mandate to the Commission. This demand was successfully channelled to the Council through

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eral agricultural sectors, in which European protection has remained crucial for producers (Schott 2001).

<sup>13</sup> MEBF is presided by two co-presidents, one from a European firm and one from a MERCOSUR firm. In 2001, the positions of two vice-presidents were created. Presidents and vice presidents have originated from transnational companies with strong interest in interregional trade liberalization. The MEBF structure also contains technical working groups for market access, for services and for investment, the latter including the financial sector.

MEBF's connections to the German government, which chaired the EU and had to organize the European part of the 1999 Rio summit.<sup>14</sup> Yet, while the MEBF, had a severe impact on the decision to give a negotiation mandate to the Commission and has made initiatives in the field of trade facilitation, its recent impact on the course of negotiations has been rather modest. This because with the beginning of concrete negotiations, different sector-specific positions within MEBF became more eminent and the forum's coherency diminished because of the short-term interests of MERCOSUR participants, who were facing domestic turbulences. While in the service and investment working groups the consensus about pushing governmental negotiations toward more liberalization is still obvious, the market-access working group has been more divided. Therefore, on the one hand, the creation of a specific organization like MEBF has increased the possibilities of pro-free-trade oriented business to articulate its interest. On the other hand, after a mandate was given to the Commission and official negotiations have started, collective action problems among pro-free-trade industries have increased. As negotiations about timetables for liberalization, exemptions clauses, etc. have become more concrete, specific concerns about possible trade deviation and restructuring of production processes have divided the heterogeneous group of pro-free-trade interests.

### 3.2 The Council, the Commission and the International Context

As demonstrated, the focus on the interplay of economic interests highlights an important causal mechanism, which in part has been responsible for the slow progress of trade negotiations (Sanchez Bajo 1999: 933). However, a purely interest-group-oriented approach ignores the influence of political actors and the institutional framework within the European Union. As such, leaving the constellation of political actors and the rules of EU policy-making unexplored would be inadequate when trying to explain a complex phenomena as interregional trade liberalization.

*Consistently, a second causal mechanism is to be integrated into the analysis, focussing on the interaction between the EC and the Council.*

On the one hand, the Commission has strong incentives to push further trade liberalization with MERCOSUR for two reasons. Firstly, the EC could use interregional trade liberalization with MERCOSUR to expand its influence by pushing the EU into complex issue areas where bureaucratic expertise is needed. Secondly, especially trade liberalization with MERCOSUR would result in additional pressures on national governments, respectively the Council to engage more profoundly in reforming the CAP. Thus, by advancing interregional trade liberalization, the Com-

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<sup>14</sup> Another, rather intellectual impact came from the Institute of European Latin American Relations (IRELA), financed by the European Union and which studies were rather pro-free trade oriented and revealed to a certain extend the intra-European-conflicts.

mission enhances its influence on urgently needed domestic reforms within the EU. In this context, allowing the involvement of pro-free-trade interest groups while excluding more protectionist ones from the decision-making process has been considered as a strategy to provide the Commission with relevant information to pursue its own interest (Greenwood 1997). On the other hand, the Council would be more sceptical about pursuing trade liberalization, since it is interested in constraining the Commission's autonomy. National governments tend to attach more importance to protectionist interest groups and non-competitive industries for electoral reasons. However, it would be overstressing the argument to assume that the interplay between Commission and Council is merely defined by conflicting interests. Neither is the Council purely "protectionist", nor is the Commission a neoliberal free trade combatant. For instance, the Commission's free trade approach may be hampered by intra-bureaucratic conflicts or by commissioners' devotion to their national career paths. The Council, well aware of domestic and external reform pressures confronting the Union, can also pursue liberalization measures if national governments successfully burden the EC with the responsibility of painful reforms.<sup>15</sup>

Furthermore, neither the Council nor the Commission are purely inward-oriented. Rather, their trade strategies also respond to international challenges. In a context of growing global economic interdependence, they have to consider the changing international environment, especially the development of the global trade regime and the international trade policies of the US, their most important economic partner and competitor in international economic affairs. Thus, the Council and the Commission can join their forces when it comes to adopting the EU's external relations to a changing international context. In such a case, the EU can be treated analytically as a unitary actor, which pursues the external goals of private and political interests. Supporting the objectives of Europe's international economic actors consists of expanding and protecting these actors' (privileged) reach to promising markets. Furthermore, political actors of the European Union are interested in "exporting" their institutional environments to other parts of the world. As such, those interest are particularly linked to normative conceptions of liberal democracy, ordoliberal economic governance and regional cooperation as an institutional framework of international cooperation. *Grosso modo*, with regard to the promotion of liberal democracy and market-economy the US and the EU pursue similar interests. However, when it comes to fostering the interests of their internationally oriented firms and the export of specific modes of economic regulation and regional cooperation, both often act as competing providers on the "international market" of goods and institutions. Furthermore, the normative connotations connected to regional cooperation and integration tend to differentiate the EU's external policies from those of the US. As such, the EU's interregional and transregional strategies tend to

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<sup>15</sup> For different perspectives on the interplay between Commission and Council in the EU's external trade policy see among others Nugent 1999, Meunier 2000;

be more encompassing with regard to issue scope and give more importance to foster regional cooperation in the counterpart region.

*Thus, a third causal mechanism explaining the EU's trade strategy towards MERCOSUR should be connected to the EU's external political and economic interests, particularly encouraging regional cooperation and securing market access against its major international competitor, the United States.*

The Commission's and the Council's strategies towards interregional institution-building with MERCOSUR thus should not only have been the result of interest-group pressures. Instead, the proposed analytical arguments suggest that they have also been driven by intra-bureaucratic conflicts, as well as by pressures stemming from the international context.

When, in 1994, the Council asked the Commission to elaborate an analysis on the feasibility of further transregional institutional-building with MERCOSUR, this request contrasted with the assumption that this body of the EU generally tended towards rather protectionist strategies. Besides the fact that protectionist lobbying had not yet started, when the request was made, the Council also responded to international developments. Especially the US' increasing attempts at expanding preferential agreements with other regions, such as the successful conclusion of NAFTA, her free trade initiative within APEC and the prospect of advancing the Initiative of the Americas were threats to European economic and political interests. Furthermore, at the time MERCOSUR was still perceived as the most promising integration scheme in the Southern hemisphere. Based on a European-style integration approach and the fact that its members had introduced democracy and engaged in economic reform, deepening relations with MERCOSUR was perceived as an attractive strategy to counterbalance US transregional activities.<sup>16</sup> Accordingly, the Council and the Commission worked together hand in hand and already at the end of 1994 both bodies, together with MERCOSUR governments, agreed on negotiating an interregional framework agreement. The next step towards interregional trade liberalization also took place in a relatively short period, as EMIFCA was signed later in 1995.

Yet, the complex agenda of EMIFCA opened up space for interest groups to lobby against trade liberalization. Since EMIFCA had to be ratified by all member states, protectionist interests that had become aware of EMIFCA's content slowed down the ratification process. In general, the Commission's defence of EMIFCA during this period is in line with the argument stating that the EC is rather pro-free-trade oriented. Even though the EC had requested a negotiation mandate to the

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<sup>16</sup> The Committee on External Relations of the European Parliament in 1995 urged the Commission and the Council to speed up negotiations with MERCOSUR. "If the EU wishes to maintain its leading role in the trade policies of this region, and to prevent the entire south American continent from falling into the political and economic spheres of influence of the US, then the necessity of establishing a middle-term strategy towards the MERCOSUR is undeniable" (Committee on External Relations of the EP, 12.05. 1995, 10)

Council in 1998, this decision was not adopted unanimously. Four commissioners voted against such a request, demonstrating how the intra-European struggle prevented the EC from acting collectively as one might have expected.<sup>17</sup>

The 1999 directive of the Council, which enabled the EC to restart official trade negotiations, can at first sight be interpreted as working against the assumption on the protective nature of this institution. However, the conflict in the making of this decision reveals the influence of protectionist interests (Sanchez Bajo 1999: 932). Ministers hailing from the agricultural secretaries of France, Ireland, and the Netherlands opposed the directive.<sup>18</sup> In contrast, the governments of Germany, Italy, Portugal and Spain strongly supported a mandate for the Commission.<sup>19</sup> The political compromise reached in Luxembourg consisted in including major deviations from the original proposal into the mandate: allowing the EC to start negotiations on tariffs only from July 2001 and allowing the conclusion of negotiations only after the end of a next WTO-round. Especially the amendments to the directive suggest that agricultural interest were able to slow down the process via their influence on the Council.<sup>20</sup> This argument is further sustained by the fact that international pressures on quickly crafting an interregional agreement had diminished at the end of the 1990s. Neither had the US-government been able to push APEC towards building a highly institutionalized trade regime nor was it able to achieve Trade Promotion Authority from congress in order to advance FTAA negotiations.<sup>21</sup> Additionally, the mandate was given before the WTO meeting in Seattle, which was then expected to initiate a new WTO round. In this context, neither the EU nor MERCOSUR members were keen on committing themselves to an interregional

<sup>17</sup> Four Commissioners voted against the initiative of the Commission to obtain a negotiation mandate from the Council on July 22 1998: among those, the Commissioner for Agriculture, Franz Fischler and the head of the Commission, Jaques Santer, who presented a study of the negative effects a trade agreement would have on the European agricultural sector. On the other hand, the Commission's Vice President, Manuel Marin, strongly in favour of a negotiation mandate, presented another study, which revealed that only two percent of the products, currently traded between both regions, would be affected negatively, while the European automobile sector, chemical industries, IT and services would gain from trade liberalization (IRELA 1998: 1).

<sup>18</sup> For instance, in September 1998, French foreign minister Hubert Védrine stated that his government was against negotiations before concluding the Agenda 2000, since the CAP reform and the structure of EU widening towards the East should be prior to any interregional commitment. Furthermore, the president of the Committee of Agricultural Organization of the European Union, Luc Guyau, considered that a free trade agreement with MERCOSUR would seriously affect the incomes of important agriculture sectors as well as creating structural problems in several regions of the European Union (IRELA 1998: 2).

<sup>19</sup> Spain's centre-right government with close links to national farmers did not obstruct EU-MERCOSUR negotiations, because of the increasing involvement of Spanish firms in Argentina and Brazil.

<sup>20</sup> However, the decision-making rules of the Council made it more difficult for protectionist oriented governments to veto trade liberalization. Until the 1980s, the Council's decisions on trade required an unanimous basis. The adoption of the Single European Act (1987) and the Maastricht Treaty (1992) introduced qualified majority voting (QMV) on trade in goods—though, significantly, not in services or intellectual property rights. Thus, even if the Council had granted the EC competences to negotiate issues related to trade in services, mixed agreements still have to be ratified by each member country (Laursen 1999). As such, coalitions of member states still could put together veto majority, but the threshold for such blockade policies has become higher.

<sup>21</sup> For a critical perspective on the development of APEC see Ravenhill 2001, for an analysis on the FTAA process see among others Feinberg 2002; Faust 2003, Wise 2003.

agreement without knowing the outcome of the Seattle results, which could have had far-reaching consequences for their overall trade strategies (Bulmer-Thomas 2000: 5; Peña 2001: 103).

From 2000-2002, the rift between Council and Commission became even more obvious. On the one hand, the EC surprisingly offered a concrete proposal to MERCOSUR in July 2001, thereby initiating a series of negotiations rounds. By contrast, the Council ceased to push the agenda of EU-MERCOSUR even if the European Parliament in its 2001 Marset inform urged the Council to put more emphasis on the successful conclusion of an agreement. This passive attitude can best be explained by the existence of domestic issues removing the Council's attention from EU-MERCOSUR relations and the absence of international factors pushing the interregional institutionalisation process. With regard to the domestic issues, despite the European Agreements in Nice, major EU members are still unanimous about the future course of the CAP and the EU's expansion towards the east. In combination with elections in major member states such as Spain, France and Germany during 2001 and 2002, the sensitive issues of trade liberalization in agriculture with MERCOSUR have almost disappeared from the Council's external agenda. The Council's passive posture has been facilitated by the international context. Firstly, the vanishing coherency of MERCOSUR, which has been facing its most serious crisis in the course of the Argentinean recession, did not allow MERCOSUR members to push EU-MERCOSUR negotiations substantially. While the MERCOSUR is surely a self-defined region aiming at an high degree of intraregional institutionalization, its coherency diminished since the beginning of Brazil's currency crisis in 1998 and it has faced its most serious crisis as monetary inconsistencies within the region were aggravated by the Argentinean recession and financial collapse. As intraregional trade as well as intraregional institution-building severely suffered from this crisis, it became uncertain during 2001 and most of 2002, if MERCOSUR would survive its member countries economic and political turmoil. Furthermore, despite declining coherency the negative economic scenario in the Southern Cone has made especially the Brazilian government even more cautious with regard to further extraregional trade liberalization. Secondly, until August 2002 the US-government had been unable to obtain Trade Promotion Authority from Congress, which is required for giving the FTAA process substantial stimulus. Thus, the missing of TPA has diminished the external pressure on the EU council to respond to such a progressing FTAA process.

Finally, the latest development since august 2002 again is consistent with the presented arguments. First of all, the success of the Bush government in finally achieving fast track has again increased the pressure on the EU for a stronger commitment to interregional trade liberalization. Secondly, the disappointing course of the global trade regime makes it necessary to pursue "second-best-strategies" to expand the Union's international influence, if the WTO meeting in Cancun sched-

uled for the end of 2003 will not bring substantial progress. Thirdly, the newly elected government of president Lula in Brazil strongly works towards regaining part of MERCOSUR's coherency and is more reserved towards a quick conclusion of the FTAA process. The renewed commitment to advancing EU-MERCOSUR trade negotiations in this changing environment is reflected by the improved proposal made by both parties in the negotiation round, which has taken place in late 2002.

#### **4. Preliminary Conclusions**

The expanding institutionalisation between the European Union and MERCOSUR is one of the few cases of pure interregionalism. Within this context, the ongoing process of trade liberalization between both mechanisms has been the most important and at the same time most controversial issue in a broad interregional agenda. The previous analysis has aimed at identifying the driving forces relevant for the specific interregional trade strategy of the European Union. The empirical evidence demonstrates that there is no single variable with sufficient explanatory power to clarify the course of EU-MERCOSUR trade relations. Therefore, an adequate explanation of this case study of economic transregionalism has been to appeal for a multi-causal research strategy.

From a bottom-up perspective, societal pressures from economic interests have influenced the process of EU policymaking. As the trade structure between both regions follows a rather traditional path of North-South relations, the most obvious conflicting interests exist between rather pro-free-trade oriented industries and agricultural interests within the EU. Both have been trying to build up collective action capacities and to become indispensable parts of the policy-process in order to influence political decision-making according to their interests. As the course of EU-MERCOSUR negotiations has demonstrated, agricultural interests are still strong but even though they could not prevent EU decision-makers from committing themselves to formal negotiations with their MERCOSUR counterparts. Thus, even if intra-industrial trade between both regions has been low, the course of interregional negotiations slowly has tended towards the interests of pro-free-trade business. The internationally oriented firms from industry and services have attempted to overcome collective action problems by creating an organization to promote their interests. The establishment of MEBF and its influence on the Council's decision to give a negotiation mandate to the Commission highlights, that pro-free-trade interests have become an integrative part of the EU-MERCOSUR policy-network, even if their coherency diminished after concrete negotiations started.

The specific institutions of the EU policy-making process and the interplay between the most important bodies of the EU's external trade policy have filtered these impacts of societal interests. Even if the Commission has not always been unanimous in the course of the policy-process, the EC has been the one of the two bodies that has been pushing interregional trade liberalization more thoroughly. This behaviour is consistent with the argument that the EC has an interest in expanding the Union's transregional trade policies as a means of increasing its influence within the EU. Yet, the influence of protectionist interests, especially through the Council has made it more difficult for the EC to use EU-MERCOSUR interregionalism to expand its influence on external affairs and on domestic reforms. On the one hand, even if the EC has the technocratic expertise in the complex field of trade negotiations, electoral cycles, the pending CAP reform and EU expansion towards the east have reduced the EC's ability to steer the EU-MERCOSUR negotiations according to its interest. On the other hand, the potential of protectionist interests to use the Council to block any advance in negotiations also has been limited. While the case of EU-MERCOSUR relations underline the argument that the Council as a representation of member states' interests, is more reserved with respect to interregional trade liberalization, the introduction of qualified majority voting has weakened the power of protectionist interests. Furthermore, the Commission as well as the Council share the goal of advancing regional cooperation and integration in Africa, Asia and Latin America by fostering interregional agreements with a broad issue-scope.

Finally, the ambivalent position of the Council becomes even clearer if one takes into account that the EU's transregional trade strategies also respond to international challenges. EU-MERCOSUR negotiations clearly reveal that cooperation between Council and EC has become a political project, when mounting international pressures make it more attractive for the EU to pursue transregional trade liberalization. On a global level, the course of the WTO-regime influenced the development of interregional institutionalisation. As in MERCOSUR and the US, pro-free-trade actors have perceived transregional trade negotiations as second-best strategies in their pursuit of increasing international influence. Thus, EU MERCOSUR relations have advanced when there seemed no significant possibility for substantial progress at the WTO level. More importantly, the EU's strategy towards MERCOSUR has been closely connected to the FTAA process (Peña 2001: 103, Page 2001: 15). As there is widespread concern among European firms and policy-makers that an agreement between the US and its Latin American counterparts would repeat the "Mexican experience" of losing market shares after the establishment of NAFTA. Any progress in the US-governments attempt to establish a Free Trade Area of the Americas thus should augment the European Council's interest to advance trade liberalization with MERCOSUR. Therefore, as Felix Peña (2001:99) speculates, the influence of competition among EU and US policy-makers as well as the interests of transnational firms pursuing the expansion of their glob-

ally-oriented production networks will tie the FTAA process and EU-MERCOSUR negotiations even closer to each other. The result could be an economic transatlantic triangle, if, and that currently seems to be the most intriguing question, MERCOSUR survives the current problems of its two biggest economies and regains its intraregional coherency.

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