

## Chapter 3 Regional Integration in the Americas and North-South Relations

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### 1. Introduction: Focus of this chapter

The chapter seeks to understand the nature of the new drive toward regional integration evident in the Americas from the 1990s and to ascertain the significance of this drive in the context of North-South relations. The North America Free Trade Agreement (NAFTA) inaugurated in 1994, the US-Chile Free Trade Agreement signed and ratified in 2003, the US-Central America Free Trade Agreement signed in 2004, and the Free Trade Area of the Americas (FTAA) under negotiation since 1994 all involve countries that by long-standing practice have been labeled either “North” or “South.” Moreover, Mexico and Chile have concluded extra-regional free trade agreements with the EU, and free trade agreement negotiations are underway between the Southern Common Market (MERCOSUR) and the EU. Mexico has entered negotiations with Japan on a free trade agreement, and Chile and MERCOSUR are also expected to begin talks with Japan. Major progress is being made in international relations heretofore regarded as “North-South relations” through free trade agreements. One characteristic of free trade agreements, however, is that all of the countries involved are essentially placed on an equal footing. Whether or not to incorporate asymmetry and special considerations — traditional elements in North-South relations — into the framework of free trade agreements will be a significant determinant in the new regimes governing North-South relations. Later in this chapter, diplomatic developments toward regional integration in the Americas in recent years will be traced and interpreted from the perspective of North-South relations. The talks seeking consensus on the Free Trade Area of the Americas (FTAA) will first be discussed as an important development, with consideration then expanded to broader commercial and foreign relations within the Americas and to relations outside the region.

### 2. Background to FTAA negotiations and recent developments

New efforts toward regional integration in the Americas gained momentum from the 1990s. The North American Free Trade Agreement (NAFTA) was concluded in 1994 and the Southern Common Market (MERCOSUR) in 1995, and a 1994 summit meeting reached a consensus on

establishing a Free Trade Area of the Americas (FTAA) in 2004. These moves toward regional integration are characterized by the various economic and political objectives of the countries involved, and quite a few have an impact on, and are impacted by, efforts transcending the region. In the Americas, the pursuit of WTO negotiations globally and ties with the EU constitute two such efforts, and these are linked to the progress of integration within the region.

One important aspect of the Americas as a region is the presence of the Organization of American States (OAS) as an official inter-governmental organization. The OAS provides a forum for across-the-board regional cooperation on political, economic, and social issues, and it has exerted a particularly strong influence in promoting democratization and protecting human rights. The FTAA concept was submitted to the 1994 OAS Summit Meeting in Miami as a resolution aimed at realizing the ideal of a region linked by democracy and free trade, and promotion of this concept was subsequently reconfirmed at the OAS Summit Meetings in 1998, 2001, and 2004. The highest level of negotiations thus far has been at Trade Ministers' Meetings, and the December 2003 Trade Ministers' Meeting in Miami reconfirmed a January 2005 deadline for completing negotiations and reached a consensus on the negotiation format. The OAS itself has not adopted a "North-South" approach, and the FTAA is also envisioned as an agreement in which all countries will essentially have the same obligations and rights. The consensus on the negotiation format achieved in December 2003 can be regarded as a partial revision of this principle.

In the course of preparations for the December 2003 Trade Ministers' Meeting in Miami, policy differences between the US and Brazil, the joint chair countries, led to a head-on clash. Simply put, the US advocated a single undertaking and an early end to negotiations, while Brazil recommended separate and continuing negotiations. At the 15<sup>th</sup> Commercial Negotiations Committee (CNC) Meeting in October in Trinidad-Tobago, MERCOSUR advocated a "selective approach" that would allow individual countries discretion in liberalizing market access in the agricultural sector and applying rules set out in the FTAA in light of the fact that member countries were at greatly differing stages of economic development. The US, Canada, Chile, and the Andes countries, on the other hand, again stressed the principle of "single undertaking," putting the two sides in opposition. The US and Brazil did agree on a negotiation format in talks just before the Miami Meeting they were to chair, however, and the FTAA agreement incorporated a "selective approach."

The US and Brazil thus opted for compromise over stalemate, agreeing on separate negotiations but an early conclusion to negotiations. The Miami Trade Ministers' Meeting,

which saw the adoption of the Miami Declaration and the 3<sup>rd</sup> FTAA Draft Agreement, agreed to push ahead with FTAA negotiations while excluding sectors such as investment, service industries, government procurement and intellectual property rights (“Singapore issues”) that the US had requested be incorporated into the FTAA and whose inclusion had been opposed by Brazil and MERCOSUR. More attention than ever was paid to the need to take into consideration the different stages of development of signatory countries. These results were seen primarily as reflecting compromises by the US side. The term “separate negotiations” as used here refers to the division of negotiation topics into two classifications: topics that impose obligations on all participating countries and topics that are the focus of special bilateral (or multilateral) consensus. At the Deputy Minister’s Meeting (February 3–6, 2004) that served as the first forum for FTAA negotiations under this two-tier structure, the US-Brazil dispute on approaches to future negotiations resurfaced; negotiations were “temporarily suspended” and postponed until the next meeting scheduled for March.

Brazil initially had sought agreement on the topics of negotiations from the viewpoint that “Singapore issues” should not be discussed at all within the FTAA framework. However, the negotiation format approved at the Miami meeting did leave leeway to discuss such issues under the two-tier structure. Within the FTAA framework the US could put pressure on Brazil by conducting negotiations on these issues with non-MERCOSUR countries. Brazil would also have little choice but to compromise on some of the “Singapore issues” if it were to elicit compromises from the US on agricultural subsidies and market access. From this perspective, the consensus at the Miami Trade Ministers’ Meeting, though appearing at first glance to be a major compromise on negotiation principles on the part of the US, can in fact be seen as establishing a negotiation framework advantageous to the US. Indeed, given the lack of progress made at the Deputy Ministers’ Meeting at the beginning of February, the US has taken the first steps toward voluntary agreements with 14 countries, including almost all of the major countries outside MERCOSUR<sup>1</sup>.

### 3. US-Brazil dispute over regional integration in the Americas

The tenor of international relations within the Americas is governed by the contest for power and influence between the US and Brazil. Since the Lula administration took office in January 2003, Brazil’s foreign policy has taken on a much more active posture. This can be deemed the development of “a commercial and foreign policy strategy” that combines efforts at three levels: South America, the Americas, and the world as a whole. In designing and expanding

this strategy, Brazil can be seen adopting a position that presupposes a similar strategy by the US and that is basically aimed at countering it. Confronted with this Brazilian policy, the US has revised and expanded its own policies as a strategy for facing off against Brazil. Competition and compromise between the US and Brazil will likely continue to be the key factors defining diplomatic relations in the Americas. This will undoubtedly have a significant impact on the development of commercial and diplomatic relations worldwide, including relations between both countries and the EU.

While continuing to discuss the objectives that delineate the foreign affairs interests of the US and Brazil, the policies of these countries on the FTAA negotiations merit closer examination.

#### (1) The US' policies

The US has sought to benefit its own companies and producers by consistently pursuing the liberalization of trade and investment and the protection of intellectual property rights at all levels: bilaterally, regionally, and globally. The US has combined approaches at different levels and pursued them with a view to producing advantageous results ("competitive liberalization"), and in this context the US regards the FTAA as an approach to liberalization on a regional scope. For the US, the significance of the commercial aspects of the FTAA is thought to lie in the opening of MERCOSUR markets, an aim not otherwise feasible. To that end, the US has apparently chosen as its fundamental course of action in these negotiations to isolate Brazil (and Argentina), extract compromises, and achieve "single undertaking and an early conclusion." By pushing ahead with bilateral and multilateral free trade agreement negotiations in parallel with the FTAA talks, the US no doubt sought to put pressure on MERCOSUR by making it all the more necessary that MERCOSUR join the FTAA in order to gain access to US markets. On November 18, just prior to the Miami ministerial meeting, the US announced that it would commence FTA negotiations with Panama and the Andes countries from the second quarter of 2004, starting with Panama, Colombia, and Peru. The US can be seen to be working to isolate the MERCOSUR countries within South America by concluding an FTA with Central America (agreement on which was reached in December) and by strengthening relations with the Andes countries.

Negotiations at the WTO have been considered a means of obtaining compromises from major extra-regional powers, namely the EU and Japan, and the US is seeking some means by which to make a breakthrough in the face of developing countries banding together under

the leadership of Brazil and taking a hardline stance against the developed countries as a group. The US is expected to reach out in various ways to the G-20 in future. In fact, US Trade Representative Robert Zellick sent a letter in early January 2004 to the relevant ministers in the G-20 countries in which the US expressed a willingness to offer serious concessions to developing countries; in addition to suggesting that a ministerial meeting in Hong Kong be held within the year to advance a new round of negotiations and encouraging compromise by developed countries on liberalizing market access in the agricultural sector to the end, the letter indicated that issues such as investment rules, competition policy, and governmental procurement — Singapore issues on which the developed countries and the developing countries were at odds — might be excluded for the time being from the agenda of the new round. The US has even reportedly proposed that either Brazil, Chile, South Africa, Pakistan or Singapore be chosen as General Chairman, despite it being the turn of a developed country to serve in that position, in order to open the way to progress in the Doha round<sup>2</sup>.

## (2) Brazil's policies

While the PSDB presidential candidate representing the former ruling party stressed that partner countries should be selected and FTAs concluded on the basis of economic benefits, Lula gave priority to MERCOSUR and deemed it a foundation for external negotiations from a geopolitical standpoint. Immediately upon taking office in January 2003, President Lula created a Deputy Minister for South America in the Ministry of Foreign Affairs to enhance his country's ability to engage in external negotiations, and put forth a two-tier strategy emphasizing MERCOSUR solidarity and seeking deeper integration while seeking opportunities for cooperation with other developing countries that share the same interests. President Lula's policies could well be said to have set the course for reinvigorating MERCOSUR. With the inauguration in May 2003 of Argentina's Kirchner administration, which similarly stressed the need for MERCOSUR solidarity, Brazil and Argentina fell completely in step. Brazil's three-pronged strategy became exceedingly clear: (1) deepen integration within MERCOSUR, (2) strengthen cooperation within South America and with developing countries worldwide, and (3) assume a pro-active stance on negotiations with developed countries.

In the context of this strategy, Brazil's policies on regional integration in the Americas can be regarded as pursuing three objectives: (1) South American solidarity based on

MERCOSUR solidarity, (2) a stronger bargaining position in negotiations with the US through the conclusion of a MERCOSUR-EU free trade agreement, and (3) demands toward the US centered on opening agricultural markets and reducing subsidies.

The next section will discuss in more detail Brazil's commercial and diplomatic strategy.

#### 4. Brazil's commercial and diplomatic strategy<sup>3</sup>

This section will examine the commercial and diplomatic strategy toward developing countries that Brazil has unveiled in the backdrop of US-Brazil relations. This strategy is being implemented at four levels: MERCOSUR, the Americas, relations with major extra-regional powers, and solidarity among countries of the "South" at the WTO.

##### (1) Deepening MERCOSUR integration

The establishment of a standing committee and a court of arbitration are said to be key for MERCOSUR in bringing about the completion of MERCOSUR as a regional community. Broadly speaking, MERCOSUR has three decision-making bodies – the Common Market Council (CMC) at the top as well as the Common Market Group (CMG) and the MERCOSUR Trade Commission (Comisión de Comercio del MERCOSUR: CCM) — but none of these are standing organizations. The MERCOSUR headquarters is responsible only for oversight of the treaty text, general affairs and accounting; it has no planning or strategy development functions. Consequently, establishing standing organizations has become crucial to improving the cohesiveness of the region and giving it a greater voice abroad. Against this background, and with Brazil and Argentina both giving MERCOSUR top priority, an extraordinary session of the Common Market Council (CMC) held on October 6, 2003 decided to establish a MERCOSUR Permanent Representatives Commission (Comisión de Representantes Permanentes del MERCOSUR: CRPM), subordinate to the CMC. The 25<sup>th</sup> Meeting of the Common Market Council (CMC) held on December 16 approved the creation of this Commission, and former Argentinean President Eduardo Duhalde was selected to serve a two-year term as its first chairman.

Commercial frictions arose frequently between Brazil and Argentina following the devaluation of Brazil's currency in 1999, but these disputes had to be referred to a WTO dispute resolution panel because MERCOSUR only had ad hoc commercial arbitration functions. A protocol signed at the February 2002 extraordinary meeting of the Common Market Council (CMC) noted that the CMC had agreed on the early establishment of a

standing commercial court of arbitration exclusively for MERCOSUR, and this protocol was approved in December 2003 by the CMC, which sought to put the decision into effect as soon as possible (Brazil had ratified the protocol on October 15, 2003). Prospects thus looked bright that systemic improvements would provide a mechanism within MERCOSUR for resolving intra-regional commercial disputes that posed risks to further integration by MERCOSUR.

## (2) Closer cooperation among developing countries in the Americas

Central and South America have long sought to strengthen cooperation within the Latin America Integration Association (Asociación Latinoamericana de Integración: ALADI) framework. As of the end of 2003, 57 economic supplementary agreements had been signed, among these being an automotive agreement in the form of an addendum protocol.

Free trade agreement (FTA) negotiations between MERCOSUR and the Andes Community (Comunidad Andina: CAN) commenced with an agreement in April 1998 to put an FTA into effect in January 2000, but these negotiations did not proceed as initially planned. At the first South America summit held in September 2000, Brazil, which had suggested the summit meeting, offered proposals for liberalizing intra-regional trade and strengthening relations within South America, envisioning FTA negotiations with other South American countries anchored by an FTA between the MERCOSUR and CAN. However, this proposal strongly reflected the wishes of MERCOSUR, which was attempting to reinforce its bargaining position in FTAA negotiations and in FTA negotiations with the EU, and the absence of clear economic benefits for CAN and subsequent political and economic disorder within the region hindered progress in this regard. In 2003 President Lula forcefully advanced negotiations, and an FTA signed between MERCOSUR and Peru on August 25 went into effect on November 1; Peru became an adjunct member of MERCOSUR. Substantial compromises by MERCOSUR, especially Brazil, are apparent in the free trade agreement between MERCOSUR and Peru, clear evidence that Brazil assigns higher priority to benefits accruing to its commercial strategy than to direct economic benefits. The FTA agreement with CAN was officially announced in a CMC joint communiqué in December. That FTA is scheduled to go into effect in April 2004.

With regard to Mexico, an economic complementation agreement (ACE No. 54) was concluded as early as July 2002, and FTA negotiations thereafter have aimed at upgrading this agreement. In September 2003 an FTA agreement was reached between Mexico and

Uruguay that was ratified on November 15; accordingly, customs duties on footwear — treated as an exceptional item under the existing economic complementation agreement — would be abolished over a 10-year period. FTA negotiations between the other three MERCOSUR countries and Mexico will likely be conducted in future (MERCOSUR in its June 2000 CMC agreed to pursue a new FTA as a bloc).

### (3) Closer cooperation with developing countries outside the region

Since the December 2000 CMC, MERCOSUR has examined the possibility of cooperation with developing countries outside Central and South America, above all, South Africa and India.

A Framework Negotiation Committee was established at the December 2000 CMC with an eye to concluding a future FTA with South Africa. Subsequent negotiations took place in October 2001, August 2002, and December 2002; in the December negotiations MERCOSUR presented South Africa with a list of 4,175 items for which it sought tariff reductions, and received from South Africa a similar list of 782 items. The next talks took place in Montevideo on October 9, 2003, where the agreement was extended to the Southern Africa Customs Union (SACU: comprises South Africa, Botswana, Namibia, Swaziland, and Lesotho) and a negotiation schedule set that called for arrival at a partial agreement prior to establishing an FTA with the SACU. Opinions were also exchanged on quarantine methods, definitions/classifications of wine and spirits, and rules of origin.

The first round of negotiations with India was carried out in March 2003 and the second round in June of that year, timed to coincide with the CMC meeting; these talks produced a framework accord between MERCOSUR and India. The agreement declared that the parties would first work to conclude a partial agreement, aiming in the next stage for a comprehensive free trade agreement to expand economic relations between India and MERCOSUR. On January 25, 2004 President Lula and Mr. Duhalde, Secretary-General of the MERCOSUR Permanent Representatives Commission, visited India and signed this agreement. MERCOSUR presented India with a list of 952 items for which it sought tariff reductions, and received from India a similar list of 549 items.

Although no specific steps have been taken to conclude a commercial agreement with China, the rapid expansion in trade between Brazil and China has prompted efforts to conclude an agreement on plant quarantine and otherwise create an environment permitting smoother commercial relations. Under the earlier Cardoso administration, Brazil had placed

safeguards on textiles and toys and made no noticeable moves toward rapprochement with China. With the sharp rise from 2001 in exports of iron ore, soybeans, and machinery from Brazil, China's presence made itself increasingly felt in the Brazilian economy. With President Lula of the Workers' Party, an organization historically on amiable terms with China, taking office in 2003, rapprochement with China has taken on great significance for Brazil in the pursuit of its two objectives of commercial profits and a stronger bargaining position vis-à-vis the developed countries.

#### (4) Formation and future of a developing countries group in the WTO

At the 5<sup>th</sup> WTO Ministerial Conference held in Cancun, Mexico on September 10–14, 2003, Brazil assumed the leadership of the developing countries group. This Ministerial Conference covered five areas, including agricultural products, non-agricultural products (industrial products, forestry products, fishery products), new topics (investment, rules, etc.), and developing countries. Failing to find points of compromise in the disputes between the developed and developing countries, however, the Conference ended with a *de facto* breakdown without adopting a ministerial declaration. Brazil strongly asserted the Lula administration's intent to seek negotiations on an equal footing with the developed countries, and organized a developing countries group (G-21; this group later increased to 22 but then dropped to 20 countries) that served as allies in a North-South confrontation. Although the G-21 was organized to push ahead the WTO negotiations rather than rupture them, the group has held to a consistently hardline negotiating stance on agricultural products. A G-20 Ministers' Meeting was held in Brasilia on December 11–12, 2003, attended by WTO Director-General Supachai Panitchpakdi and EU Trade Commissioner Pascal Lamy. While the G-20 countries at the meeting deemed it important that the Doha Round be concluded within the prescribed deadline, the participants insisted on more open markets in the agricultural sector, calling for cooperation with the Africa group in this regard. President Lula proposed that a framework accord be reached with the developing countries on a preferential duty agreement and that a free trade agreement be concluded among the G-20 countries. The next G-20 Ministers' Meeting will be held in São Paulo in June 2004, coinciding with the 11<sup>th</sup> Meeting of the United Nations Council on Trade and Development (UNCTAD)<sup>4</sup>.

#### 5. North-South schemes in the Americas and their features

This section will review the commercial agreements that “Southern” countries in the Americas — the countries of Central and South America — have with “Northern” countries within and outside the Americas, and will demonstrate an understanding of the nature of such agreements.

(1) North-South schemes within the Americas

The following are commercial agreements within the Americas that include countries from both the “North” and the “South”:

North American Free Trade Agreement (NAFTA: the US, Canada, Mexico)

US-Chile Free Trade Agreement

Canada-Chile Free Trade Agreement

Canada-Costa Rica Free Trade Agreement

US-Central America Free Trade Agreement (CAFTA)

US and Central America/Caribbean Basin Trade Partnership Act (CBTPA [commonly known as the Caribbean Basin Initiative, or CBI])

Canada-Caribbean Community Preferential Trade Agreement

Andean Trade Preferences and Drug Eradication Act (ATPDEA) (US-Andes countries)

The free trade agreements among these lay down fundamentally equal and reciprocal relations, whereas the preferential trade agreements define unilaterally (North to South) preferential relations.

Below will be discussed the features of the free trade agreement between the US and five Central American countries (CAFTA, final accord: January 25, 2004), the most recent free trade agreement in the region<sup>5</sup>.

The US has given considerable consideration in this free trade agreement to matters of interest to its Central American partners, and the preferential treatment in terms of access to US markets enjoyed by the Central American countries under the existing preferential trade agreement (CBTPA) will be further expanded by CAFTA.

The main text of the agreement consists of 22 chapters that cover a broad range of areas including market access, standards and certification, trade facilitation, trade relief measures, governmental procurement, investment, services, intellectual property rights, labor and the environment. Major differences in the timing of liberalization measures between the US and

Central American countries as typified by the tariff reduction schedule for trade in goods as well as careful consideration of the concerns of the Central American countries have been incorporated into the agreement. Although the US will immediately lift tariffs on almost all commodities, the Central American countries are only required to lift tariffs straight away on about 80% of industrial products (72% for Costa Rica; figures vary by country); tariffs on industrial products produced within Central America will be lifted in stages over a 10-year period. The agreement also stipulates that the US will immediately lift tariffs on almost all agricultural products, while the Central American side will be allowed to lift these in stages over an extended period. On sensitive commodities from Central America in particular, the agreement sets out conditions advantageous to the Central American countries, including a long transition period — up to 20 years, longer than the 12 years provided in the US-Chile Free Trade Agreement and the 15 years in the North American Free Trade Agreement (NAFTA) — a freeze on current tariff rates for a given period once the agreement goes into force, and special safeguards against the rapid increase in imports. Consideration has been given to circumstances in Central America in setting the rules of origin as well, with the agreement including rules more relaxed than those in NAFTA, and there is greater room to enjoy the benefits of utilizing cheap labor in Central America to process raw materials imported from outside the region and then export them to the US.

Of great interest to the Central American countries during the CAFTA negotiations was continuation of the free zone system that the Central American countries have placed at the heart of their efforts to solicit investment and encourage exports. Free trade agreements customarily contain two provisions: (1) a ban on customs duty drawbacks and deferments for raw materials and parts used in the manufacturing of products to be exported to a signatory country, and (2) a ban on tariff exemptions linked to performance requirements such as export obligations (seen as export subsidies by the WTO). In fact, after the conclusion of NAFTA, Mexico abolished the tariff-related preferential measures it had theretofore granted to Maquiladora companies. As a similar approach was expected in CAFTA as well, the Central American countries negotiated for the continuation of their existing free zone and drawback systems.

The provisional draft of the CAFTA only set down a ban on tariff exemptions linked to performance requirements (Article 3.4). In other words, there were no particular provisions covering customs duty drawbacks and deferments, and it is unclear whether or not Article 3.4 of that agreement applies to tariffs on raw materials and parts. The governments of

Central America have clearly expressed their desire to continue their current drawback systems as long as these are permitted by the WTO.

The countries of Central America have since 1984 been enjoying preferential duties under the US' CBI (the current law is the Caribbean Basin Trade Partnership Act: CBTPA), and they aimed at expanding the existing preferences during CAFTA negotiations. The CAFTA made it newly possible to export canned tuna, jewelry, footwear and other items excluded from coverage under the CBI to the US duty-free. A new duty-free quota framework for sugar was established for Central America by adding to the duty-free import quota granted by the US under the CBI.

With regard to textiles and sewn products, Central America's chief exports to the US, the rules of origin constituting the preconditions for preferential duties under CAFTA have changed greatly, and access to US has been improved. The principal changes are as follows:

#### Use of raw materials produced in Central America

Under CBTPA, preferential duties were conditioned on the use of US-made thread and fabric. Use of relatively expensive US-made thread and material in apparel and other final products to be exported to the US has been one factor lowering price competitiveness vis-à-vis products from China, Vietnam and other Asian countries, and the US' imports of apparel products from Asia have climbed much faster than those from Central American countries in recent years. Under CAFTA, apparel using thread and fabric manufactured in Central America is treated as duty-free and this is expected to boost the competitiveness of cotton apparel and other goods. As demand for Central American-made thread and fabrics grows, exports from countries such as El Salvador that export cotton thread and fabrics within Central America are expected to expand.

#### Use of raw materials produced outside the region

The rules of origin for textiles in many FTAs and preferential trade agreements utilize the "thread principle" that acknowledges local origin if processing from thread production (spinning) onward takes place within the region. Exceptions have been made, however, that grant local origin status to raw materials imported from outside the region if they are produced in small quantities within the region. Far more raw materials may be procured from outside the region under CAFTA than under either NAFTA or CBTPA. Because relatively expensive raw materials produced in small quantities within the region can be secured through imports from outside the region, raw material procurement costs can be

reduced.

#### Use of raw materials produced in NAFTA countries

Class HS62 apparel products sewn together in Central America using thread and fabric from Mexico or Canada are nevertheless regarded as being of local origin under CAFTA. A maximum allowance of 100 million square meter equivalent (SME) of apparel using thread and material of NAFTA origin has been set for the first year and an annual allowance of 200 million SME from the second year onward. This provision enables Central American apparel manufacturers to procure raw materials from the most suitable locations throughout the North American continent.

#### Adoption of substantive processing standards

Of apparel products, brassieres are eligible for preferential duties under NAFTA and CBTPA if cutting and sewing is done within the region, regardless of the origin of the raw materials. Under CAFTA, brassieres, trunks, nightwear and pajamas are among the products granted local origin status based on the location at which such substantive processing takes place.

The US-Central America Free Trade Agreement (CAFTA) can thus be seen to reflect more of the interests and wishes of the South than had been the norm for free trade agreements to that point. One likely reason for this is that CAFTA expands and replaces the Central America/Caribbean Basin Trade Partnership Act (CBTPA) with the US. Another reason that can be inferred is that the US is willing to grant preferential measures to countries on its side in its contest with Brazil for influence. If this is the case, Brazil's stance of seeking to secure its interests through "Southern" solidarity may have the ironic effect of working to the advantage of non-MERCOSUR countries in their negotiations with the US, even if it does not bring about a consolidation of Central and South America.

## (2) EU-Americas schemes

The following frameworks have been established for relations between the EU and the Southern countries within the Americas:

EU-Mexico Free Trade Agreement

EU-Chile Free Trade Agreement

EU-Caribbean Preferential Trade Agreement / EU-Central America Preferential Trade Agreement

## EU-Andes Community dialogue

### EU-MERCOSUR Cooperative Framework Agreement

The trade agreements above correspond in nature to the agreements between the US and these countries. By contrast, the ties with the Andes Community and MERCOSUR go beyond just commercial or economic matters and are considered extremely broad-ranging, extending also to political, social, and cultural matters. This is a reflection of the fact that the EU regards itself as an antecedent (and successful) example of a regional community and has a policy of supporting the development of the Andes Community and MERCOSUR as latecomer regional communities. Commercial and economic ties are placed within a more comprehensive context and, in that limited sense, these frameworks appear to have the same significance for the EU that the Organization of American States (OAS) has for the US.

As mentioned above, Brazil views the conclusion of an EU-MERCOSUR free trade agreement as vital to bolstering its bargaining position vis-à-vis the US. Keeping close watch on the US' growing presence in Central and South America, an area of importance commercially and diplomatically, as a result of the conclusion of the FTAA, and securing more advantageous conditions for itself are matters of great interest to the EU. With the interests of the two parties thus matched, the EU-MERCOSUR free trade agreement negotiations are being pursued in parallel with the FTAA negotiations and, like the FTAA negotiations, are moving into their final stage.

For a time, little progress was made in the EU-MERCOSUR free trade agreement negotiations following the conclusion of an inter-regional framework agreement at the December 1995 meeting in Madrid. It was subsequently announced at the June 1999 EU-MERCOSUR Summit Meeting in Rio de Janeiro that negotiations would begin toward the conclusion of an FTA; a negotiation framework was determined at the collaboration conference held in November of that same year. A Subcommittee on Cooperation (SCC) and a Technical Group (TG) were established under the Bi-regional Negotiations Committee (BNC) that provided general oversight for the negotiations; negotiations on individual topics began at the 1<sup>st</sup> BNC meeting in April 2000. At the 5<sup>th</sup> BNC meeting in July 2001, the EU proposed to MERCOSUR that agricultural products be divided into six categories, that the pace of tariff reductions (tariffs to be lifted immediately, in four years, in seven years, in ten years, and import quotas) be determined for each of these categories, and that tariffs on industrial and marine products be lifted over a 10-year period (presuming the agreement

goes into effect from January 1, 2006). The proposal put forth by the EU listed 9,286 commodities (based on HS 8-digit codes) targeted for tariff reductions and 988 commodities, primarily agricultural products, to be treated as exemptions. MERCOSUR expressed dissatisfaction at the inclusion among these exceptions of products in which it was competitive, such as dressed meat, dairy products, vegetable oil, and sugar. Nevertheless MERCOSUR also named 5,719 commodities (505 agricultural products and 5,214 industrial products) that it wished to exempt from tariff reductions, and passive postures by both parties marked the first stages of negotiations. A working program for trade liberalization was put forth at the Rio de Janeiro ministerial conference in July 2002. Negotiations on liberalizing trade in goods were carried out in line with this program, and MERCOSUR proposed at the 9<sup>th</sup> BNC meeting in March 2003 that within 10 years tariffs be reduced on 83.5% of commodities by value (using the 3-year average imports for 1998–2000); in the initial negotiations, reductions were proposed for only 32% of commodities by value. In November the final negotiation schedule was set at the EU-MERCOSUR ministerial conference held in Brussels. This schedule mandated that the two sides exchange “wish lists” on goods, to include such areas as governmental procurement, investment, and agricultural products, in April 2004. The BNC was also to meet six times by July 2004 (a total of 15 times from the start of the negotiations) and a ministerial meeting was to be held in Mexico on May 28–29, 2004 in conjunction with the EU-Latin America Summit; at this ministerial meeting, the results of negotiations to that point would be analyzed and instructions given for the final stage of negotiations. Another ministerial meeting, this one to be held in the EU, is scheduled for October 2004.

### (3) The nature of North-South schemes in the Americas

As seen above, North-South schemes in the Americas have developed in a variety of forms reflecting the diverse interests and concerns of the countries involved. The core interests and concerns of the South are ensuring and expanding access to the markets of the North and soliciting direct investment from the North. The key commercial interest of the North, on the other hand, is establishing conditions advantageous to the overseas expansion of its own companies with regard to the liberalization of trade and investment, competitive policy, governmental procurement, the service sector, the protection of intellectual rights, etc. Other factors that may well have a major impact on negotiations are the contest between the US and Brazil for power and influence and the competitive relations between the US and the

EU. In light of the contention between the US and Brazil over power and influence, the US has been endeavoring to isolate MERCOSUR and has thus been concluding free trade agreements with non-MERCOSUR countries that offer conditions advantageous to these countries. As was confirmed in the case of CAFTA, these free trade agreements consequently have strong overtones of “asymmetry and preferential treatment.” The competitive relations between the US and the EU can be seen as having a similar impact. The EU tends to show more consideration toward the South than does the US, and it is seeking to establish broad-ranging and cooperative economic relations. While it is not clear in what way or to what degree this will affect the US’ stance toward the South, it is not unthinkable that, as the US and EU engage in competition globally, their battle for power and influence in the Americas will heat up.

#### 6. Conclusion: Implications for Japan

In view of the matters discussed in this chapter, the implications for Japan can be summarized in three points.

The significance of expanding regionalism in the Americas for Japan’s foreign policy toward Central and South America

The expansion of regional economic integration across the Americas as typified by efforts to create an FTAA is prescribed by the disputes and compromises between the US and Brazil (or the US and MERCOSUR, given that the foreign policy stance of the current Argentinean administration is close to that of Brazil). Diplomatic policies and considerations are the fundamental driving forces behind the FTAA, with economic interests apparently secondary. To bolster their respective positions, the US and Brazil have been lobbying the countries of Central and South America, and the countries of the region are undoubtedly adopting stances that allow them to derive the greatest diplomatic benefits from their ties with the US and Brazil. The EU plays an important role within this scheme as an extra-regional actor. Above all, closer ties between MERCOSUR and the EU have been used by Brazil as leverage in its relations with the US. Brazil may wish to improve its ties with Japan for a similar purpose. Japan must bear in mind the significance of its relations with Brazil for its relations with the US in the Americas (although Japan’s weight in the region is far less than that of the EU).

As the US and the EU build up their commercial ties with the countries of Central and South America by concluding free trade agreements, Japanese companies are suffering — and are expected to continue to suffer — tangible harm by being placed at a disadvantage vis-à-vis European and American companies in many countries in the region. Although it is possible to respond at the corporate level by utilizing subsidiary companies in Europe and the US, an adverse impact on exports from Japan is inevitable. As one solution, Japan has put on its agenda the conclusion of free trade agreements with several countries in Central and South America, and negotiations are already underway with Mexico. It has become clear in the course of these negotiations with Mexico, however, that Japan is considered far less important than the US or the EU by the countries of Central and South America. Absent substantial expansion in access to Japanese markets, these countries will have little incentive to conclude free trade agreements with Japan. Japan cannot avoid facing the difficult domestic political challenge of balancing the interests of export-oriented manufacturers against those of agricultural producers (or small companies in some cases) facing import competition.

#### Brazil's diplomatic strategy

Brazil's Lula administration is pursuing Third World diplomacy worldwide. The key to this strategy is improving diplomatic ties with other major third-world powers such as China, India, and South Africa, as well as increasing the say of the developing countries as a group in forums such as WTO negotiations (Brazil is simultaneously pursuing closer economic ties with all of these countries through trade and investment). As a result of this policy, the Third World has emerged as a player on the world diplomatic stage for the first time in many years. Japan must recognize that an increasingly unambiguous “anti-Third World” stance will surface in the context of schemes granting equal status to developed and developing countries (with the focus on agricultural subsidies for the time being).

Brazil's Lula administration is also seeking to exercise influence as the flag bearer of the global socialist movement through the Socialist International and the World Social Forum. The Socialist International convened an October 2003 World Congress in São Paulo, whose mayor is the Deputy Chairman of the Workers Party (PT),. The World Social Forum held its first three assemblies in Porto Alegre, whose city government is dominated by the Workers Party (PT),, but the 4<sup>th</sup> Assembly was “exported” to Mumbai,

India in January 2004. Both of these organizations are expected in future to play a more important role in forming public opinion and influencing policy design worldwide as groups advancing a global socialist movement. Japan should accurately assess Brazil's role in that regard.

#### Footnotes

1. Doug Palmer, "U.S. to Seek 14-Country Trade Deal Within FTAA," Reuters, February 7, 2004. These 14 countries are the US, Canada, Mexico, Guatemala, El Salvador, Honduras, Costa Rica, Nicaragua, Panama, the Dominican Republic, Colombia, Ecuador, Peru and Chile.
2. This final point draws from *JETRO Central and South America Bulletin*, No. 586, February 17, 2004.
3. This section relies heavily on *JETRO Central and South America Bulletin*, No. 574, January 28, 2004.
4. The G-22 comprises the following countries: Brazil, Argentina, Paraguay, Bolivia, Chile, Peru, Ecuador, Colombia, Venezuela, Mexico, Guatemala, Costa Rica, Cuba, China, India, Pakistan, Indonesia, the Philippines, Thailand, Egypt, Nigeria, and South Africa.  
The G-20 consists of the G-22 countries minus Peru, Ecuador, Colombia, Costa Rica, Guatemala, and Thailand but adding Tanzania and Zimbabwe. Ecuador and the Caribbean Community (CARICOM) attend G-22 conferences as guests.
5. This portion relies on *JETRO Central and South America Bulletin*, No. 583, February 13, 2004.