

**Venezuela's Withdrawal from the Andean
Community of Nations and the
Consequences for Regional Integration**

Carlos Malamud

Working Paper (WP) 28/2006

15/11/2006



Venezuela's Withdrawal from the Andean Community of Nations and the Consequences for Regional Integration

Carlos Malamud *

Summary: The President of Venezuela took advantage of a meeting with his colleagues from Bolivia, Paraguay and Uruguay on 19 April 2006 to unexpectedly announce the country's withdrawal from the Andean Community of Nations. Regardless of the real reasons behind Commander Chavez's attitude, Venezuela's move sent a deep shudder of concern through other CAN members and further stirred the already choppy waters of regional integration in the continent.

Introduction

The President of Venezuela took advantage of a meeting with his colleagues from Bolivia, Paraguay and Uruguay on 19 April 2006 to unexpectedly announce the country's withdrawal from the Andean Community of Nations (*Comunidad Andina de Naciones* or CAN), the sub-regional integration block formed by Bolivia, Colombia, Ecuador, Peru and Venezuela, whose annual trade turnover totals close to US\$9 billion. Ten days later, Bolivia's President Evo Morales announced the nationalisation of the country's hydrocarbons. Venezuela insists that withdrawal from the CAN was a direct result of the immediate harm it would be caused by the free trade agreements (FTAs) signed by Colombia and Peru. Regardless of the real reasons behind Commander Chavez's attitude, Venezuela's move sent a deep shudder of concern through other CAN members and further stirred the already choppy waters of regional integration in the continent.

In the Andean Community, Colombia and Peru held Chávez responsible for withdrawing from the block, Bolivia clearly aligned itself alongside Venezuela and Ecuador took a more neutral stance, although it defended the process of regional integration. Theoretically, Venezuela's withdrawal from the CAN should imply a greater and more active role for the Bolivarian regime in Mercosur, which has not pleased Argentina and Brazil, who are suspicious of attempts by Chávez to align with the smaller countries in the block, Paraguay and Uruguay, which in turn have their bones of contention with the two major players. At the same time, Chávez was scathingly critical of Mercosur, adding that it needed to make a social turnaround if it did not wish to end up like the CAN. Venezuela's withdrawal from the CAN threatens to undermine the viability of the two major regional integration blocks in South America (CAN and Mercosur) and places a major question mark over the future of the South American Community of Nations (*Comunidad Sudamericana de Naciones* or CSN), Brazil's brainchild, and could even jeopardise Brazil's leadership in South America. This threat was corroborated by two subsequent events: the Havana Summit, where Evo Morales decided to join the Bolivarian Alternative for the Americas (*Alternativa Bolivariana para las Américas* or ALBA), alongside Commanders Castro and Chávez; and, more worryingly for regional equilibrium, the Bolivian nationalisation decree. Despite the smiling faces at the Puerto Iguazú photo

* Senior Analyst, Latin America, Elcano Royal Institute

shoot which apparently augured well for the unviable South American gas pipeline, positions are starting to polarise and it is regional integration itself that is under the knife.

Venezuela's withdrawal from the Andean Community of Nations (*Comunidad Andina de Naciones* or CAN) has had major repercussions in the region, including an impact on the process of Andean integration itself, but also affecting Mercosur. President Chávez's decision to opt decidedly for Mercosur, confirmed by his withdrawal from G-3 (Colombia, Mexico and Venezuela), raised suspicions in the governments of Brazil and Argentina, which had hitherto been enthusiastic about welcoming Venezuela into their regional integration programme. Nevertheless, Venezuela will be granted full membership of Mercosur at the next regional summit in Córdoba, Argentina, on 20-21 July, despite some outstanding issues regarding regulatory harmonisation and tariff deregulation.

The geopolitical map of the region was complicated by Bolivia's decision to nationalise its hydrocarbons, with the support of Commanders Castro and Chávez, which had a negative impact on Argentina and Brazil, the two largest buyers of Bolivian gas (this issue will be tackled in the third and final part of this series of papers). The disputes centred on the political and ideological interpretations of the Free Trade Agreements (FTAs) and –as never before in the recent past– the countries in the region conveyed an impression of divisiveness, as made evident at the Fourth EU-Latin America and Caribbean Summit, held in Vienna. Consequently, Bolivia's future attitude will shape not only the CAN's fate but also regional balance itself. As for the future, Venezuela's entry into Mercosur raises a number of questions: (1) how will it affect the talks currently underway with the European Union and those scheduled with the United States?; (2) how will the United States react and how will its reaction affect bilateral relations with Brazil and Argentina?; and (3), above and beyond possible trade advantages for Argentina and Brazil stemming from entry into a market such as Venezuela, will there be domestic reactions to the interference which Venezuela's presence might imply?

An important question to analyse is the effects of the nationalisation of Bolivian hydrocarbons and the impact this has had on the bilateral relationship with Brazil, which has not yet been normalised. Bolivia assumed the rotating presidency of the CAN and, after establishing that the Andean Community of Nations is useful to its national interests, president Evo Morales convened a presidential summit in Quito to boost the CAN's revival. This made it possible to relaunch preliminary negotiations with the European Union (EU) for the signing of a Treaty of Association between the two blocks.

There have been other significant events on the unsettled regional and energy game board following Alan García's victory and the tense atmosphere in bilateral relations with Venezuela, which even led to the withdrawal of ambassadors. After his second round election, García visited Brazil, Chile, Colombia and Ecuador in a bid to re-launch the CAN, and although the President-elect emphasised that he did not wish to set up a front against anyone, alluding to Hugo Chávez, the way in which some actors are behaving does not fully satisfy Venezuelan interests, regardless of contradictory moves such as the Chilean and Brazilian governments' support of Venezuela's election to the UN Security Council as a non-permanent member or the convergence on energy matters between Chávez and Uribe. The appeal of Venezuela's financial and energy resources, and its determination to use them time and again according to its political objectives, is so great that many leaders in the region end up backing Venezuela's points of view.

Venezuela's Withdrawal from the CAN

On Wednesday 19 April, at a meeting in Asunción, Paraguay, between the Presidents of Bolivia, Paraguay and Uruguay, Hugo Chávez announced Venezuela's withdrawal from the Andean Community (*Comunidad Andina de Naciones* or CAN), which he

uncompromisingly branded 'a big lie', saying it had been left mortally wounded after the signing of the FTAs between Colombia and Peru and the United States. According to Chávez, it makes no sense for Venezuela to remain in the CAN, a body which serves only the elites and transnational companies and not 'our people, the Indians and the poor'. Accordingly, Venezuela should do something else. His complaint suggested that while Latin Americans are in the doldrums and some are trying to pull them together, 'those who do not want us to integrate do have their strategy' that is clearly aimed at disintegration. Chávez thinks that although Latin American countries know the essentials of regional integration, they do not have the right strategy to implement it. That is why he has opted for Mercosur, although without relinquishing his star project, ALBA, which at the recent Havana Summit gained another supporter, and expects to add Ollanta Humala and Daniel Ortega (present at the event) if they win their respective elections.

The decision to opt for Mercosur is not a naive one, since it is a regional block which moves US\$150 billion in annual trade, versus the CAN's US\$9 billion, and is much more significant from Chávez's point of view. However, since its creation, the CAN has generated sizeable exports among its members. 2005 was the second consecutive year of record highs, at US\$8.92 billion, up 21% on 2004 (US\$7.30 billion). The CAN dates back to 1969, when Bolivia, Colombia, Chile, Ecuador and Peru signed the Andean Pact to set up a customs union within 10 years and, while Venezuela joined in 1972, Chile withdrew in 1976, under the Pinochet dictatorship, triggering the Community's first crisis. Politically, Mercosur might be seen as more cohesive than CAN, although internal wrangling (Paraguay and Uruguay against their 'mistreatment' by Argentina and Brazil, and Argentina against Uruguay due to the construction of the Fray Bentos paper mills) plus the announcement by Uruguay that it plans to strengthen ties with the United States do not augur well for what was formerly the 'model' for Latin American integration.

The announcement of its withdrawal from the CAN came when Venezuela was exercising the rotating presidency, enabling it to block some urgent initiatives, such as the call for a presidential summit. Consequently, Chávez either knowingly and skilfully or unwittingly managed to undermine the entire South American geo-strategic game board and not just the CAN. With one fell swoop, all South American Foreign Affairs ministries offices were affected. Subsequently, President Morales added fuel to the flames by suggesting that some CAN governments (in direct reference to Colombia and Peru) had made a deliberate effort to weaken it, and he branded President Toledo a 'traitor' for signing the free trade agreement with the United States. He also said he was not surprised by President Uribe's support for the free trade agreement, since 'we all know where he comes from'. At the same time, he aimed his criticism at Allan Wagner, the Secretary General of the CAN, saying that 'he had played dirty'. Vice-President García Lineras underpinned the Bolivian position by indicating that 'when a person tells the truth, he has no need to apologise'.

The purpose of the Asunción meeting was to announce the construction of a gas pipeline between Bolivia and Paraguay, to be partly financed by Venezuela and which would eventually supply gas to Uruguay. No-one quite understood Chávez's presence at the meeting, except because of his interest in evidencing leadership in energy matters and his sponsorship of the Morales government in Bolivia. In fact, by supporting construction of the pipeline, Chávez sent a clear message that he is able to act in the south of the continent without being spoon-fed by Brazil and Argentina, to the irritation of Presidents Lula and Kirchner.

The next day, in a speech during his visit to Brazil, Chávez said that the free trade agreements between the United States and Colombia and Peru were a nail in the CAN's coffin and sparked his decision to withdraw, since it was to become a kind of small Free Trade Area of the Americas (FTAA), undermining Andean integration and contravening

regional trade dispositions. In contrast, Colombia and Peru cite 'Decision 598' by the CAN, relating to the Cartagena Agreement, which establishes that in the event that it is not possible to negotiate as a community, bilateral talks may take place. Article 2 of the Decision clearly provides as follows: preserve Andean law, take into consideration the trade sensitivities of the other Andean partners in regard to free trade and maintain an adequate exchange of information and consultations throughout talks, within a framework of transparency and solidarity. The two governments under fire from Chávez claim that they have fulfilled all these requirements and that it was Venezuela which breached Decision 598 when it decided to link up with Mercosur. In view of this background, the Peruvian Minister of Foreign Affairs, Oscar Maúrtua, said that the CAN allows its members to sign free trade agreements with the United States or the EU in order to open new markets.

Although the CAN treaty establishes that after denouncing the Cartagena Agreement the withdrawing country should maintain the free trade benefits for its former partners during five years, traders in the region, especially in Colombia, pessimistically suggest that the chances of Chávez turning a blind eye to international law are not low. However, Chávez did offer a glimmer of hope that trade flows might remain open via bilateral agreements, although without specifying their main characteristics. This possibility was received by some Colombian business organisations as the lesser of two evils, although they recognised that they would lack the efficacy of a multilateral agreement.

Chávez's move to withdraw from G3 (the Group of Three), also comprising Colombia and Mexico, has made evident that withdrawal from the CAN is all but final. The announcement came at the same time as the decision by Chávez not to attend the inauguration ceremony of the new President of Costa Rica, Oscar Arias. Arias had been hoping to take advantage of the occasion to set up a meeting between Chávez and Uribe to iron out differences in regard to bilateral agreements.

Possible Reasons for the Move

Chávez's announcement came as a surprise to many, although some analysts think the decision was actually taken months ago, but that Chávez was waiting for the best time to announce it. As events have transpired, a change of heart by Chávez should not be ruled out if Peru and Colombia relinquish the free trade agreements, which appears impossible unless Ollanta Humala wins the presidency of Peru in the second round of the elections. Even if he does, he might not be able to afford such a measure if he has weak parliamentary support. Only a landslide victory over Alan García would give him the legitimacy to implement such controversial measures.¹ Consequently, the question mark remains as to the reasons for Venezuela's withdrawal from the CAN, although the electoral aspect of the measure cannot be ignored, since Peru and Colombia will be holding presidential elections in the coming weeks, with the Peruvian contest promising to be a much closer call than the Colombian poll. At the same time, it is worth recalling that Presidents Toledo and Uribe hope to strengthen relations with Washington, a notion which, as we have seen, is not pleasing to Chávez. At all events, the announcement was a surprise, to the extent that some senior civil servants in Venezuela were not aware of the scope of the news when it was actually announced. For instance, when the Colombian Foreign Affairs Minister, Carolina Barco, called her colleague Alí Rodríguez, he told her that he did not know the extent of the decision by Chávez.

Another possible reason lies in the increasing tensions with Colombia and the Venezuelan President's desire not only to make Uribe pay for unresolved past controversies, but also to influence his re-election campaign. From early April, Colombia has been in crisis with

¹ See Carlos Malamud, 'García Wins: What Comes Next?', ARI nr 68/2006, Elcano Royal Institute, available at <http://www.realinstitutoelcano.org/analisis/1006.asp>

Venezuela again, after reports that the Colombian intelligence services and some paramilitary groups had dreamed up a plot to oust Chávez. The crisis gained momentum when the former systems chief of the Administrative Security Department (*Departamento Administrativo de Seguridad* or DAS), Rafael García, accused the body's managers and paramilitary chiefs of plotting together against Chávez. Although the Venezuelan government already knew that paramilitaries were allegedly involved in the plot, the crisis deepened when García gave details of the actions of Colombian intelligence operatives. As a result, Vice-President José Vicente Rangel and the President of the National Assembly, Nicolás Maduro, demanded that Uribe offer an explanation in regard to the role of the DAS in the plot. Just before his trip to Brazil, Uribe also found out about the decision by Venezuela's Attorney General, Isaías Rodríguez, to request the extradition of Pedro Carmona, exiled in Colombia since May 2002, one month after renouncing the Venezuelan presidency. Both decisions sounded alarm bells in Uribe's government, which insists that Chávez had 'consented' to both Colombia's decision to sign the FTA with the United States and Carmona's remaining in Colombia, after several meetings between the countries' two leaders.

Some analysts also think that the decision to withdraw from the CAN will not be fully implemented, since Chávez only sought to provoke in the political arena, an idea initially shared by some Colombian businessmen. However, as time goes by, the breakaway looks increasingly irreversible. Consequently, at this point the question must be: who does Chávez want to provoke? While the obvious answer is the United States, which is why he is so critical of the free trade agreements with Colombia and Peru, a slap in Europe's face is not to be ruled out. After all, Chávez made his announcement when the Secretary General of the CAN, the Peruvian Allan Wagner, was in Brussels to put the finishing touches to the solemn announcement of talks between the EU and the CAN at the Vienna Summit. Chávez has made no secret of his distaste for talks of this kind which are not directly run by him and in which he does not stand to make any personal gain.

Before leaving for Brussels to participate in the EU-CAN meeting on 19 and 20 April, Venezuela's Deputy Foreign Minister for Latin America and the Caribbean, Pável Rondón, had expressed his reluctance to sign an agreement between the two blocks. His position is summed up by the lack of internal agreements in the CAN, when there is not even agreement over the FTAs with the United States. However, Rondón insisted that Venezuela was interested in nurturing its relationship with the EU and said that proof of this was Chávez's presence at the Vienna Summit. The fact is that the Venezuelan delegation, comprising almost one-hundred people, will be the largest of all Latin American delegations. For his part, the Peruvian President Alejandro Toledo reiterated the CAN's interest in continuing to make progress in talks with the EU, despite Venezuela's withdrawal.

At the same time, an increasing number of European countries are critical of Chávez's government and this explains why Venezuelan government representatives have come up against some difficulties in including their messages in the final statement. The growing rejection of Chávez in Europe is further fuelled by his influence on Morales. Holland's warning against Chávez and the latter's tough response should not be ignored. In March, the Dutch Defence Minister Henk Kamp asserted that Venezuela wants to take control of the Aruba, Curaçao and Bonaire Islands, just 50 kilometres off the Venezuelan coast, in the Dutch Antilles. This is why the Dutch government will be taking part in naval manoeuvres in the Caribbean alongside the US, Canada, France and Belgium. Chávez's response focused on accusing Kamp of being Washington's 'backing chorus'. Venezuela also aims to apply a new tax on oil operations, which would affect, among others, the UK's BP and France's Total (as well as Norway's Statoil). The problem for Spain is that the sympathies for Chávez in European governments are on the wane and Spain could

become the lone defender in Brussels of a government wholly opposed to representative democracy and whose actions are starting to undermine European interests.

The Various Andean Partners' Responses

The initial responses by the various CAN partners were cautious, even expecting the news would finally not be confirmed and that it would all end up being a passing whim of Chávez. However, as it became clear that the scope for reversing the decision was narrowing, the tone of statements from one side and another began to heat up, reaching a climax with President Morales's accusation to his Peruvian colleague, Toledo, of being a traitor to the indigenous peoples. At the same time, Morales, who will be taking over the rotating presidency in the next few months, expressed his concern for the situation he would inherit in the wake of the Venezuelan withdrawal and the efforts he would have to make to rebuild the regional block, at a time when the Constituent Assembly will be keeping him very busy.

Despite the widespread concern, for now perplexity reigns and no specific response has been prepared. And although the Secretary General of the CAN, Wagner, raised the possibility of a meeting of the Community's presidents in order to find 'the best possible scenarios' for resolving the crisis, the meeting has not yet materialised. These circumstances could result in various scenarios, such as the rebuilding of the CAN without Venezuela, a withdrawal by Bolivia following Chávez's lead with the emergence of a new block formed by Colombia, Peru and Ecuador, or the definitive breakdown of the entire system. The uncertainties are also affecting the future of negotiations between the EU and the CAN.

In Chávez's view, Colombia is mostly to blame for his withdrawal from the CAN, since the FTA with the United States will inundate Venezuelan markets with strongly subsidised US products. At the same time, Colombia stands to lose the most as a result of the withdrawal, since the two countries' bilateral trade is the most significant within the CAN. Venezuela is Colombia's second-largest trading partner, after the United States. Whereas in 2005 Colombian exports to Venezuela totalled US\$2.09 billion (up 29.2% on 2004 and accounting for 10% of all Colombian exports), its imports totalled US\$1.02 billion, firmly tipping the balance of trade. A good deal of these exports are manufactured goods and it would be hard to find alternative markets for them. Expectations for 2006 were higher, since growth was expected to exceed 7% for the Venezuelan economy. On both sides of the border bilateral trade has generated close to one million jobs, now under threat. But while Venezuela's oil revenues allow the government to subsidise those affected by the loss of cross-border flows, mitigating the risk of social unrest, the Colombian government is in a less comfortable position, because of the amount of public expenditure on the war on terror and drug trafficking. Nevertheless, since Venezuela's exports to CAN countries, starting with Colombia, are not energy products but manufactured goods, it will also be hard to channel them into alternative markets, and this will hurt the country's production structure.

The Colombian government initially opted for something of a 'reinvention' of the Andean Community in order to preserve its trade position. It tried to call an urgent meeting between Presidents Chávez and Uribe, which never came about, eventually leading to the mediation of President Lula in the conflict. At the same time, the expectations surrounding the early hints by Evo Morales that he might call a presidential summit of the CAN were quickly dampened by Morales's accusations against the Secretary General of the CAN and President Toledo. Consequently, Uribe, after calling for calm and 'in-depth analysis', said that Colombia is seeking 'an open CAN, which can overcome these levels of poverty, which is why we wish to... find ways to make things go well for all of us'.

Colombia's Industry and Trade Minister, Jorge H. Botero, said that the FTA talks upheld Andean regulations and were respectful of the sensibilities of partners and that the CAN is protected, since the Andean law prevails over the FTA, 'as expressly provisioned in the final text of the Treaty'. Other members had been consulted about potentially sensitive products which might be affected by the FTA. The Minister also said that at the end of March he received a letter from the CAN General Secretariat certifying that the country met all the requirements and obligations towards Andean countries in its negotiations with Washington and that 'it is worth noting that Colombia has no reproaches in regard to the intention of Venezuela of creating a free trade zone with Mercosur, even if it imposes upon us, as it will, very tough competition in the Venezuelan market from Brazil and Argentina'. Botero also recalled that Colombia and Venezuela share a very active border and that they have joint plans to build infrastructures, such as a gas pipeline and a multiple transport pipeline enabling Venezuela to send its oil to Asian markets via Colombian ports on the Pacific Ocean. In Venezuela's case, bi-national trade was protected with seven-year tariff relief for petrochemical exports and ten-year 10 relief for the iron and steel sector, while for the automotive sector a series of periods and preferences were established.

Once the news broke in Peru, President Toledo called Chávez to ask him to reconsider his decision. When his pleas proved to be in vane, he asserted that 'the CAN will march on' and that he trusted that the claims by Chávez 'are the expression of a temporary reaction' because 'I know he is an integrator and that he will think again', since he could not believe that Chávez 'wants to disintegrate and dismember the CAN'. Even Ollanta Humala, who does not hide his sympathies for Chávez, lamented the decision to abandon the CAN, despite his understanding of Venezuela's motives. Humala's view that the move was 'a sovereign decision' by Venezuela lays bare the contradictions of the Bolivarian discourse, by subordinating what is theoretically the main interest of Latin America, regional integration, to national interests. The national sovereignty argument could equally be used to justify Colombia and Peru signing the FTAs. After these initial skirmishes, the controversy built up, even affecting presidential candidate Alan García, who had a tough exchange with Chávez, the consequences of which have so far included the recalling of ambassadors (in a way reminiscent of former controversies between Cuba and some Latin American countries like Mexico and Peru).

Although Bolivia shares Venezuela's displeasure (the Colombia-US FTA affects its soy exports), initially it did not manifest an interest in withdrawing from the CAN, although it did join in other initiatives fomented by Chávez, like the ALBA and the Peoples' Trade Treaty (*Tratado de Comercio de los Pueblos* or TCP). Morales, despite giving the impression of following in Chávez's footsteps, made a u-turn and said he was in favour of calling a meeting between presidents. For Morales, there are countries who seek disintegration, although he added 'I am sorry that the Andean Community is dead, but we must do something', and he claimed that ALBA had beaten FTAA. Vice-President García Linera still sees the CAN as an important tool to overcome poverty and close the development gap, since the country needs its neighbours to export its products. He said that Bolivia, unlike Venezuela, does not export billions of dollars-worth of oil. He later asked Peru and Colombia to stop any talks with the United States on the FTA.

Bolivian exports to the CAN (mainly to Colombia, Venezuela and Peru) total US\$466 million annually, accounting for 17% of its overall exports, which gives us an idea of the huge negative impact on the country if the block does finally break down completely. In 2005, Bolivia exported US\$180 million to Colombia, US\$159 million to Venezuela, US\$124 million to Peru and US\$3 million to Ecuador, with Santa Cruz the region most benefiting from trade with Andean partners. The CAN is Bolivia's main regional market, and in recent years it has had a trade surplus there, unlike in Mercosur and despite gas exports to Argentina and Brazil

Ecuador chose to keep a low profile and refrained from making high-sounding statements, although it did say it was in favour of the CAN's integrity. However, coinciding with the announcement by Venezuela there was a very interesting agreement on energy with Mexico, materialised during the official visit by Ecuador's President Alfredo Palacio to Mexico City. This process, according to some observers, goes beyond a simple cooperation agreement. The project, linked to the Puebla-Panama Plan, entails building a gas pipeline right across Central America, including Colombia. One of Mexico's aims is to increase, or recover, its presence in Latin America and offset the influence of Chávez. In this regard, the joint Mexican-Ecuadorean statement supports the FTAA, which is equivalent to underpinning the free trade agreements with the United States. From Ecuador's standpoint, a vital concern is Petroecuador's need for technical consultancy services, which it could obtain from Pemex. This is evidence of Ecuador's desire to distance itself from Chávez.

But while Mexico is trying to increase its influence in the Andean region via Ecuador, Venezuela is doing the same via Nicaragua, in a repeat of what it already did in El Salvador with some municipal governments controlled by the FMLN. While Chávez hopes that Daniel Ortega will win November's presidential elections, and is financing his campaign, he has started to make some moves, such as the agreement between the PDVSA and 53 Nicaraguan municipal governments belonging to the AMUNIC (Nicaraguan Association of Municipalities) to create the company Alba Petróleos de Nicaragua which would sell fuel at preferential prices to these municipalities. Chávez took advantage of the agreement to reiterate his support for Ortega, while denying that he is interfering in Nicaragua's internal affairs.

Venezuela and Mercosur

Since the most often-used reason for withdrawing from the CAN (Andean Community of Nations) was the desire of the Hugo Chávez government to immediately join Mercosur, it is natural to think that the impact of such a stance should immediately be felt in that regional block. After all, when President Chávez announced his decision to withdraw from the CAN, on Wednesday 19 April, he also sent a poisoned dart to Mercosur, whose member countries were beginning to show concern in regard to the Venezuelan leader's moves. The announcement of Venezuela's withdrawal from the Andean Community came at a meeting in Asunción, Paraguay, with the Presidents of Bolivia, Paraguay and Uruguay, the latter two being members of Mercosur. The impact of the meeting was such that a senior government official from Argentina asked: 'How can there be a meeting of Mercosur which excludes Brazil and Argentina?' The question was followed by a bitter complaint: 'There was no-one from our countries. No-one.'

The meeting in Asunción served the smaller members of Mercosur –Paraguay and Uruguay– to express their displeasure at the direction the block was taking and the behaviour of its larger members –Argentina and Brazil– which the governments of Asunción and Montevideo consider to be discriminatory towards their interests. It is no coincidence that there is renewed talk of Argentine and Brazilian sub-imperialism, a term also brandished in Bolivia as a result of the recent tensions with Petrobras. Accordingly, while the Uruguayan President, Tabaré Vázquez, said that 'Mercosur is not working', his counterpart from Paraguay, Nicanor Duarte, called for Mercosur to consider 'the equality of its members' rights', in clear reference to the hegemonic role of the big two. And although most complaints from Buenos Aires and Brasilia were addressed to the two smallest members of the block, for their rebellious behaviour, Venezuela's conduct was by no means ignored, and was described as interference in the internal affairs of the Southern Cone, which is a playing field that has been hitherto reserved for Brazil and Argentina. One of the main bones of contention was the request by Uruguay that a Bolivian pipeline currently in the research phase be mapped to avoid Argentine territory.

Mercosur Resolution 32, approved six years ago, provides that to maintain the status of fully-fledged member of the block, no trade or economic agreements may be negotiated individually with other countries. In reference to this point, Vázquez indicated in the United States that Uruguay had signed a 'free trade agreement with Mexico and Presidents Lula and Kirchner made no move to oppose it. We expect the same treatment vis-à-vis the US.' In the event of opposition to his proposal, the Uruguayan strategy would focus on changing its status within Mercosur, from fully-fledged member to associate member, like Chile and Peru.

The paper mill crisis is still pitting Uruguay against Argentina, with the resulting repercussions on Mercosur's workings. In this regard, one of the possibilities which the Uruguayan government is considering is that President Vázquez might not attend the plenary summit in Córdoba in July. The conflict over the pulp mills has shown up Mercosur's incapacity to resolve internally and through negotiation and dialogue the disputes between its member countries, which have resorted to other means, such as Argentina's unprecedented decision to appeal to the International Court of Justice in The Hague.

As mentioned above, this time Chávez –in addition to announcing Venezuela's withdrawal from the CAN– asserted that the country would enter Mercosur, but 'a new Mercosur', since 'if Mercosur has to die for true integration to be born, then so be it'. He also warned its members that if Mercosur did not undertake a profound restructuring, laying greater emphasis on social issues, it might endure the same fate as the CAN. Although it is true that the volume of foreign trade in Mercosur is larger than in the Andean Community, Venezuela's chances, especially in its manufacturing sector, of competing with Brazil and Argentina are far from evident. Another controversial aspect is the Venezuelan government's head-on opposition to the FTAs, based on the argument that they are neoliberal tools which do nothing to help a country's people. This is the same argument which the Venezuelan government used when it left the G-3, an integration group which emerged in 1989, although it became officially active in 1995.

In regard to the FTAs and Mercosur there are two major issues to consider. First, the provision in the Mercosur bylaws preventing its members from negotiating free trade agreements individually. This means that it must be the block which negotiates on behalf of its members. And while Venezuela is not yet a fully-fledged member of Mercosur, since it must first bring its legislation into line with the provisions of the block's various agreements, fast-track procedures for full membership are already beginning to yield rewards. Consequently, the question raised now is what will happen if the Doha round of WTO talks concludes and, as a result, negotiations with the EU are unblocked. Who will prevail? Venezuela, which is radically opposed to the agreement, or Argentina, in favour of it? At the same time, it is the known intention of the governments of Paraguay and Uruguay –who feel discriminated against by the larger members of the block, Argentina and Brazil, and who think that they are not receiving all the benefits from Mercosur to which they are entitled– to request authorisation to separately negotiate an FTA with the United States. This would be, on the one hand, a tough blow to the Mercosur philosophy, which always insisted in its talks with both Washington and Brussels on the 4 + 1 formula, and, on the other hand, it would undermine Venezuela's philosophical premises, which oppose free trade. Will Venezuela really be able to impose its will, despite not being fully integrated? Or will the more pragmatic position of Brazil and Argentina (who will not want their brainchild dismantled) prevail?

Secondly, it is worth recalling that Chile, which enjoys observer status in Mercosur, has signed 15 FTAs, including agreements with the US, EU, China and Korea (it is currently in the process of negotiating others, among them with India and Japan). The Bachelet

government's relations with Chávez are paradoxical,² since for strategic reasons Caracas has so far decided to maintain good relations with the Chilean President (Chávez has even declared himself to be a fervent 'bacheletist'), leading him to tread carefully over any criticism of the agreements Chile has signed. What will happen when Venezuela becomes a full member of Mercosur? Will it demand Chile's withdrawal or, on the other hand, will it relinquish its place in the block in view of the fact that there are already countries with FTAs signed? In the same situation as Chile –an associate member of Mercosur– are Colombia and Peru, whose FTAs were theoretically what drove Venezuela out of the CAN.

Lula's position in regard to the international role of Brazil is quite clear. That is why he said that countries must avoid 'making ideology out of our political and trade relations'. And while Argentina and Brazil did not openly oppose Chávez's stance against the FTAs, at the various meetings between leaders and between Chávez, Lula and Kirchner, there were moments of tension deriving from this situation. Lula even told Chávez, during the Puerto Iguazú meeting on 4 May, three days after the announcement of Bolivia's decision to nationalise its hydrocarbons, that Chávez was harming not only the South American gas pipeline project, but also regional integration itself. According to Marco Aurelio García, Lula's main foreign policy advisor, Brazil is not in favour of dismantling Mercosur. Not only that, the Brazilian Foreign Affairs Minister, Celso Amorim, during a Senate hearing to account for the measures implemented by his government in relation to the Bolivian situation and the manner in which Brazilian interests were affected, stated firmly that 'Mercosur does not have to adapt to Venezuela, it is Venezuela which has to adapt to Mercosur', since, otherwise, no agreement will be reached.³

In the wake of Venezuela's announcement of its withdrawal from the CAN, at a mini presidential summit, and in view of the subsequent events –which are all somehow interlinked–, there was a significant increase in the number of meetings (bilateral and multilateral) between South American presidents, and a flurry of ministerial trips. This is a clear indication of how serious the situation is, above and beyond the good-natured smiles at photo sessions, and proves the impact of Venezuela's exit from the CAN. On 24 April, Lula met President Uribe, and although the meeting had long been scheduled (initially it was to have been held on 7 March), it enabled Uribe to ask for Lula's mediation with Chávez and to request that he prevent the CAN's break-up. Lula later received a visit from Kirchner and the very next day both leaders met Chávez. Then came the Havana Summit (Castro, Chávez and Morales) and the many informal meetings during the EU-Latin America and Caribbean Summit in Vienna. And the final touch was President Chávez's visit to Bolivia, together with Cuban Vice-President Carlos Lage, to launch a barrage of cooperation projects, clearly evidencing the increasingly central role which Venezuela is playing in Bolivia, a country that was previously off limits to it.

The meeting in São Paulo between Presidents Lula, Kirchner and Chávez served not only to discuss the continental gas pipeline mega-project, but also to tackle the CAN crisis and Venezuela's position in Mercosur. To the Argentines and Brazilians, the meeting between Chávez, Morales, Tabaré Vázquez and Duarte Frutos was clear evidence of an incursion into issues which they had hitherto considered their own. At first glance one might say that

² The Chilean vote for renewing the Latin American member of the UN Security Council has divided both the Government and the ruling coalition, the Concertación: while some prefer to maintain their commitment to Venezuela –the leading candidate for the seat–, others would like to find a consensus candidate –better positioned than Guatemala and which would allow a reorientation of the Latin American votes–.

³ The tension between Lula and Chávez flared up during the Mercosur Summit in Córdoba. If previously Lula had decided to cancel a meeting with Chávez in Brazil, on arriving in Córdoba he failed to attend the official dinner, annoyed by the Venezuelan President stealing the limelight. While Chávez claimed that a new Mercosur was emerging, Lula insisted that Brazil and Argentina were the regional bloc's Germany and France, thereby asserting their leadership at the expense of Venezuela.

the current situation contrasts with the one some months ago, when both Lula and Kirchner were anxious to have Chávez as a partner to reinvigorate Mercosur, and especially considering its sizeable oil reserves. However, direct pressure from Chávez on the other Mercosur presidents to accelerate Venezuela's entry into the block has yielded good results and could point to a different scenario. It should not be forgotten, though, that from the standpoint of Brazil and Argentina, with both presidents up for re-election, although at different times (Lula in October 2006 and Kirchner one year later), an open conflict with Venezuela would be suicidal.

However, improving Chávez's relations with Paraguay and Uruguay could be more complicated, in view of these two countries' intention to negotiate an FTA with the United States. Yet, since Venezuela is a new arrival and has only just left the CAN, Chávez may not object too much to the Montevideo and Asunción governments' projects.

From the announcement of Venezuela's plan to join Mercosur, some events have raised concerns in both Brasilia and Buenos Aires, since they could negatively impact on already-strained relations with the United States. First among them was Chávez's defence of the Iranian nuclear programme alongside Cuba and Syria. Chávez not only said that any country was entitled to have access to nuclear technology but that Venezuela would also aspire to it. Indeed, he also opposed moves to address this issue by the Security Council, of which Argentina is currently a member. Secondly, were the pressures (some open, others covert) by Venezuela on other Latin American governments to aspire to a seat on the Security Council. In 2005, Venezuela and Iran signed trade, industrial and agricultural cooperation agreements as part of their closer bilateral relations. Although this is not called into question by Brazil and Argentina, what is not clear is the nuclear aspect of the programme. Thirdly, Chávez's increasing radicalism, plus his strengthened presence in Bolivia, have caused alarm bells to sound in Itamaraty and San Martín –the Foreign Ministries of Brazil and Argentina, which had promised Washington they would try to moderate Chávez–. An example is Chávez's threat to blow up all Venezuela's oil fields in the event of a US invasion.

Questions Arising from the Nationalisation of Bolivian Hydrocarbons

Bolivia, Venezuela and Cuba

One of the main results of Venezuela's withdrawal from the CAN was a strengthening in relations between Bolivia, Cuba and Venezuela. Following Morales' election in December 2005 and his visits to Havana and Caracas, the ties between Cuba, Venezuela and Bolivia could be seen to get stronger, and the signing of the *Tratado de Comercio de los Pueblos* or TCP (People's Trade Treaty) only served to reinforce this course. Venezuela's presence became more evident, starting with the PDVSA (the *Petróleos de Venezuela* oil company) technicians and their red uniforms, as well as a good number of Venezuelan military personnel, also in uniform, who move around Bolivia with complete freedom.

The TCP was signed in Havana on 29 April, and although it is a euphemism to avoid speaking about free trade, the Treaty is a free trade agreement which makes it possible to sell Bolivian products to the other two countries with zero tariffs, plus some cooperation clauses, such as selling Venezuelan fuel at subsidised prices and sending Cuban doctors and teachers to Bolivia. The question is why the TCP was signed at that time. In a way, there was a desire to convince Morales to reduce his criticism of the crisis created by Venezuela's withdrawal from the CAN, and to guarantee him alternative markets for his products. The fundamental issue is whether, beyond the promise made by Castro and Chávez to buy coca and cinchona from Bolivia, it will be possible to replace the Andean markets which are central to the country's exports. Morales' bid to relaunch the CAN and the Andean request, at the bidding of Bolivia and Ecuador, to ask the US to renew the

Andean Trade Promotion and Drug Eradication Act (ATPDEA) clearly point to an answer in the negative.

Exports of Bolivian soy to Colombia could be affected by the FTA with the US, whose soy could replace Bolivian soy in supplying the Colombian market. Uribe promised to compensate Bolivia for the losses from the agreement with the US but Morales decided on the Venezuelan solution and asked producers in Santa Cruz, who were the most concerned about this measure, 'not to worry about your soy, we have a market... Venezuela is committed to buying all [our] soy' in transactions outside the CAN. The question is whether the Venezuelan market has the capacity to absorb that amount of soy. Equally, Morales also showed his confidence in the Asian and African markets.

At the same event in Havana, Bolivia also made evident its commitment to ALBA (Bolivarian Alternative for the Americas), an undefined project close to Chávez's heart. It is plausible that at this summit, attended by Daniel Ortega, the basis was established for the announcement made on 1 May regarding the nationalisation of hydrocarbons. It was no surprise as the Minister for Hydrocarbons and the Vice-President, García Linera, insisted on its rapid implementation, but contradictions within the Government prevented it from coming to fruition. At that time the Venezuelan investments in the Bolivian energy sector must have been cleared. And although Morales might have been satisfied with the promises made by Chávez, we will have to wait and see how they materialise, in view of other promises which have ended only in unfulfilled projects.

During the electoral campaign for the Constituent Assembly, the main opposition force, *Podemos*, tried to make a central theme of Venezuela's massive presence in Bolivia although it lacked the impact it had in Peru and, to a lesser extent, in Mexico. This presence is defined as open interference by the opposition and as cooperation by the Government. According to an opinion poll run by the Apoyo, Opinión y Mercado company in July 2006, 51% of Bolivians think that Chávez is interfering in national affairs whilst 41% consider that he is cooperating. Forty-eight percent of those interviewed indicated that they did not like the situation and 38% approved of it. The Venezuelan presidency receives the highest level of rejection in Santa Cruz, where 69% consider it to be interfering. The opinion poll was carried out in a month which saw an 'intense Venezuelan presence': a visit by Chávez (including the broadcasting of *Aló Presidente*, Chávez's weekly talk show) and the signing of a number of bilateral agreements.

The Nationalisation of Hydrocarbons

Energy has become a central issue in Latin America's integration process although question marks are arising with regard to the way in which energy integration is developing despite the fact that the region is, in general terms, a net fuel exporter. The Secretary General of ECLAC, José Luis Machinea, said that Latin America has not been able to 'construct a system of energy integration', unlike Europe (despite its problems). Neither has it been able to 'create an energy map' as Europe has, nor are there common energy regulations among Latin American countries. In his opinion, 'it is going to be very difficult to move forward in the process of energy integration in Latin America in the short term, and in any event what can be hoped for are bilateral agreements and the consolidation of agreements between Bolivia and Argentina and Bolivia and Brazil'. To cap it all, according to his viewpoint, there is a great risk of matters being politicised.

The last event on the geopolitical game board in the region was the Bolivian Government's Supreme Decree to nationalise hydrocarbons. In São Paulo President Lula asked Chávez to intercede with Morales with regard to what he believed to be a systematic attack on Brazilian interests. These fears were confirmed by the nationalisation decree which affects both Petrobras and Brazil's gas supply. Hence the tough Brazilian reaction, both from Petrobras and the Government, and the urgent presidential summit in

Puerto Iguazú (Province of Misiones, Argentina), with Lula, Kirchner, Morales and Chávez. The absence of Tabaré Vázquez, who has a dispute with Kirchner over the construction of two cellulose plants, was a surprise. The surprise reinforced Vázquez's announcement regarding the possibility of withdrawing from Mercosur. When the summit was held, Vázquez was at a meeting with Bush and one of the themes on the agenda was the expansion of bilateral trade and the signing of the Investment Treaty between the two countries, delayed by the US Congress. This is a step prior to the signing of an FTA, a step which Uruguay is at present not going to take as its Government does not want to take the first step towards destroying Mercosur, hence its caution. Its strategy is to try and obtain, in the not-too-distant future, permission from Mercosur's members, particularly Argentina and Brazil. For this reason it will be interesting to see Venezuela's position, in view of its arguments for leaving the CAN.

There was clear electoral motivation behind the nationalisation decree, as it was a message directed to the MAS's (Movement for Socialism) voters and grass-roots supporters in the midst of the campaign for the Constituent Assembly. However, its effects did not stop there. They had direct repercussions on the energy sector and also on the Bolivian Government's relations with the oil companies present in the country, starting with Petrobras and Repsol. They also affected foreign relations, particularly with Brazil and Argentina, the two largest markets for Bolivian gas. The Morales Government's plan to increase the price of gas created tensions with the country's neighbours, and although these were resolved in the case of Argentina, they still exist with Brazil. The supply of gas to Brazil and Argentina was guaranteed by Vice-President García Linera, although at new prices. Bolivia exports 24.3 million cubic metres of gas to Brazil each day and between 4.5 and 5 million cubic metres to Argentina. Just over 50% of Brazil's gas and 75% of the gas consumed in São Paulo, the country's industrial power-house, comes from Bolivia. Of the 44 million cubic metres produced each day by Bolivia, 30 million go to Brazil, which at the time of nationalisation paid around US\$3.23 per million BTU (British thermal units), and Argentina, which paid US\$3.18. However, in the medium term, Brazil has a clear strategy to achieve full self-sufficiency with regard to gas, something which would be a tough blow for the Bolivian coffers.

The Negotiations with Argentina

Argentina was first to make an agreement with Bolivia following long and complex negotiations, and will pay US\$5 per million BTU instead of the previous US\$3.18, a 56% increase. This is the highest price paid for gas in South America and will apply until the end of 2006 when it will be revised using an updating formula to be established by the two governments. The price increase will enable Bolivia to raise an additional US\$70 million by the end of the year. However, the agreement gave rise to some tension in Bolivia, particularly in Santa Cruz and Tarija, the two main hydrocarbon production centres, where civic committees rejected a clause in the agreement because it appropriates 'the departmental operating fees and all the resources generated by the 32% direct tax on hydrocarbons' (*Impuesto Directo a los Hidrocarburos* or IDH). They fear that the central Government will appropriate a large proportion of the profits from the exportation of gas and that if the agreement serves as a basis for negotiations with Brazil, to which they export five times as much, the appropriation will be five times greater.

The agreement, should both parties fully observe it –which remains to be seen– should build up confidence and make the consumption of gas in Argentina more predictable, although this depends on other variables such as private and state investment in prospecting. From the regional point of view, the agreement should reduce the risk of renewed cuts of Argentine gas to Chile, at least in theory. Given the disputes between Chile and Bolivia, Argentina should not re-export Bolivian gas to the Chilean market. From the Argentine point of view, the agreement with Bolivia can be seen as an attempt by President Kirchner, in coordination with Lula, to limit Venezuelan influence in Bolivia. Yet

for this to occur, a number of conditions will have to be met. First of all, Morales will have to agree to change his sources of aid and, above all, aid must indeed come from Argentina and not just remain at the rhetorical stage. It is also necessary for Argentina to keep its distance from Chávez, but in view of the declarations made by Kirchner and the planned issue of the Bono del Sur, backed by Venezuela, it will be fairly difficult for this to occur.

The agreement seeks to define some lines of future action. Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) will become a partner of Enarsa (the Argentine national energy company) in the construction of the gas pipeline to north-eastern Argentina (*Gasoducto al Nordeste Argentino* or GNEA) which will be 1,500 km long and will supply Bolivian gas to eight Argentine provinces. The limit of 7.7 million cubic metres per day set in 2004 will be maintained although there are plans for an increase of a further 20 million cubic metres to feed the pipeline in the next 20 years, as well as for the construction, with Argentine credit, of a gas industrialisation plant. The construction of the pipeline will take two and a half years with a budget of around US\$ 1 billion to be covered by an international tender, but it is in the financing that part of the problem lies. The wilful interpretation of the two Governments, which has of late been omnipresent in all of these issues, assumes that the external financing needs can be easily covered, as far as both YPFB and Enarsa are concerned. The Bolivian authorities' response is symptomatic. They say that on the one hand YPFB has the full capacity to construct the gas pipeline but that it will not be the state company or the Bolivian Government which will invest the necessary capital. For this reason they hope, as with all other gas pipelines constructed by Transredes, to obtain external financing, although pipelines built in this way were constructed before the nationalisation decree. The authorities in both countries have decided to link the project to the southern gas pipeline (*Gasoducto del Sur*) plan, the overambitious project promoted by President Chávez and which theoretically should guarantee the supply of gas for the whole of South America with a main branch of 8,000 km from Venezuela to the south of Brazil and Argentina.

The Disputes with Brazil

The Bolivian Government wants the agreement with Argentina to be a sign to negotiate with Brazil on the price of gas. However, the Brazilian situation is special: it imports a higher volume; investments made by Petrobras more than exceed the insignificant level reached by Argentina; and it demands that the price updating system included in the contract signed by both parties be in force. Lula's Government believed that Morales would never take a unilateral decision given Brazil's importance for Bolivia's GDP. In 1991 Bolivia exported US\$30 million to Brazil in contrast with the current US\$700 million. The increase basically centres around the GasBol gas pipeline which was built seven years ago. Although the gas supply is guaranteed, there are serious problems. 'Brazil is the hen which lays Bolivia's golden eggs' and Morales only 'wants to increase the size of the eggs', said a Petrobras manager. For Bolivia, integrating its economy with Brazil was a clear strategic option which would have driven its growth. Lacking direct access to the sea, the production of energy, raw materials, consumables and manufactured goods for the large Brazilian market was something which was within reach and which Evo Morales' Government has blown away in a single stroke. It will be difficult for Brazil to increase business again with a partner as unreliable as Bolivia.

Relations with Brazil have reached a deadlock, proof of the current crisis and something which was unthinkable a few months ago. From a historical point of view, it is impossible to understand Morales' turnabout with regard to Brazil. The only plausible explanation is linked to constant references to the 500 years of colonial exploitation that condemned Bolivia to poverty. Taking the argument to an extreme, Brazilians are the new *conquistadores*, the local imperialism, determined like the US to suck the country dry. Yet the conflicts with Brazil do not stop at energy issues. Some of the large landowners and

main soy producers in the country's eastern departments are Brazilian or of Brazilian origin. Those who have property less than 65km from the border, something which is forbidden by Bolivian law, are directly threatened by the Government, as are those further from the border whose properties may be affected by an indiscriminate agricultural reform which could put an end to a large proportion of soy exports.

There is also the case of the MMX mining company, a subsidiary of the Brazilian iron and steel giant EBX, which has been invited to leave Bolivia, although the withdrawal has not been fully implemented.⁴ Here, two explanations converge. On the one hand, there is environmental destruction, as the MMX project wanted to use charcoal which would have destroyed a good part of the nearby forests. This being a strong argument, it should not have been difficult to convince the company to use an alternative energy source. The other explanation lies in the ban on building foreign factories less than 50km from the border. This conflict was not unrelated to the incorporation of the Minera del Sur (Minensur) company by Bolivia and Venezuela to exploit Bolivian iron deposits, and particularly the El Mutún deposit. The international tender process sponsored by the previous Government to exploit the El Mutún deposit was postponed on two occasions by the current administration, as the State's participation in the whole process was not guaranteed. The end result was that the number of bids was reduced to two: those made by Jindall Steel and Mittal Steel respectively, both with Indian capital, after the Argentine company Siderar abstained from making a bid. As Mittal was disqualified in the presentation stage of proposals, the project was awarded to Jindall.

Lula's initial support for Morales suggested a deepening in bilateral relations which would be beneficial for Bolivia. However, since the nationalisation of hydrocarbons, the conflicts have deepened, leading to the current uncertainty, no matter how hard Brazil tries to keep up appearances and its support of Bolivia. Lula refused to meet Morales in Caracas when they both attended the ceremony of Venezuela's admission to Mercosur. Morales wanted to negotiate the increase in the price of gas at the highest level, thinking that the friendship between the two would oil the negotiations. Lula was very hard and told the press that he had not gone to Caracas to discuss prices as that was why technical commissions exist. This proves Brazil's anger with the Bolivian Government, and Lula's in particular, and their intention to do nothing to improve things given the policy of self-sufficiency which Petrobras is aiming for with new and substantial investments in the Santos maritime area. Petrobras, which invested over US\$1.5 billion, will not invest in Bolivia in spite of its plans to develop production fields and to cooperate in gas industrialisation with a petrochemical complex in Puerto Suárez and a thermoelectric plant. Petrobras called the nationalisation of hydrocarbons 'unilateral' and the Minister for Mines and Energy called it 'unfriendly'. Later, however, the Brazilian Government lowered the tone of its protests and in an official communiqué said that, 'The Bolivian Government's decision to nationalise its underground riches and to control their industrialisation, transport and commercialisation is recognised by Brazil as inherent to its sovereignty'.

After agreeing on US\$5 per million BTU with Argentina, YPFB suggested to Petrobras that it raise its price. While Bolivia wants to reproduce the scheme of negotiations between governments, Brazil, which is holding its position firm, is committed to bringing the technical commissions together. Petrobras and the Brazilian Government insist that the signed contract is valid, according to which the new rate should increase by 10%. From this point of view, the Brazilian authorities point out that they had already agreed to pay US\$4 from 1 July and that they do not consider the US\$5 agreed on with Argentina as a reference since their contract is different, being valid for twenty years and expiring in

⁴ There has been some speculation about the possibilities of reaching an agreement with Evo Morales' Government once the elections for the Constituent Assembly are over.

2019. For its part, YPF specifies that the agreement sets out that every five years, a period which ended in 2004, any party may suggest modifying prices. The technical negotiations are at a standstill and there are no indications that they are to resume, except that Brazil has formally communicated that it will not accept an increase outside the current contract. Regardless of these matters, another storm front threatens, as Petrobras Bolivia Refinación wants to increase the price of the fuels it delivers to YPF.

Chile, Argentina and Bolivia

The effects of nationalisation in the region do not end in Brazil and Argentina, as it has regional repercussions, starting with the natural gas supply to Chile which comes solely from Argentina. Chile, with its open regionalism, is seeking to diversify its sources of supply, increasing liquid gas imports for which it already has a sufficient infrastructure. It would also like to import gas from Peru or Bolivia although the latter possibility implies a three-way diplomatic agreement due to the legacy of the War of the Pacific which conditions Bolivia's demand for access to the sea. The Chilean Foreign Minister, Alejandro Foxley, showed his concern about the reach of Bolivian hydrocarbon nationalisation by pointing out that he questioned the existing 'schemes of integration'. The recent measure taken by the Argentine Government to increase the price of fuels in border areas for foreign lorries and cars demonstrated not only the growing difficulties which the Argentine authorities are facing in the field of energy supply, but also the Chilean government's irritation at the measure.

Chile fears that the increase in the price of Bolivian gas to Argentina will have direct repercussions on the pockets of Chilean consumers and will cause inflation to rise sharply. The increase in the price of gas for Chile could reach around 35% (or 100% according to Chilean sources) to compensate for the extra US\$110 million which Argentina has to pay each year to Bolivia. The price for Chile will be greater than that paid by Uruguay and Brazil (the current US\$3.40 per million BTU will increase by 10%). Foxley has warned that if the situation persists, 'economic and employment growth in the whole of Latin America' will decrease. Chile will have no alternative but to accept an increase based on a tax on natural gas exports, 'a decision made by the Argentine Government related to local taxes'. The problem for Chile is that given its high level of dependence on Argentine gas, its possibilities for retaliation are limited at present.

The price increase will affect electricity rates. Normally, Chile imports 22 million cubic metres of Argentine natural gas on a daily basis to produce 47% of its electricity. Along the border Argentine gas flows through five pipelines which supply industry and homes. Two months ago, Argentina resumed the cuts started two years ago. These cuts exceed 40% of the gas which Argentina should supply to the Chilean market, in accordance with the protocols signed in 1995 which for this type of situation provide for causes of *force majeure* such as the domestic needs of the supplier country. The main difficulties can be seen in the north of Chile where cuts are at over 80% and are affecting industrial and mining activity.

Because of the existing difficulties and the lack of investment in the Argentine energy sector, Chile is seeking to repair its relations with Bolivia and to regularise its energy supply. This explains the treatment given by President Bachelet to Morales and the efforts being made by Chile to normalise the conflictive relationship. Bolivia still complains about its lack of access to the sea, something for which it holds Chile responsible. During the popular uprising which brought an end to Sánchez de Lozada's Government two and a half years ago, anti-Chilean nationalism galvanised the protests. In July of this year, an important step was taken with the creation by Chile and Bolivia of a Bi-national Commission to analyse 'specific matters' and this will be completed with a meeting of the Deputy Foreign Ministers in August. The arrival of Alan García in Peru, who has already been welcomed in Santiago by President Bachelet, has also opened up new expectations

for an improvement in bilateral relations which will enable Chile to benefit from Camisea gas.

Bolivia and the Future of the CAN

Bolivia has to resolve an important issue regarding regional integration: whether to stay in the CAN or become a full member of Mercosur, of which it is already an associate member. After assuming the rotating presidency of the CAN and despite initial doubts, Morales' Government committed itself to the CAN because if it did not, internal tensions and disputes would increase, particularly in the sectors most dependent on the Andean markets. The presidential summit in Quito was a good test of this despite the 'popular' and ethnicist rhetoric in which the Bolivian delegation tried to coat the final statement. During the Caracas summit, in order to give expression to the admission of Venezuela as a full member of Mercosur, vows were made for the early admission of Bolivia, but Morales was very cautious and said that it was necessary for Bolivia to have a 'deeper' knowledge of the possibilities so as not to venture into something without knowing the benefits of the change. Although he said that there were 'good relations' with Argentina and 'excellent' ones with Brazil, the fundamental issue is to see whether 'they can help Bolivia economically', given the difference in size of their economies and the fact that their priority is to bring the Andean region together as their integration is the foundation 'from which to develop the great unity of South America' with Mercosur.

Bolivia is not the only country interested in maintaining the CAN. Alan García is promoting Andean integration, as shown by his trips to Colombia and Ecuador as well as Chile, which highlights his decision not to travel to Bolivia initially. On 28 July when he took power, the Presidents of the Andean Community met and President Bachelet was invited so that Chile might return to the block which it left in 1978, although it does have observer status. The proposal arose out of García's visit to Bogotá and his meeting with President Uribe in which they agreed to work together to strengthen the CAN and to get Chile to rejoin in order to give it greater solidity and to move forward in the Association Treaty with the EU. However, Chile's reluctance to link itself with a regional scheme of integration which does not have the same low tariffs is almost nil.

After Brazil (where he promoted a strategic alliance with Brazil and the promotion of bilateral relations) and Chile, García went to Colombia and Ecuador with the aim of strengthening the CAN and tightening relations with some neighbours, particularly those who would be most useful in his clash with Chávez. The meeting with Uribe was important for bilateral relations which will maintain the same tone of cooperation reached with Toledo, particularly in the position taken towards the conflict in Colombia. García's gesture, by backing any initiative to end violence in Colombia, is a new setback for Hugo Chávez, the main international backer of García's rival Ollanta Humala: 'I will not allow Peruvian territory to be used against Colombian democracy, nor for it to be used as a corridor for arms trafficking, nor for subversive combatants to rest in'. In Quito García announced his willingness to meet Chávez to normalise diplomatic relations between the two countries, but he criticised him by saying that his withdrawal from the CAN did not correspond to an ideological factor, but rather to his oil revenues which exceed US\$70 billion per year, and he predicted (although this is less probable) that when an Agreement is signed with the EU, Venezuela will return to the Andean block.

García arrived in the capital of Ecuador with a pacifist and integrationist message. He reiterated that Ecuador and Peru had no outstanding issues and emphasised that peace between the two countries guaranteed fraternity for 'ever and ever'. García met President Alfredo Palacio with whom he spoke about matters regarding regional integration and of bilateral interest after he showed his solidarity with the Ecuadorean request to extend the system of tariff preferences with the US. García wants Ecuador to join a regional economic axis with Brazil, Chile and Colombia which will counterbalance Venezuela and

he backed Palacio on two important questions: his turnaround on oil policy including the exit of the US company Oxy, and the request that the US extend the preferences to the ATPDEA and resume negotiations to sign an FTA.

Peru is trying to position itself on the world market following the Chilean model. It is looking towards Chile as a complementary economy: it profits from the bilateral trade balance and receives significant investments. The two see each other as partners for entering Europe and Asia. The rapprochement between Chile and Peru could also strengthen a Pacific block in which Bolivia and Ecuador appear to be isolated. Bolivia's priorities as regards institutional reform and the energy issue distance Morales from the US agenda of free trade and bring him closer to Mercosur, but at the same time they leave him in a difficult position with regard to Chile and Peru. However, there are large differences between Bolivia and Ecuador, as well as in their individual trade relations with the US and Peru and Colombia.

The CAN summit in Quito was used by Bolivia and Ecuador to request the backing of their Andean partners to get the US to renew the ATPDEA granted to the Andean countries as part of the aid given for the fight against drug trafficking. For Bolivia and particularly for craft production in El Alto and other exportable manufactured goods, it would be a great blow if the preferences are not resumed. Bolivia exports manufactured goods to the US which are difficult to place on other markets. Vice-President Álvaro García Linera insisted on extending the ATPDEA for one year until the Constituent Assembly establishes which trade agreement should be signed with the US as he is not convinced by the format of the FTA. This is where one of the problems lies with Bolivia, because it tries to create trade relations with the US on ideological premises, which are difficult for Washington to accept. For their part, business people are requesting an extension of the ATPDEA. According to a senior Bolivian business leader, 'The FTA has failed us because we saw the FTA as a continuation of the ATPDEA. Thus the political will of the last two Governments has failed us'.

Finally, Morales' Government completed the complicated process of appointing its Ambassador to Washington and the US government accepted the appointment of the journalist Gustavo Guzmán as Ambassador. Guzmán, in tune with his Government, believes that Bolivia can be a good trade partner for the US without distancing itself from Hugo Chávez. At the same time, Philip Goldberg was appointed US Ambassador to La Paz, an announcement which enabled the Bolivian Government to insist on its belief that bilateral relations can improve, although without indicating what they themselves will contribute.

Following the arrival of Morales, the bilateral agenda became complicated with a number of controversial points –apart from the ATPDEA–, such as Bolivia's relations with Venezuela and the programmes to eradicate coca and the fight against drug trafficking. The new Government's particular vision, which is in favour of boosting the traditional use of coca, does not help improve relations with Washington. Another controversial theme is the request for the extradition of former President Sánchez de Lozada who Morales wishes to try for murder. According to Guzmán, the Bolivian Government promised to eradicate 5,000 hectares of coca by the end of the year if the US is to extend the ATPDEA. The Bolivian offensive includes a trip to Washington by Vice-President García Linera, the date of which is yet to be confirmed. To add further lustre to the trip, the Government obtained a national agreement with representatives of exporters and Congress. The main achievement was the unanimous resolution made by Congress to send a letter to US politicians to extend the ATPDEA as the periods are getting shorter. The US Congress has a tight schedule up to the end of the year: the legislators have a summer recess and in September will start the electoral campaign for the November elections for the House of Representatives and one third of the Senate. In June the

Secretary General of the CAN, Allan Wagner, headed a high-level delegation to Washington where he met members of the US Executive and Legislative. Wagner said that there had been significant achievements with regard to the fight against drugs, one of the conditions for the tariff preferences.

Conclusions

Venezuela's decision to withdraw from the CAN has impacted on the entire network of South American regional integration, undermining the Andean Community itself and evidencing some of the limitations and contradictions of Mercosur. Consequently, the doubt remains as to whether Chávez really is in favour of Latin American unity, as he constantly insists, or whether, above and beyond the content of his speeches, he is becoming an objective disintegration factor. The situation has become so complicated that Marco Aurelio García, President' Lula's main foreign policy advisor, has publicly declared that his country does not want a cold war climate in Latin America, a climate which, according to him, is being propitiated by Venezuela's actions abroad.

It is very significant that the events sparked by Venezuela's withdrawal from the CAN and compounded by the Havana Summit and the hydrocarbons nationalisation decree in Bolivia are also accentuating the contradictions between Brazil and Venezuela. If this continues, there could be a tough battle to secure leadership of the region and this could be a serious obstacle to the Bolivarian project. This would be an unequal fight, in which Chávez has a fistful of oil dollars but a hugely polarising foreign policy, whereas Lula has all the support of his Foreign Ministry, despite the difficulties of not wanting to invest in regional leadership. Consequently, we will have to wait and see if the repercussions of the political move by Hugo Chávez could be to strengthen the CSN, albeit at the price of undermining Brazil's power in South America. Above and beyond its impact on the integration processes, it is also worth asking how all of this is likely to influence electoral outcomes in the region. In the clash between Brazil and Venezuela –or between Lula and Chávez– Cuba's role will certainly not be insignificant, as became evident at the Mercosur Summit in Córdoba, Argentina.

Hugo Chávez's decision to take Venezuela out of the CAN came at the same time as his announcement of a fast-track incorporation into Mercosur. However, in his bid to accommodate the various different regional integration projects in Latin America to his own ideological position, his proposals have a certain foundational air about them. He has talked of creating a new Mercosur if necessary, and his intention to launch a Bolivian Andean Confederation to allow the political, economic, social and 'even military' integration of Bolivia, Peru, Ecuador and Venezuela should be seen in the same light, although from his standpoint the future of Colombia is not clear. A similar problem arises with South American Unity (*Unidad del Sur* or *Unasur*), since no-one has yet clarified whether it is compatible with the South American Community of Nations. All of these moves by Chávez should be examined as part of his attempts to change, by his own admission, the geopolitical map of Latin America. For this purpose, he prefers the so-called 'Southern Cross', whose vertical axis would be Caracas-Buenos Aires and whose horizontal axis would be La Paz-Brasília. For now, faced with all these initiatives, starting with Venezuela's entry into Mercosur, even stretching legal deadlines, the governments of Argentina and Brazil have opted for a *laissez-faire* approach. The main question now is what they hope to gain from this policy, which threatens to undermine real and potential leadership positions in the Southern Cone.

Despite Venezuelan attempts to make energy and energy cooperation a privileged field to boost regional integration in Latin America, it can be seen that at present efforts are not producing the expected results. Furthermore, in the same way that bilateral conflicts have emerged with other aspects concerning regional integration (see *The Increase in Bilateral*

Conflicts in Latin America: Its Consequences In and Outside the Region, ARI 61/2005), energy is a field which has also been affected. Negotiations between Brazil and Bolivia with regard to the price of gas are at a complete standstill. Argentina and Chile still cannot find the most suitable tone to deal with problems which have recently been made worse by Argentina's intention to charge foreign lorries and cars more for fuel at the border, something which harms Chilean hauliers enormously and has led Bachelet's Government to toughen its position.

In addition to these matters, we have to add the possibility that in the next few months competition between PDVSA, Petrobras and Pemex will increase in their dispute to obtain new partners and new areas to increase their business which, at times and depending on the situation, is dressed up as energy cooperation projects. Lately the number of energy projects which require considerable investment has multiplied, although many of them simply remain on paper and end in failure, as occurred with the opportunity for cooperation between PDVSA and Petroecuador. And although the profitability offered by high oil prices is a good incentive, we will have to wait and see how many of all these projects are carried out in the end. Will Venezuelan capital and the Venezuelan guarantee be enough to cover all the region's needs and to reduce the distrust of some investors with regard to the increasingly state-centred drift of a number of Latin American governments? It really looks as though the large southern gas pipeline, Hugo Chávez's most beloved project, will remain on paper, and it is perhaps the best example of the fate which some of the current energy projects could suffer.

In the case of Bolivia's rapprochement with Venezuela there exist many question marks regarding the advantages in terms of growth and development –in decline from the rupture with Brazil– which the new rapprochement can bring. Everything seemed to indicate that Bolivia's economic growth was indissolubly linked to Brazil and its possibilities for expansion. In the last few years numerous Brazilian companies, starting with Petrobras but not ending there, as well as agricultural producers, have gained a presence in Bolivia. The nationalisation of hydrocarbons in Bolivia ended the honeymoon with the Brazilians and the question which arises is what Bolivia gains from its punishment of the local operator, beyond the fact that the agreements with Venezuela are from one country to another and the presence of private companies will be rather limited. PDVSA's know-how for the exploitation of gas is appreciably lower than Petrobras's and it lacks Petrobras's more than highly regarded record. It will be interesting to see how the negotiations between Petrobras and YPF to set the price of gas exported to Brazil by Bolivia develop because if they do not reach an agreement, the big question is what Bolivia will do with all the gas which it can only sell to Brazil through the already constructed gas pipelines. Will it have the capacity to attract the necessary investment to sell the gas, after liquefying it, to markets further afield? How will it compensate for the enormous fiscal losses which would arise if it can no longer count on the Brazilian market?

Carlos Malamud
Senior Analyst, Latin America, Elcano Royal Institute