

# **An analysis of the impact of Argentine membership of Mercosur**

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## **RESUMO**

O Mercado Comum do Cone Sul (MERCOSUL) estabeleceu-se entre Argentina, Brasil, Uruguai e Paraguai em 1991 e passou a existir formalmente em 1995. Desde então, tem-se realizado progressos significativos em termos de redução de tarifas entre os países membros e o estabelecimento de uma tarifa externa comum. Como resultado, ocorreram mudanças significativas no volume, na direção e na composição de mercadorias dos fluxos de comércio. Este artigo procura examinar a filiação ao MERCOSUL da perspectiva argentina. Faz-se uma análise do efeito da reorientação do fluxo de comércio da Argentina na direção de seus parceiros no MERCOSUL e as mudanças decorrentes nos níveis de comércio intra-indústria. São discutidas as implicações, para a Argentina, das novas filiações da Bolívia e do Chile, bem como dos acordos internacionais com outras regiões. O impacto da estrutura institucional do MERCOSUL é avaliado, sendo apresentadas nas conclusões as questões que provavelmente afetarão o futuro progresso do processo de integração e a perspectiva da Argentina sobre tais questões.

**Palavras-chave:** Argentina, Mercosul, comércio.

## **ABSTRACT**

The Common Market of the Southern Cone (Mercosur) was established between Argentina, Brazil, Uruguay and Paraguay in 1991 and formally came into being in 1995. Since then, significant progress has been made in terms of tariff reductions between the member countries and the establishment of a common external tariff. As a result, notable changes have occurred in the volume, direction and commodity composition of trade flows. This article seeks to examine the impact of Mercosur membership from the Argentine perspective. An analysis is made of the effect of the reorientation of Argentine trade flows towards its Mercosur partners and as a consequence changes in levels of intra-industry trade. The implications for Argentina of the new associate members of Bolivia and Chile and newly concluded trade accords with other regions are discussed. The impact of the institutional structure of Mercosur is also assessed, and issues that are likely to affect the future progress of the integration process and the Argentine viewpoint on these matters are presented in the conclusion.

**Key words:** Argentina, Mercosur, trade.

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## Introduction

Mercosur, the customs union between Argentina, Brazil, Uruguay and Paraguay, was established in 1991 with the Treaty of Asunción. The objective of the treaty was to provide for the establishment of a common market between the member countries, with free movement of goods, services, capital and labour. The Treaty marked the beginning of a transition period which continued until January 1995, when the trade block formally came into being. During the transition period, the member countries carried out an ambitious agenda, including a program of reductions in tariff barriers, which led to tariff levels of zero for 90 per cent of intra-regional trade by 1995 and a commitment to progressively phase out the remaining 10 per cent by the year 2000. A common external tariff (CET) was agreed and was implemented in January 1995 to cover 85 per cent of product categories, with an average level of 14 per cent. The Asunción Treaty also provided for the coordination of sectoral and macroeconomic policy, although no specific objectives were set for this or the procedures implemented. The Treaty marked a new period of optimism regarding the benefits of regional integration, while the Mercosur initiative was seen as a complement to the general economic liberalisation process that member countries were carrying out during this period.

The objective of this article is to review the impact and achievements of Mercosur in its initial five years, in relation to Argentina. The first section will examine the regional integration process and the corresponding impact on trade flows, in terms of volume, direction and changes in composition of trade. It is, however, difficult to directly relate changes in trade flows to regional integration due to other inter-related factors taking place at the same time. For instance, increases in trade could be related to general increases in economic growth in Mercosur, trade creation and diversion effects, extended trade augmentation or suppression.<sup>1</sup> The second section addresses changes in intra-industry trade, which is the simultaneous import and export of goods in the same industry, while the third section surveys the implications of the new associate members, Bolivia and Chile. Fourthly, the institutional structure is examined; and finally the important issues affecting the future of Mercosur are assessed.

## The trade liberalisation process

The speed at which Mercosur countries have implemented trade liberalisation measures has been particularly impressive. Tariffs have been phased out for 90 per cent of intra-Mercosur

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1 Extended trade augmentation or suppression occurs through the process of implementing a common external tariff. If tariffs are lower than previously, then trade augmentation will occur, resulting in increases in trade. If tariff barriers are higher than previously, then the process of trade suppression results in a decrease in trade.

trade, while the remaining 10 per cent will be gradually phased out. Argentina and Brazil are scheduled to do this by 1 January 1999 and Uruguay and in Paraguay by 1 January 2000. These exemptions cover products that are particularly sensitive for the countries involved. Argentina for instance, has chosen for tariffs to remain on steel, textiles, shoes and paper, whereas for Brazil, textiles, rubber and wine are still protected. Uruguay has kept tariffs on textiles and chemicals, and Paraguay, textiles, shoes, paper and steel. Interestingly, all the member countries have opted for tariffs to remain on textiles, suggesting that none of them feel they have a comparative advantage vis-à-vis their regional partners in this sector.

With regard to the CET, the 15 per cent of goods that are excluded are mainly capital goods, telecommunication equipment, chemicals and petrochemicals. These sectors will be included in the CET by 1 January 2001, although telecommunications are allowed a longer transition period, with inclusion by 1 January 2006<sup>2</sup>. These exemptions were permitted in order for the countries concerned to have a longer period to adjust to foreign competition or higher import prices. The former applies more to Brazil and the latter to Argentina, Paraguay and Uruguay, who already have lower import duties for these products.

Agreements covering cars and sugar have still yet to be negotiated, and, due to their sensitive nature, will not be included in free trade arrangements until the year 2000, although it is still by no means certain that they will be subject to a CET. Problems in reaching agreements on cars have arisen as a result of the structural differences in the Argentine and Brazilian car industries<sup>3</sup> and in their regulatory frameworks. Nonetheless, a transitional agreement reached on 22 January 1996 between Argentina and Brazil allows for companies located in either country to import vehicles and parts tariff-free from the other, on the understanding that they match such imports with exports.<sup>4</sup> The Mercosur Trade Commission has established a technical committee to put forward proposals outlining the automobile regime, which will come into force by the year 2000.

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2 The maximum CET for capital goods has been agreed at 14% and 16% for information and telecommunication products.

3 In 1995, Brazilian production of cars was 1.7 million a year and Argentine 400,000. Uruguay has a small number of producers and Paraguay none.

4 This agreement resulted from a bilateral dispute in 1995 over automobile import levels. Increases in Brazilian demand for automobiles were being met by imports from producers in Argentina. As a consequence, Brazil felt that trade in automobiles was becoming unbalanced in Argentina's favour.

### **Changes in the geographical composition of trade flows**

Since these trade liberalisation measures were implemented, trade flows between member countries have increased rapidly. Intra-Mercosur exports increased from \$3.6bn in 1990 to \$16.2bn in 1996, an increase of 22.2 per cent a year between 1990 and 1996. (CEPAL, 1997) Although some of this increase in trade can be accounted for by the intra-regional trade liberalisation program, which began in 1991 and continued to reduce tariffs by semi-annual installments, it is unlikely that this would fully explain the huge increase in intra-regional trade by itself. The member countries also experienced economic growth during this period, which would account for part of the increase in trade. Trade creation could be taking place, which involves a shift in domestic consumption from a high-cost domestic source to a lower-cost partner source, as a result of the abolition of tariffs between trade block partners. By contrast, it may be a process of trade diversion which is being observed, i.e., the replacement of imports from a low cost supplier outside the trading block, by a higher cost supplier within the trading block. Alternatively, extended trade augmentation may take place, due to a general lowering in tariff barriers between the four countries, which will encourage trade between them. Lastly, extended trade suppression can result if tariff barriers are higher between the members than before the formation of Mercosur, although this is unlikely to have been the case for Mercosur as average tariff levels have fallen. The formation of Mercosur has played a part in the expansion of intra-regional trade although it is difficult to quantify by precisely how much.

This expansion in trade can be seen in the case of Argentina in Table 1. Argentina has not only experienced a general increase in the level of total exports and imports, there has also been a significant geographical re-orientation of trade flows towards its Mercosur partners. Between 1990 the year before the introduction of the customs union and 1996, Argentina experienced a rise in total global exports of 92 per cent, as compared to an increase in exports to its Mercosur partners of 331 per cent. At the same time, intra-regional imports increased by 553 per cent between 1990 and 1996 and imports which originate from the rest of the world rose by 463 per cent.

**Table 1**  
**Absolute Levels of Imports and Exports for Argentina, 1990-1996**  
**(millions \$)**

Year	Exports to World	Imports from World	Exports to Mercosur	Imports from Mercosur	Exports to rest of world	Imports from rest of world
1990	12353	4077	1833	875	10520	3202
1991	11978	8275	1978	1804	10000	6297
1992	12235	14872	2327	3755	9908	11117
1993	13118	16784	3684	4214	9434	12570
1994	15839	21590	4803	5147	11036	16803
1995	20963	22162	6772	4511	14191	17651
1996	23732	23731	7907	5722	15867	18040

Source: Ministerio de Economia y Obras y Servicios Publicos Secretaria de Programacion Economica, *Republic of Argentina Economic Report, 1996*, April 1997, Year 6 number 20.

Tables 2 and 3 demonstrate this geographical reorientation of trade flows by percentage share. Table 2 shows that in 1990, 15 per cent of exports were intra-Mercosur; by 1996, this figure had increased to 33 per cent. Correspondingly, the share of Argentina's exports to the North American Free Trade Area (NAFTA) and the European Union (EU) has declined as a percentage of total exports. In 1990, 17 per cent of exports went to NAFTA, whereas by 1996, this share had fallen to 10 per cent. Similarly, in 1990, 31 per cent of Argentina's exports went to the EU, while by 1996 this had declined to 19 per cent.

Imports from Mercosur countries, as shown by Table 3, were already significant in 1990 for Argentina, and their share has increased at a lesser rate than exports, from 21% in 1990 to 24% in 1996. NAFTA's share of Argentine imports changed little, at 25% in 1990 and 26% in 1996, while the EU's share of imports increased from 29% in 1990 to 32% in 1996. This demonstrates that Argentina's imports by geographical area did not experience such large shifts as trade in exports.

**Table 2**  
**Argentina's Exports by Geographical Area, 1990-1996**

	Brazil	Paraguay	Uruguay	Mercosur	NAFTA	EU	Rest of World
1990	12%	1%	2%	15%	17%	31%	37%
1991	12%	1%	3%	17%	13%	34%	37%
1992	14%	2%	3%	19%	13%	31%	37%
1993	21%	3%	4%	28%	12%	28%	32%
1994	23%	3%	4%	30%	13%	26%	31%
1995	26%	3%	3%	32%	10%	21%	37%
1996	28%	2%	3%	33%	10%	19%	38%

Source: International Monetary Fund, *Direction of Trade Yearbook* 1995 and *Direction of Trade Statistics* June 1997.

**Table 3**  
**Argentina's Imports by Geographical Area, 1990-1996**  
**( by percentage of total imports)**

	Brazil	Paraguay	Uruguay	Mercosur	NAFTA	EU	Rest of World
1990	18%	1%	3%	22%	25%	29%	24%
1991	19%	0%	2%	21%	21%	24%	34%
1992	22%	0%	2%	24%	24%	26%	26%
1993	21%	0%	3%	25%	25%	26%	25%
1994	20%	0%	4%	24%	25%	33%	18%
1995	21%	1%	2%	24%	26%	31%	19%
1996	22%	1%	1%	24%	26%	32%	14%

Source: International Monetary Fund, *Direction of Trade Yearbook* 1995 and *Direction of Trade Statistics* June 1997.

Due to these geographical changes in trade flows, concern has been expressed, most notably by Yeats (1996), about the possible trade diversion effects of the Mercosur. In particular, the dramatic increases in intra-regional exports have been identified as a possible source of trade diversion as the sectors in which trade has increased are those in which it is suggested that Mercosur does not have a comparative advantage. These products are capital intensive goods which member countries cannot export competitively to the rest of the world. They are also still protected by higher than average tariff barriers. However, trade diversion occurs when a lower cost supplier outside the customs union is replaced by a higher cost supplier from within the customs union. Thus, what is important in determining levels of trade creation and trade diversion is changes in geographical flows of **imports** rather than **exports**.

In order to have an idea of whether imports from countries outside Mercosur have been displaced by increased imports from Mercosur members, the ratio of Argentine imports intra-regionally and extra-regionally as a percentage of Gross Domestic Product (GDP) is examined in Table 4. The data shows that generally the ratio of total imports to GDP has been increasing since 1990. When this is disaggregated by region, it can be seen that imports from Mercosur as a percentage of GDP were 0.6 per cent in 1990 and 2.0 percent for the rest of the world. By 1996, the figure for Mercosur had increased to 2.0 percent of GDP and for the rest of the world 6.1 per cent. This would suggest less likelihood of trade diversion as the intra-regional and extra-regional shares of imports have both increased and at similar rates.

**Table 4**  
**The Ratio of Argentine Imports as a Percentage of Gross Domestic Product (GDP)**

Year	Total Imports (\$m)	Total Imports as a % GDP	Imports from Mercosur (\$m)	As a % of GDP	Imports from rest of world (\$m)	As a % of GDP
1990	4077	2.6	875	0.6	3202	2.0
1991	8275	4.9	1804	0.7	6297	3.9
1992	14872	6.5	3755	1.6	11117	4.8
1993	16784	5.6	4214	1.6	12570	4.6
1994	21590	7.6	5147	1.8	16803	5.9
1995	22162	7.9	4511	1.6	17651	6.2
1996	23762	8.0	5722	2.0	18040	6.1

Source: Inter-American Development Bank, *Statistics and Quantitative Analysis* 1995. INDEC, *Statistical Yearbook of Argentina*, Vol 11, 1995.

Viner (1950) stressed that in order to assess whether a customs union is beneficial or harmful, it is the relative strength of the trade creation and trade diversion effects which should be examined. Trade creation is the replacement of expensive domestic production by imports from a partner country, thus, what is needed is the trade creation effects to outweigh the trade diversion effects.

### Changes in the commodity composition of trade flows

It is important to assess whether these changes in geographic trade flows have also resulted in changes in the commodity composition of trade. Table 5 presents data on the commodity composition of exports of Argentina to Brazil, Argentina's main trading partner within Mercosur, which, in 1996, accounted for 78% of Argentina's intra-regional exports.

**Table 5**  
**The Structure of Argentina's Exports to Brazil for Selected Years Between, 1990-1996**  
**(by percentage share)**

	Primary products	Manuf. of Agri Origin	Manuf. of Ind. Origin	Fuel & Energy
1990	39	22	39	0
1991	40	23	36	2
1992	43	14	36	7
1993	31	12	39	18
1995	24	18	45	13
1996	22	16	43	19

Source: Ministerio de Economía y Obras Y Servicios Públicos Secretaria de Programación Economía Republic of Argentina Economic Report 1995 April 1996, Year 5. Centro de Economía Internacional, Comercio Exterior Argentino Nov. 1996, Vol 4, N. 10.

The data demonstrate that significant changes in the commodity composition of exports to Brazil have occurred. The data indicate that the share of primary products has declined from 39 per cent to 22 per cent in 1996, while the share of exports of manufactured goods of agricultural origin has also diminished, from 22 per cent in 1990 to 16 per cent in 1996.



Correspondingly, the share of manufactured products of industrial origin rose from 39 per cent of exports in 1990 to 43 per cent in 1996. The most dramatic increase is seen in the fuel and energy sector, which had a zero share of exports to Brazil in 1990, but a 19 per cent share in 1996.

In comparison, the figures in Table 6 show total Argentine export figures for selected years between 1990 and 1996, excluding Brazil. These figures demonstrate that exports to the rest of the world did not follow the same trends as the pattern of Argentine exports to Brazil. The share of primary products in total exports did not alter significantly between 1990 and 1996, unlike exports of primary products to Brazil, which declined. The share of exports of industrially manufactured goods declined from 26 per cent of exports in 1990 to 21 per cent in 1996, whereas exports of industrially manufactured products to Brazil increased. Agro-industrial manufactured exports hardly changed, with a 40 per cent share of exports in 1990 and 43 per cent in 1996, a smaller decline than that for the same category of exports to Brazil. The share of exports of fuel and energy again remained relatively unchanged, with total exports in this sector at 9 per cent in 1990 and 11 per cent in 1996. In contrast, this sector's share of exports to Brazil rose at a dramatic rate during this period.

**Table 6**  
**The Commodity Composition of Argentina's Total Exports**  
**(excluding Brazil) for Selected Years Between, 1990-1996**  
**(by percentage share)**

	Primary Products	Manuf. of Industrial Origin	Manuf. of Agricultural Origin	Fuels and Energy
1990	25	26	40	9
1991	26	23	44	7
1992	26	21	44	9
1993	23	22	44	7
1995	23	26	43	9
1996	25	21	43	11

Source: Ministerio de Economía y Obras Y Servicios Públicos Secretaria de Programación Economía *Republic of Argentina Economic Report 1995* April 1996, Year 5. Centro do Economía Internacional, *Comercio Exterior Argentino*, Nov. 1996, Vol 4, N. 10.

An analysis of the imports of Argentina in 1996 by commodity composition and geographic origin is shown in Table 7<sup>5</sup>. The figures demonstrate that the share of imports of intermediate goods originating from Argentina's Mercosur partners is high at 30.3 per cent, as compared to the shares of NAFTA and the EU at 24.9 per cent and 26.1 per cent respectively. Capital goods, however, are still overwhelmingly imported from outside the region, with Mercosur's share at 16.1 per cent, NAFTA's at 35.8 per cent and the EU's at 32.8 per cent. Also, more spare parts and passenger vehicles are imported from the EU than Mercosur. This demonstrates that Argentina is still heavily reliant on extra-regional sources for its major imports.

**Table 7**  
**Imports of Argentina by Type of Good, 1996**  
**(Millions of US\$)**  
**Relative Share (%)**

	World	Mercosur	NAFTA	EU	Mercosur	NAFTA	EU
Capital Goods	5385	868	1928	1764	16.1	35.8	32.8
Intermediate Goods	7735	2345	1928	2019	30.3	24.9	26.1
Fuels	764	160	66	147	20.9	8.6	19.2
Spare Parts	3800	1227	710	1274	32.3	18.6	33.5
Consumer Goods	3309	809	615	790	24.4	18.6	23.8
Passenger Vehicles	1157	311	167	607	26.8	14.4	52.5
Others	11	2	4	3	18.1	36.4	27.2
Total	22162	5722	5419	6602	25.8	24.4	29.9

Source: Ministerio de Economía y Obras Y Servicios Públicos Secretaria de Programación Economía *Republic of Argentina Economic Report 1996* April 1997, Year 6, Number 20.

<sup>5</sup> The import figures shown in table 7 are calculated as freight on board (FOB). This explains the discrepancy between the total import figures shown here and in previous tables.

## Intra-industry trade

Another way of assessing the degree of integration that is occurring in a region is by measuring levels of intra-industry trade (IIT) i.e the simultaneous export and import of commodities in the same industry. High levels of intra-industry trade would suggest that productive structures are complementary between trading partners, and increasing levels of IIT would indicate gains in terms of specific sectoral specialisation. Studies of the EU have shown increasing levels of intra-industry trade. (Verdoorn, 1960 and Balassa, 1963) The value of total IIT is the value of total trade after subtraction of net exports or imports. This is then expressed as a percentage of each country's combined exports or imports. The resulting index varies between 100, when exports of an industry equal imports and 0 when there is no IIT and there are either exports but no imports or no exports but imports. In order to provide a comparison, the index of IIT in the United States in 1985 for Standard Industrial Trade Classifications (SITC)<sup>6</sup> sections 3 and 5 to 9 were 63.0, for West Germany 70.0, and 81.0 for the United Kingdom. (Globerman and Dean, 1990) Empirical analysis assessing the experience of other regional groupings has demonstrated that industrial adjustment as a consequence of trade liberalisation is likely to be less disruptive if adjustment takes place through intra-industry as opposed to inter-industry specialisation.<sup>7</sup> This is due to the fact that the process of adjustment occurs within firms within the same industry rather than in different industries. Thus, the argument follows that this will lead to lower adjustment costs and fewer changes in income distribution.

Table 8 shows the IIT index of manufactures for Argentina for 1989 and 1995, expressed as a percentage and calculated using the Grubel and Lloyd index of intra-industry trade at SITC 3 digit level, sections 5 to 8.<sup>8</sup>

6 A degree of consensus has emerged in the literature on IIT, that the third digit level of SITC coincides with what is commonly defined an industry.

7 Greenaway and Milner (1983 and 1985).

8 The Grubel-Lloyd multilateral index of a country (I) for an industry (k) is defined in the analysis as follows:  $B_{ik} = \frac{[X_{ik} + M_{ik}] - |X_{ik} - M_{ik}|}{(X_{ik} + M_{ik})} * 100$ . Where X is the value of exports and M the value of imports for (k) an 'industry' at a given level of statistical aggregation.  $B_{ik}$  measures intra-industry trade as a percentage of total trade of industry k in country I. Similarly, the bilateral index of ITT of country I with country j is defined as:  $B_{ij} = \frac{[1 - |S_{Xij} - M_{ij}| / S(X_{ij} + M_{ij})]}{S(X_{ij} + M_{ij})} * 100$ .

**Table 8**  
**Intra-industry Trade Index of Manufactures for Argentina 1989-1995**  
**(as a percentage)**

	Rest of World	Brazil	Paraguay	Uruguay
5. Chemical and related products - 1989	45.6	60.5	0.0	37.9
1995	40	61	2	36.2
6. Manufactured Goods - 1989	25.9	33.6	2.5	25.4
1995	31.7	41	6.1	35.5
7. Machinery and transport equipment - 1989	47.2	69.5	3.1	56.5
1995	15.2	70.4	0.7	57
8. Miscellaneous manufactured article - 1989	28.5	34.1	0.0	47.7
1995	29	60.8	15.6	64.5

Source: Computed from United Nations Comtrade Statistics.

What is striking about the trends in ITT for Argentina is that ITT with the world as a whole has decreased in two categories of manufactured goods, with a particularly dramatic decrease in section 7, machinery and transport equipment. This is due to large increases in imports in this category from the European Union, which have not been matched by corresponding exports from Argentina to the European Union. Section 6, manufactured goods, has increased, while section 8, manufactured goods, has remained at almost the same level. Interestingly, ITT with Brazil has risen in all four categories, particularly in section 8, miscellaneous manufactured articles. Argentina's intra-industry trade with Uruguay has also increased for all manufactured goods, apart from section 5, chemical and related products, which marginally declined.

Paraguay has extremely low levels of IIT with Argentina, although levels increased in all categories apart from section 7. machinery and transport equipment.

This data on IIT demonstrates that between Argentina and its Mercosur partners, levels of IIT are on the whole increasing, and, according to economic theory, this would appear to suggest that the changes in trade flows due to regional integration which Argentina is experiencing are likely to involve less disruption as levels of intra-industry trade are higher than with the rest of the world, and adjustment can take place through intra-industry as opposed to inter-industry specialisation.

## The widening of Mercosur

The members of Mercosur have always professed to follow a policy of 'open regionalism' with expansion as a principal goal. This acknowledges the objective of regional integration as a stepping stone towards full insertion into the global economy. Also, Argentina views future expansion as necessary to act as a counterweight to the economic power of Brazil. (Stevens, 1996) However, there is an inevitable tension between the objectives of 'widening' and 'deepening' and the time framework within which it will occur. Brazil has strongly supported the expansion of the trade block to increase the market size of Mercosur. Argentina, on the other hand, has displayed more caution, arguing that a prerequisite to expansion is the deepening of the integration process between the original members. (Gosman, 1996)

Economic theory also indicates that regional groupings will be more beneficial when they include more countries. This rests on the assumption that the larger, the market the more scope for efficiency gains due to enhanced levels of competition and, more importantly, the likelihood of trade diversion is diminished, as the cheapest supplier of a product is more likely to be inside the trade block than outside. Larger size also brings the possibility of better terms of trade as a consequence of an improved international bargaining position. (El-Agraa, 1994)

Chile became the first associate member, with a free trade agreement that began on 1 October 1996. The agreement allows for 85% of products to be duty free by the year 2004 and with longer time periods for more sensitive products. Chile is an important trading partner of Argentina. In 1996, Chile was Argentina's third largest trading partner, representing 7.4 per cent of total Argentine exports. For Chile, Argentina represented the second largest country by origin of its imports in 1996, with 9.4 per cent of Chilean imports coming from Argentina. The major imports originating from Argentina were petroleum products and chemicals.<sup>9</sup>

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9 Economist Intelligence Unit, *Chile: Country Report*, 2nd quarter, 1997.

Despite Chile being an important trading partner for both Argentina and Brazil and also the main foreign investor in Argentina, the agreement with Chile proved difficult to negotiate. First, Chile's external tariff averages 11% as compared to an average of 14% for Mercosur's CET. Secondly, the Chileans were reluctant to include agriculture in the free trade agreement as they felt they had less competitive advantages in many products vis-à-vis Argentina, although they finally agreed to do so, after receiving a transition period of 18 years.

The benefits of Chilean membership to Argentina derive from potential increases in exports to Chile, further rises in investment from Chilean companies and the demonstration/imitation effects of competing with technologically advanced Chilean companies. (Nofal, 1996) An important outlet to the Pacific is also gained, allowing improved access to Asian markets. In return, the Chileans gain access to an increased market and the corresponding export opportunities.

Bolivia signed a free trade agreement with Mercosur on 17 December 1996, which came into force on January 1 1997. Argentina is an important trading partner of Bolivia, its fourth largest export market in 1996, with natural gas its major export, 92.4 per cent of Argentine imports from Bolivia in 1996. Argentina primarily exported chemicals, and rubber manufactured products to the Bolivian market in 1996.<sup>10</sup>

The first preferential tariff rates were effective as from May 1997, and import duties will be phased out within 10 years for most products, 18 years for sensitive items. (*Buenos Aires Herald*, 19.12.96) Bolivia, like Chile, will be an associate member, becoming a non-voting partner in what has been termed a '4+1' agreement.

The Bolivian government hopes that associate membership will not only provide increased market access, but competition will act as a spur to the business sector to improve its efficiency and competitiveness. In contrast, the business community have voiced fears over what they see as Bolivia's competitive disadvantage, which they believe may lead to unemployment in certain industries. For Argentina, the gains lie in Bolivia's energy sector, which already exports a significant amount of natural gas to Argentina.

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10 Economist Intelligence Unit, 'Bolivia; Country Report, 2nd quarter 1997.

In February 1997, negotiations with the other Andean Pact<sup>11</sup> countries began. The Brazilians in particular regard closer links with Colombia and Venezuela as important in order to encourage growth in the lesser developed regions of the North and Northeast of the country, geographical proximity being an important factor in encouraging agreements with these countries. It is also a reflection of the objective stated by Cardoso to “*expand the sphere of influence of Mercosur in South America and open the way to full continental integration.*” (*Buenos Aires Herald*, 17.12.96) As part of this objective, Menem invited the Central American<sup>12</sup> countries and Panama to open negotiations in May 1996. Argentina and the other Mercosur countries were, however, less sympathetic to Venezuela’s request for membership, due to the economic problems that Venezuela was experiencing.

Mercosur is also seeking an association agreement with the Caribbean Community (Caricom) and talks will begin between the two regional groupings after negotiations with the Andean Pact have finished. It is expected that any agreement would focus on energy, telecommunication, tourism and agriculture.

A Cooperation agreement has also been signed between Mercosur and the European Union. The interregional frame agreement was signed on 15 December 1995. This agreement acknowledges the European Union’s position as one of Mercosur and Argentina’s largest trading partners and a leading investor and therefore aims to consolidate existing ties. The agreement covers a range of issues and broadly aims to achieve more interregional political and economic associations. The agreement represents increased opportunities for trade with the EU and investment flows from European countries. It also provided credibility and international recognition for Mercosur. For Argentina, the agreement was the culmination of a series of unsuccessful initiatives to gain trade concessions with the European Union. More generally, the European Union acts as a balance to the increasing influence of the United States, in particularly after the formation of the North American Free Trade Agreement (NAFTA). For the EU, on the other hand, it was an opportunity to counter American influence in the region.

Disappointment was expressed about the agreement by the Mercosur countries as it did not represent a trade or investment liberalisation agreement. However, the need for future discussions was acknowledged as a prerequisite for commercial accords after the year 2000.

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11 The members of the Andean Pact are Colombia, Venezuela, Ecuador, Bolivia and Peru.

12 The members of the Central American Common Market are Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

Any future discussions would involve negotiation on highly sensitive issues, such as agricultural products, where Mercosur is in direct competition to the EU producers. In particular, Argentina exports products such as beef, wheat and dairy products, which compete directly with the member states of the European Union. Any tariff concessions on these products would conflict with the objectives of the Common Agricultural Policy, which provides subsidies and price support to European farmers. However, the recent possibility of a revised EU budget by 1999 that results in a decrease in agriculture subsidies would provide a more positive environment for negotiations. From the Argentine point of view, an agreement that provides increased access for farm products is essential.

In December 1994, at the Summit of the Americas, the member countries of Mercosur agreed, along with 30 other countries in the Western Hemisphere, to initiate negotiations for a Free Trade Area for the Americas (FTAA) to be completed by 2005. However, since this date, there have been differences in opinions, particularly between Brazil, speaking on behalf of Mercosur, and the United States, on how the negotiations towards the FTAA should proceed. Mercosur favours a gradual approach to talks on tariff reductions, beginning with negotiations on business deregulation and facilitation. Then trade related rules and dispute settlements would be discussed, and only later would tariff reductions be discussed. The rationale for this position is that their economies are not at present strong enough to cope with further tariff reductions. Another concern is that the FTAA is an attempt to weaken Mercosur's strength, a view further compounded by the United States nominating Argentina as a 'close non-Nato Ally' a move which upset both Brazil and Chile.<sup>13</sup> Nonetheless, the benefits to Mercosur of participation in an FTAA depend primarily on the preferential access granted to American markets as, currently, many important products have difficulty entering United States markets.

### **The institutional structure**

Since its beginning, it has been clear that Mercosur's institutional structure would not involve the extensive bureaucratic structure which characterises the EU. Indeed, the objective was to create a minimum of supranational institutions with contact to take place at an inter-governmental level. The protocol of Ouro Preto, signed on 17 December 1994, established the institutional structure of Mercosur as follows:

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<sup>13</sup> This incident was then exacerbated by Menem criticising Brazil's bid for a permanent seat on the UN Security Council. Indeed, Jose Sarney, the former Brazilian President accused Carlos Menem of being an instrument of the US who wished to 'destabilise' Mercosur at the expense of an FTAA (Financial Times, 26 August 1997).



The Council of the Common Market

The Common Market Group

- The Mercosur Trade Commission
- The Joint Parliamentary Commission

The Economic and Consultative Forum

- The Mercosur Administrative Secretariat

The Council of the Common Market, The Common Market Group and the Mercosur Trade Commission are the three main bodies. The Administrative Secretariat is relatively small and provides support to the Common Market Group, while the Joint Parliamentary Commission and the Economic and Consultative Forum are both consultative bodies.

The Common Market Council is composed of the Ministers of Foreign Affairs and Economic Affairs of the four countries and decisions are made by consensus and become binding after ratification by each parliament. The Council meets twice a year and the presidency rotates every six months. The Council has responsibility for political decisions and ensuring that timetables and objectives are met.

The Common Market Group has responsibility for the implementation of the Treaty and decisions taken by the Council, while the Trade Commission administers the common trade policy. A number of working groups have also been established to examine various issues relating to the integration process.

A dispute mechanism has been established under the Brasilia Protocol (1991) if negotiations fail to reach a solution acceptable to all parties. This enables the Common Market Group to obtain expert technical advice and refer the dispute to the Council of the Common Market to adopt appropriate recommendations. However, due the lack of a supra-national court, treaty obligations cannot be enforced upon a member state, while legal enforcement at a national level depends on the interpretation by national courts of Treaty obligations.

As a result, Mercosur's institutional bodies have no powers to force member governments to comply with their rulings. Decision-making is on a consensus basis while officials are representatives of their respective governments and are there to defend their national interests. This has led many commentators to remark that this may lead to future problems due to

differences in national agendas within the member countries.(Bouzas, 1995) For instance, in September 1997, the Argentine Senate overrode President Menem's veto of a law imposing tariffs of 20 per cent on imports of Brazilian Sugar. Also, Brazil, in April 1997, introduced restrictions on short-term import financing. After strong opposition from Argentina, Uruguay and Paraguay, the three member countries were given a temporary exemption.(*Financial Times*, 12 September 1997)

Up to now, disputes have been solved by negotiations between the parties involved. For example, when Argentina introduced a statistical tax<sup>14</sup> in 1992 to control spending and raise revenue, Paraguay and Uruguay were exempted after protesting, although Brazil continued to face the levy.(Bouzas, 1995) Similarly, in April 1995, Brazil, in order to combat a surge in imports and inflationary pressures, raised tariffs on 109 products from 32 percent to 70 percent, while quotas were introduced on automobile imports.(Inter-American Development Bank, 1996) This not only attracted internal condemnation from Brazil's trading partners, but also the attention of the World Trade Organisation, who ruled that it went against Brazil's commitments to trade liberalisation. However, the lack of a dispute resolving mechanism with any legal footing continues to work against the interests of Argentina, and the smaller members, Paraguay and Uruguay, as there is no formal mechanism to protect their interests against the strength of Brazil<sup>15</sup> and its tendency to act unilaterally in trade measures.

It would appear that a prerequisite of the success of future aims of both widening and deepening the Mercosur would require some degree of supra-nationality. Uruguay and Paraguay have been particularly vocal in stressing the need for a Mercosur bureaucracy, while Argentina has more recently begun to emphasize the need for some common institutions. However Brazil has consistently demonstrated its opposition.

## Conclusion

Despite the progress achieved so far in Mercosur, serious issues will need to be addressed in order for regional trade to continue increasing in the future. Harmonisation of policies, in particular, is an area that will have to be addressed. For instance, free movement of goods is an essential prerequisite for a common market. Currently, goods that have cleared customs and

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14 The tax ranged from between 3 to 10% and was a response to a large increase in imports from partner countries.

15 An example of Brazil's often unilateral action on trade and investment policy, was the announcement by Cardoso in December 1996 of fiscal incentives for automobile manufactures who invest in the poorer northern regions of Brazil. This resulted in strong protests by Argentina, Paraguay and Uruguay.(*El Cronista*, 20.12.96).

paid the common external tariff face the further levying of import duties by the importing Mercosur partner. Also, differences in methods of customs valuation defeat the objective of having a CET, and bureaucracy at borders compounds the problem. The harmonisation of intellectual property rights, services, government procurement, air transport, competition policy and consumer protection are all additional issues that are in need of consideration.

The harmonisation of economic policy is another area that will need to be examined. The use of industrial subsidies and incentives by Brazil obviously puts the other member countries at a disadvantage. At the same time, there is a lack of coordination of economic policy between Argentina and Brazil. Both are experiencing similar economic problems, in particular high rates of unemployment, caused by restrictive monetary policy and overvaluation of their exchange rates designed to curb inflation. Therefore, to a certain extent, there is cause for a certain degree of concern as to how these economies will be affected by these factors in the near future and what measures they will put in place to solve them and whether they will be compatible.

At the 11th meeting of the Council of Mercosur, in December 1996, Argentina demonstrated its preference for deepening rather than broadening Mercosur, stressing the need for the inclusion of areas such as services into the free trade agreement in the near future and the harmonisation of regulation on capital movements, labour markets, the environment and energy. Deepening it will not only encourage further integration and increases in intra-regional trade and investment, but will also strengthen Mercosur's position in trade negotiations with other regions, such as NAFTA and the EU. Brazil has indicated its preference for the option of widening, showing less enthusiasm for harmonisation due to its reluctance to give up its ability to act unilaterally.

As this article has outlined, significant progress has occurred in the integration process, with large increases in trade between Argentina and its Mercosur partners. Nonetheless, the extent to which the issues outlined above are resolved will in turn control the speed at which further integration and progress takes place and the degree to which Argentina can reap further gains from regional integration.

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