

PATHS TO REGIONAL INTEGRATION

THE CASE OF MERCOSUR

Woodrow Wilson Center Reports on the Americas • #5

PATHS TO REGIONAL INTEGRATION

The Case of MERCOSUR

Ricardo Rozemberg

Javier O. Tizado

José Botafogo Gonçalves

Alcides Costa Vaz

Roberto Bouzas

Monica Hirst

José Augusto Guilhon Albuquerque

Felipe de la Balze

Beatriz Nofal

Edited by

Joseph S. Tulchin and Ralph H. Espach

with Heather A. Golding

Woodrow Wilson Center Reports on the Americas • #5



**Woodrow Wilson
International
Center
for Scholars**

Latin American Program

WOODROW WILSON INTERNATIONAL CENTER FOR SCHOLARS

LEE H. HAMILTON, DIRECTOR

BOARD OF TRUSTEES

Joseph B. Gildenhorn, Chair; Steven Alan Bennett, Vice Chair. Public Members: James H. Billington, Librarian of Congress; John W. Carlin, Archivist of the United States; Bruce Cole, Chair, National Endowment for the Humanities; Roderick R. Paige, Secretary, U.S. Department of Education; Colin L. Powell, Secretary, U.S. Department of State; Lawrence M. Small, Secretary, Smithsonian Institution; Tommy G. Thompson, Secretary, U.S. Department of Health and Human Services. Private Citizen Members: Joseph A. Cari, Jr., Carol Cartwright, Jean L. Hennessey, Daniel L. Lamaute, Doris O. Matsui, Thomas R. Reedy, Nancy M. Zirkin

WILSON COUNCIL

Steven Kotler, President. Diane Aboulafia-D'Jaen, Charles S. Ackerman, B.B. Andersen, Cyrus A. Ansary, Charles F. Barber, Lawrence E. Bathgate II, John Beinecke, Joseph C. Bell, A. Oakley Brooks, Charles W. Burson, Conrad Cafritz, Nicola L. Caiola, Raoul L. Carroll, Scott Carter, Albert V. Casey, Peter B. Clark, William T. Coleman, Jr., Michael D. DiGiacomo, Sheldon Drobny, F. Samuel Eberts III, J. David Eller, Sim Farar, Susan Farber, Charles Fox, Barbara Hackman Franklin, Morton FUNGER, Gregory M. Gallo, Chris G. Gardiner, Eric Garfinkel, Bruce S. Gelb, Steven J. Gilbert, Alma Gildenhorn, David F. Girard-diCarlo, Michael B. Goldberg, William E. Grayson, Raymond A. Guenter, Gerald T. Halpin, Edward L. Hardin, Jr., Carla A. Hills, Eric Hotung, Frances Humphrey Howard, John L. Howard, Darrell E. Issa, Jerry Jasinowski, Brenda LaGrange Johnson, Shelly Kamins, Edward W. Kelley, Jr., Anastasia D. Kelly, Christopher J. Kennan, Michael V. Kostiw, William H. Kremer, Dennis LeVett, Harold O. Levy, David Link, David S. Mandel, John P. Manning, Edwin S. Marks, Jay Mazur, Robert McCarthy, Stephen G. McConahey, Donald F. McLellan, J. Kenneth Menges, Jr., Philip Merrill, Jeremiah L. Murphy, Martha T. Muse, Della Newman, John E. Osborn, Paul Hae Park, Gerald L. Parsky, Michael J. Polenske, Donald Robert Quartel, Jr., J. John L. Richardson, Margaret Milner Richardson, Larry D. Richman, Edwin Robbins, Robert G. Rogers, Otto Ruesch, B. Francis Saul, III, Alan Schwartz, Timothy R. Scully, J. Michael Shepherd, George P. Shultz, Raja W. Sidawi, Debbie Siebert, Thomas L. Siebert, Kenneth Siegel, Ron Silver, William A. Slaughter, James H. Small, Thomas F. Stephenson, Wilmer Thomas, Norma Kline Tiefel, Mark C. Treanor, Christine M. Warnke, Ruth Westheimer, Pete Wilson, Deborah Wince-Smith, Herbert S. Winokur, Jr., Paul Martin Wolff, Joseph Zappala, Richard S. Ziman

ABOUT THE CENTER

The Center is the living memorial of the United States of America to the nation's twenty-eighth president, Woodrow Wilson. Congress established the Woodrow Wilson Center in 1968 as an international institute for advanced study, "symbolizing and strengthening the fruitful relationship between the world of learning and the world of public affairs." The Center opened in 1970 under its own board of trustees.

In all its activities the Woodrow Wilson Center is a nonprofit, nonpartisan organization, supported financially by annual appropriations from Congress, and by the contributions of foundations, corporations, and individuals. Conclusions or opinions expressed in Center publications and programs are those of the authors and speakers and do not necessarily reflect the views of the Center staff, fellows, trustees, advisory groups, or any individuals or organizations that provide financial support to the Center.

TABLE OF CONTENTS

Preface	viii
Introduction: MERCOSUR at a Crossroads	1
<i>Joseph S. Tulchin and Ralph H. Espach</i>	
PART I. MERCOSUR IN A HISTORICAL CONTEXT	
MERCOSUR: Between Skepticism and the Relaunch	17
<i>Ricardo Rozenberg</i>	
PART II. GOVERNMENT PERSPECTIVES	
The Next Stage of MERCOSUR	81
<i>Javier O. Tizado</i>	
MERCOSUL Past and Present: A Brazilian Perspective	89
<i>José Botafogo Gonçalves</i>	
PART III. ASSESSING MERCOSUR'S PERFORMANCE	
MERCOSUR: Achievements and Challenges of a Decade of Integration	95
<i>Alcides Costa Vaz</i>	
MERCOSUR After Ten Years: Learning Process or Déjà-vu?	115
<i>Roberto Bouzas</i>	
MERCOSUL Politics: Between Fragmentation and Integration	135
<i>Monica Hirst</i>	

**PART IV. LOOKING AHEAD: THE FUTURE OF
MERCOSUR**

MERCOSUR in a Regional and Global Perspective	155
<i>José Augusto Guilhaon Albuquerque</i>	
The Future of MERCOSUR: Argentina's Options	173
<i>Felipe de la Balze</i>	
Relaunching or Restructuring MERCOSUR	201
<i>Beatriz Nofal</i>	
List of Contributors	226

GLOSSARY

THE FOLLOWING ACRONYMS ARE FREQUENTLY USED IN THE TEXT

ALADI	Association for Latin American Development and Integration
ALALC	Latin American Free Trade Area
CAN	Andean Community of Nations
CET	Common External Tariff
CMC	Common Market Council
CMG	Common Market Group
ECLAC	Economic Commission for Latin America and the Caribbean
EU	European Union
FTAA	Free Trade Area of the Americas
GATT	General Agreement on Tariffs and Trade
IDB	Inter-American Development Bank
IMF	International Monetary Fund
ISI	Import Substitution Industrialization
MERCOSUR	Southern Common Market (Spanish)
MERCOSUL	Southern Common Market (Portuguese)
NAFTA	North American Free Trade Agreement
OAS	Organization of American States
OECD	Organization for Economic Cooperation and Development
WTO	World Trade Organization

PREFACE

On November 9, 2000, the Woodrow Wilson Center's Latin American Program hosted the conference, "Paths to Regional Power: The Case of MERCOSUR." The conference brought together key policymakers and policy analysts from Latin America and the United States to discuss the implications of regional integration, drawing on the Southern Common Market (MERCOSUR) as a case study. The seminar focused on MERCOSUR's development, economic and political importance, and efforts to effect a "relaunching" of the common market enterprise.

This volume includes several of the papers presented at the conference which address topics such as: where does MERCOSUR stand today and where is it heading; what are the economic and political implications of MERCOSUR; and, how does MERCOSUR relate to other integration efforts such as the North American Free Trade Agreement (NAFTA) or the European Union (EU). Although these papers were written before the present crisis in Argentina, the lessons they offer provide great insight into the contemporary status of MERCOSUR.

ACKNOWLEDGEMENTS

This publication and the conference from which it developed would not have been possible without the help of many people. Luis Bitencourt, Director of Brazil @ the Wilson Center, was instrumental in identifying and securing the participation of key Brazilian officials and policy analysts. Heather Golding, former Program Associate of the Latin American Program, coordinated the conference and oversaw the publication of this volume. Special thanks to Lisa Tulchin for translating and copyediting the chapters, and for her excellent work on the design and layout of this volume. Also, thanks to Craig Fagan, Jacqueline Lee, Jonathan Goldberg, and Derek Lawlor whose attention to detail was indispensable in preparing this volume for publication. The Ford Foundation was generous in its support of this project.

MERCOSUR at a Crossroads

JOSEPH S. TULCHIN AND RALPH H. ESPACH

As this volume is published, The Southern Common Market (MERCOSUR or MERCOSUL) faces its gravest challenge to date. Suffering under financial crisis, Argentina has passed emergency fiscal measures that compromise the rules of the trade bloc, and it has abandoned MERCOSUR's common external tariff (CET). Uruguay and Paraguay, also racked by the crisis, have altered their tariff levels unilaterally. Although these measures are supposed to be temporary, their long-term effects are uncertain and they have had the immediate effect of straining political relations within the trade bloc. In the context of economic sluggishness in the U.S. and Brazil, and the depth of its debt burden, Argentina's crisis will not pass quickly or easily.

At the same time, MERCOSUR is in a critical phase of free trade negotiations with the EU, while the Free Trade Area of the Americas (FTAA) initiative may get new life from the Bush presidency. Just as the regional bloc seems poised to achieve a political breakthrough, it is riven by internal tensions. The chapters in this volume, authored by Argentine and Brazilian trade officials as well as renowned regional analysts, who are working out these negotiations and shaping these debates at the national level, reflect the intensity and uncertainty of the period. Together, they present various, often contrasting analyses of MERCOSUR's accomplishments and failures, the challenges it faces, and the national contingencies and strategies that will determine the future depth and form of South American regional integration.

MERCOSUR faces serious challenges, and in many aspects it has fallen short of its ambitions. Nevertheless, the initiative itself and the changes precipitated among its member countries during the 1990s have affected profoundly the region's political, security, and economic relations. The

MERCOSUR project has promoted not only economic integration, but transnational confidence, cooperation, and institutional development at a range of levels and in various issue areas. By opening new markets for regional producers and helping to attract new investment, it has increased the competitiveness of local industries and paved the way for trade liberalization on a broader scale. Of equal importance, it also has reinforced free market economic and institutional reforms in each member country.

MERCOSUR always meant more than economic integration. Its inception, in the mid-1980s, driven by the normalization of relations between Argentina and Brazil, was motivated primarily by the need to build support and legitimacy for these fledgling democratic governments and to reduce security tensions. Bilateral accords and cooperative projects covered a range of issues beyond economics. This rapprochement defused the Brazilian–Argentine strategic rivalry, which included the potential for nuclear arms, and led to a series of bilateral and regional confidence-building measures. Later, these cooperative security relations would expand to include Chile as well.

In 1991, the multiple bilateral agreements provided a framework for the creation of the Common Market of the South, to include Uruguay and Paraguay. Since that time, MERCOSUR has accomplished a number of important goals. Intra-regional trade has increased more than fivefold since the early 1980s, contributing to the economic growth and stability required by national programs of political and economic reform. This economic growth — nurtured by an international environment favorable to investment in so-called emerging markets — helped to strengthen these democratic governments and to enhance their international legitimacy as political partners and important markets, especially relative to the rest of South America. MERCOSUR also has expanded the foreign policy options of its members. The trade bloc has explored free trade pacts with the EU, the Andean Pact, and the Asia-Pacific Economic Community (APEC), and has worked to form a common regional position in the FTAA negotiations.

However, MERCOSUR has failed to meet many of its economic and political objectives. The ambitious goal of forming a regional common market, with the free movement of capital, goods, and labor, is far from realized. Several key industries continue to enjoy various forms of protection, the source of angry complaints against Brazil in particular. Without a

Introduction

dispute settlement mechanism independent of government influence, regular procedures for macroeconomic coordination, or even uniform customs and trade laws, MERCOSUR is among the least institutionalized of the existing regional integration projects. Moreover, in the late 1990s, divergence among the region's economic cycles, coupled with the effects of the devaluation of the Brazilian real, turned optimism and cooperation into discord. With recriminations and threats of countermeasures flying between Buenos Aires and Brasilia, doubts arose over whether the commonality of goals alone could overcome the increasingly apparent divergences between these countries' economic cycles and political agendas.

In the year 2000, there was a brief glimmer of optimism. Brazil rebounded quicker than expected from its currency crisis, and elections in Uruguay and Argentina generated hopes for new approaches to intra-regional relations. In the second half of 2000, amid lingering doubts and differences, and calls for faster liberalization and deeper institutionalization, leaders in each country announced their determination to "relaunch" MERCOSUR. Negotiators successfully agreed on statistical standardization and some policy coordination. But these successes were not enough to overcome the worsening regional economic climate at the end of the year. Throughout 2001, the deepening crisis in Argentina, and the unilateral tariff measures undertaken in response, generated a series of emergency meetings at various levels just to prevent MERCOSUR from further deterioration. On the eve of 2002, Argentina's economic crisis finally exploded into a political crisis, and in recent months the devaluation of the peso has begun the process of a slow, uncertain recovery, in which Argentina's collaboration with its MERCOSUR partners will play a critical role.

The spectrum of viewpoints and assessments represented in this collection demonstrate that MERCOSUR truly stands at a crossroads. Will regional integration proceed to a new level of coordination and deeper ties, and if so, who will lead, and what will be its institutional structure? Have MERCOSUR countries hit a ceiling in the economic gains they can expect from intra-regional trade, and if so, will they pursue engagement with new markets such as the FTAA or the EU as a bloc, or individually? What does MERCOSUR represent, politically and strategically, for its various members? Can they — and Brazil in particular — overcome these national differences to agree upon measures for consolidating

MERCOSUR policies and institutions? The tensions and differences discussed in these chapters, and the negotiations and decisions made to address them in the coming years, will prove decisive for MERCOSUR's future, and for that of hemispheric trade in general.

“RELAUNCHING” MERCOSUR: A NEW AGENDA FACES OLD CHALLENGES

From 1991 to 1998, the economic performance of MERCOSUR countries was generally positive, and enhanced trade and economic liberalization was rewarded by increasing foreign investment. Intra-regional trade more than doubled to 19% between 1991 and 1994, to 19%. Member countries complained softly of relative gains, dumping, and various non-tariff barriers, but with overall stability and growth under democratic rule, public and official opinion regarding MERCOSUR was positive. In these early years, debate centered on the optimal timeline for further liberalization, and whether the region's improved efficiency and growth were permanent or largely the results of the fortuitous global scenario. On the political side, analysts wondered whether MERCOSUR was mostly a building bloc for global integration, or if it was destined to develop as an autonomous economic and political entity. Today, however, the situation is more ambiguous and the possibilities more wide-ranging.

From 1994 to 1998, the macroeconomic cycles of both MERCOSUR powers, Brazil and Argentina, were approximately in synch. Short-term weakness in one was mitigated by increases in the other's demand for imports. This circumstance helps to explain the relative ease with which interdependence grew among former rivals. However, it also contributed to MERCOSUR's lack of institutionalization and depth. Contrary to the expectations of neo-liberal theories of economic integration, the dramatically different macroeconomic and monetary policies of Argentina and Brazil did not converge. Argentina stood by its pegged exchange rate, while Brazil established a controlled floating rate, and both pursued different forms of competition policies. Despite these differences, however, in times of general growth, problems such as gaps in relative gains, non-tariff barriers, and exceptions for certain industries were successfully managed by ad hoc actions at the ministerial level and periodic intergovernmental meetings. As long as prosperity and stability lasted, this shallowness and minimal management were deemed acceptable to, and even a strength of,

the regionalist effort. However, when both Brazil and Argentina fell into recession in 1999, the lack of institutions for macroeconomic cooperation was sorely felt. The costs of increased interdependence, and especially the growing dependence of the smaller nations on Brazil's massive market, intensified demands for deeper institutionalization.

MACROECONOMIC COOPERATION

In his contribution to this volume, Roberto Bouzas describes this shift in detail and argues that MERCOSUR's problems did not emerge from the Brazilian devaluation, but were thrown into high relief by the crisis. They had existed and had gone unaddressed for years. While MERCOSUR succeeded in lowering tariffs overall, especially in its early phase, the conspicuous exceptions of the automobile and sugar industries have only very recently received serious attention from all sides. Also, similar to the problems the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) have faced, the elimination of non-tariff barriers has proven difficult, since these obstacles can be imposed at the local level, or by legislators or government agencies less sensitive to pressure from the executive branch. Bouzas emphasizes the domestic constraints on MERCOSUR's further consolidation, especially the power of key industrial lobbies and the divergent strategic perspectives of the Argentine and Brazilian foreign policy officials.

Improved cooperation is necessary if MERCOSUR is to address these various problems. At the very least, nontariff barriers must be reduced through deregulation and the establishment of uniform customs standards. Brazil's chief trade negotiator, José Botafogo Gonçalves, writes that the removal of many nontransparent barriers and bureaucratic controls have been the focus of recent negotiations. In 2000, members were able to reach several agreements, including the standardization of statistical measurements for international comparisons of inflation, growth, services, and also for the quarterly publication of fiscal indicators, and coordinated targets for fiscal accounts and debt. In his chapter, Javier Tizado, Director of Strat Consulting and formerly Argentina's Secretary of Industry, argues that these successes, and an agreement on the production of autos and auto parts, are signs that MERCOSUR is effectively responding to the crisis. Integration requires constant effort, not just to maintain the gains already achieved, but to press onward toward the deepening of relations.

The progress recently achieved on standardization and information-sharing could serve as the first step towards agreement on common goals for inflation, debt management, and fiscal policies.

DISPUTE RESOLUTION MECHANISMS

An arbitration tribunal has existed in MERCOSUR since 1995, but unlike that of the European Union, its decisions are not binding. The first ruling of the tribunal was that all nontariff barriers had to be eliminated. National legislators never agreed, however, and the ruling was largely ignored. Several of the authors in this volume identify the lack of a legitimate, supranational dispute resolution mechanism, like the European Commission and the WTO, as a glaring weakness of MERCOSUR. Without access to an effective and legitimate adjudicating body, protected from the influence of national governments, businesses and investors cannot proceed with confidence in their cross-border activities. Moreover, without an autonomous dispute resolution mechanism, disputes within specific trade sectors or those which might be considered minor areas of commerce can become politicized and rapidly escalate into binational tensions at the highest level.

However, proposals for the creation of a supranational adjudicating mechanism have been met with resistance. From the perspective of Brazil, MERCOSUR countries' diversity in their national capacities and interests, has meant that the protection of national sovereignty has always been a fundamental principle of the group. MERCOSUR's institutionalization was designed to have a low profile, to be flexible, and to respond collectively in an ad hoc fashion to problems as they arose. At the public presentation of these papers, José Botafogo Gonçalves agreed:

“... We are certainly not going to reproduce the European experience and its bureaucratic administration. First, because we don't have the money to do it—and that's enough. But even if we had the money, more and more Europeans are fed up with the way the European Commission is wasting their money on all kinds of activities, including those that are politically controversial, like their agricultural policy. We are not going to reproduce this mess in MERCOSUR.”

Since Brazil remains the most protectionist and cautious of the MERCOSUR members, Argentina and the smaller members are the chief advocates of a supranational adjudicating body. Brazil argues that MERCOSUR

SUR is structured both pragmatically and realistically, suitable to the diversity of its members' policies and institutions and the principle of national sovereignty. However, in the wake of its currency devaluation, which flooded Argentine markets with cheap Brazilian goods and crippled the exports of other members, Brazil's slow-footed pragmatism was perceived as tantamount to exploitation. Without institutional redress, Argentina in 1999 imposed an Association for Latin American Development and Integration (ALADI)-based safeguard measure against Brazilian imports. This move, and the angry response it drew from Brazilian industrialists, as well as some foreign ministry officials, threatened to rupture MERCOSUR in the summer and fall of 1999. Argentine critics rued that they had tied their economy to such an unreliable partner — one with hegemonic intentions. Brazilians responded that they had made enough concessions, and suggested that Argentina should reconsider its fixed currency exchange regime. These tensions ultimately were resolved, and the crisis following the passage by Argentina of unilateral emergency measures in 2001 has been handled more effectively. These examples make clear that without further macroeconomic coordination of some kind, and a more efficacious means of addressing trade disputes, MERCOSUR is ill prepared to weather regional economic turbulence.

In his chapter, Felipe de la Balze argues that a variety of factors account for Brazil's weakness as the regional hegemon — a role that economic theory suggests is crucial for the success of regional integration. Without such leadership or cooperation from Brazil in establishing institutions for the stability and deepening of the MERCOSUR partnership, Argentina must assess its other, less preferable strategies for long-term economic partnership. It may be in the best interest of Argentina and MERCOSUR's other, smaller members to abandon the original intention of following the EU model, and instead settle for a much looser, less restrictive partnership along the lines of the North American Free Trade Agreement (NAFTA).

INTERNATIONAL NEGOTIATION AS A BLOC

Javier Tizado, along with other chapter authors, emphasizes the importance to regional economic growth of expanding extra-regional exports. The spirit of MERCOSUR is to open itself to the world, and commitment to this goal is demonstrated in its free trade negotiations with multiple part-

ners. Even before the worsening of the Argentine crisis, however, these negotiations had faced significant internal and external difficulties. One of the institutions Felipe de la Balze considers necessary, if MERCOSUR is to be consolidated, is the creation of a single MERCOSUR negotiating committee, so that in future talks with the EU, Andean neighbors, or other extra-regional partners, the bloc would negotiate with one voice. It was the lack of such collective agreement and clarity that undermined negotiations with the Andean Pact, which would have created a framework for the creation of a South American Free Trade Agreement. However, even without such an intergovernmental institution, MERCOSUR was successful at putting forth a consensual bargaining position at the Quebec meeting of the FTAA initiative, and in negotiations with the EU.

The resolution of these key issues, including mechanisms for macro-economic convergence and dispute resolution, will depend on the ability of member nations to stitch together common interests and policies through negotiations and concessions. As was the case in MERCOSUR's earliest years, the benefits at the aggregate level – increased trade region-wide, rising incomes, improved stability, and interdependence – must be emphasized over national benefits in relative terms. This conceptual shift is made difficult by the persistence of economic hardship in Argentina and the smaller countries, and by the perception that the political interests and aspirations of the various member nations are increasingly at odds. Whether the solution to these difficulties lies in supragovernmental institutions, as Felipe de la Balze advocates, or incrementally through closer and more conciliatory dialogue, as José Botafogo Gonçalves prefers, it will require a degree of political leadership and commitment – especially in overcoming resistance from key domestic industries – beyond that which we have thus far witnessed in MERCOSUR.

THE DOMESTIC POLITICS OF MERCOSUR: A CALL FOR INTERNAL COHERENCE

The principal challenges to the further consolidation of MERCOSUR are not economic, but political. As is common in trade reform, the sectors in which most liberalization took place in the early years were those that were already competitive internationally or had little national political clout. Thus through most of the 1990s, MERCOSUR negotiators and politicians left many of the most difficult issues and sensitive sectors insu-

Introduction

lated from the effects of liberalization. Now it is to these challenges, left pending for years, that leaders must turn. These politically troublesome cases include the sugar, automobile, and various agribusiness industries, as well as the need to reduce nontariff barriers through the reform of domestic laws and institutions.

There are two principal reasons why the passage of domestic reforms that strengthen and meet the conditions of MERCOSUR will be difficult. First, without an extra-governmental, multilateral negotiating institution that has enforcement power, most key reforms must be passed through the congressional bodies of member nations. This requirement for congressional review makes the process vulnerable to a host of internal political issues and disputes. Alcides da Costa Vaz argues in his chapter that the future of MERCOSUR depends on the tighter integration of its member countries' international and domestic politics. The key question is to what extent are these governments, Brazil in particular, capable of and willing to compromise short- or medium-term domestic political and sectoral interests for the long-term stability of the collective project? In this regard, MERCOSUR's historical record is not promising. During its halcyon years of growth and optimism (1995-1997), member governments did take advantage of the public support for MERCOSUR and the overall gains to push the process ahead by tackling sensitive issues. To do so now, in a climate of increased division and frustration, and within a less favorable international economic climate, will be much more challenging. It will require political determination, leadership, and risk-taking from two administrations currently under siege.

Second, many of the regulatory reforms being proposed for the purpose of strengthening MERCOSUR – if accepted by legislators – will place tremendous pressure on domestic regulatory and judicial agencies, many of which are newly created or are undergoing reforms of their own. Despite the attention given to the intergovernmental relations of MERCOSUR, the intragovernmental politics are even more complicated and pose a larger dilemma. These negotiations and key reform proposals take place within the context of the ongoing evolution in legislative-executive affairs in all member nations, especially regarding the increasing activities of the legislature and civil society in the formulation of foreign policy.

In her chapter, Monica Hirst argues that despite the legacy of trade and economic disputes, MERCOSUR has created a foundation for the deep-

ening and expansion of a “pluralistic security community” of countries which increasingly share political and economic objectives, security operations, institutional norms, and social values. Cooperation and exchange have improved along a variety of dimensions beyond trade, including: education; public planning and infrastructure; tourism; cultural understanding; cross-border ties between cities and states; and the work of proliferating intra-regional organizations, public and private. MERCOSUR is viewed positively in most public opinion surveys, a trend that has thus far survived – though diminished – recent economic tensions.

Hirst and Costa Vaz both address the vexing issue of MERCOSUR’s “democratic deficit,” by which they mean the lack of openness of its negotiations and procedures to input from civil society. The economic growth and institutional reforms generated by MERCOSUR have done little to ameliorate the poverty and social inequality that plague its member countries. The authors are undecided in their assessments about whether MERCOSUR will contribute to the development, or be constricted by the weaknesses, of its member countries’ democratic institutions.

MERCOSUR’S ROLE IN REGIONAL AND INTERNATIONAL POLITICS

Internationally, the consolidation of MERCOSUR could take one of three forms. First, regional relations could grow increasingly institutionalized, through mechanisms such as a dispute settlement mechanism or an intergovernmental macroeconomic condition board. This institutionalist path of regional integration, based on the model of the EU, would generate a balanced, cooperative regional grouping, and eventually might lead to the establishment of supranational institutions. Theoretically, this institutionalization would enhance the global competitiveness and international standards of MERCOSUR production, and prepare these markets and exporters well for eventual free trade agreements within the FTAA or with the EU. From an institutionalist perspective, such an evolutionary path would lead to a stronger subregional community and give the group more power in the broader international community. At the same time, this form of regionalism would require visionary political leadership, a shift toward convergence among the interests of member nations, and steady progress in a number of difficult domestic economic and regulatory reforms.

Introduction

A second possible scenario is the continuation of the recent pattern of MERCOSUR negotiators muddling through from issue to issue. Governments might be prodded and restrained by various sectoral and political interests, and would continue to respond “pragmatically” – to use the Brazilian description – to specific problems, instead of establishing institutions that might be considered to impinge on their sovereignty. Brazil, which exchanges only approximately 15% of its foreign trade within MERCOSUR, is less committed to regional growth than are countries which are more dependent on intra-regional trade. As a result, Brazil’s unwillingness – and to a lesser extent, that of Argentina – to tackle politically sensitive domestic issues in order to improve MERCOSUR confines the trade bloc more or less to its current form. According to this functionalist projection, future effects of spillover and institutionalization will follow sectoral or special interest demands instead of long-term strategic prerogatives. Intra-regional trade will not deepen much further, because although extra-regional trade could continue to increase, protectionist interests will persist. Governments will continue to wait and monitor attitudes toward the FTAA and other international initiatives, and generally to maintain the status quo. De la Balze suggests that this is the path MERCOSUR is most likely to take, and the one least preferable to Argentina’s long-term interests. Without a more firm commitment from Brazil for addressing regional asymmetries, Argentina should engage bilaterally in extraregional relations, as does Chile, and work towards a looser, NAFTA model for MERCOSUR. In this scenario, the influence of MERCOSUR as a bloc will rely on the “soft power” of the group, acting as a unit to the extent they are able, as in the current negotiations with the EU.

The third scenario for the future of regional relations within MERCOSUR supposes that Brazil assumes an increasingly hegemonic role of leadership and agrees to certain concessions to deepen interdependence and institutionalization within MERCOSUR. This realist scenario depends chiefly on two factors. First, the Brazilian government would have to shift its economic policy – and its industrial policy in particular – in a more internationalist direction, despite the resistance of powerful domestic interest groups. Second, Brazil would have to demonstrate the capacity to provide its partners with mechanisms to assure stability, open market access, and other benefits in exchange for their acceptance of its leadership.

Under President Cardoso, Brazil has openly coveted the role of South America's regional leader, and in particular has encouraged MERCOSUR members and other neighbors to maintain a collective position in support of an FTAA accord more sensitive to the vulnerabilities of its developing members. However, according to Bouzas and de la Balze, thus far Brazil has not shown the willingness or ability to lead the region. It has been reluctant to engage with its neighbors in macroeconomic coordination, and has been unable to overcome the resistance of entrenched sectoral groups, especially in agriculture, in regards to further liberalization. On the other hand, Brazil's recent response to the Argentine crisis, in which its Central Bank assumed Argentina's short-term debt to Brazil owing to the devaluation, and tariffs were lowered on some key Argentine exports, were positive steps in this direction. There is little question that if MERCOSUR were to be consolidated as a legitimate political bloc, negotiating with one voice, and expanded to include the whole continent in a SAFTA arrangement, the region's negotiating position vis-à-vis the United States or the EU would improve dramatically. However, Chile's decision to enter into free trade negotiations with the U.S., while negotiations with MERCOSUR have dragged on, complicated Brazil's hopes for regional cohesion.

Chile continues to state that it is committed to strengthening regional ties, and eventually to joining MERCOSUR as a full member. Due to the small size of its economy, Chile's membership would not have a tremendous effect in terms of trade or investment. However, it would send an important message to the rest of the world that a country highly regarded for its low tariffs, economic stability, export success, and a firmly consolidated democracy, has the confidence to integrate with its neighbors. Nevertheless, it is doubtful that MERCOSUR nations – and Brazil in particular – could feasibly commit either to a tariff level near the Chilean target of six percent, or to the various deregulatory policies that Chile would likely require. Furthermore, if Chile successfully negotiates a free trade agreement with the United States, this will sharply reduce its potential usefulness to Brazil and any South American bloc as a political ally in negotiating the terms and timeline of the FTAA. Indeed, Chilean membership in NAFTA would likely stimulate within Argentina and Uruguay a reassessment of their strategic trade options. From a realist's perspective, the ultimate success of MERCOSUR depends on Brazil's willingness to

use its power as a regional leader and that, in turn, forces Brazil to assume a correspondingly greater role as a “rulemaker” in international affairs.

MERCOSUR AND THE FREE TRADE AREA OF THE AMERICAS

The fundamental challenge facing the MERCOSUR project is that the members, of vastly different size, population, and levels of economic development, have significantly dissimilar international strategic interests. While all MERCOSUR members aspire to attract more investment, maintain stability, increase exports, and achieve sustained economic growth and development, Brazil, with the world’s eighth largest economy, envisions for itself a political role with global influence. Argentina and the other members also seek to enhance their international influence, but without Brazil’s size or resources, they are exploring alternative means of insertion into international politics. Many MERCOSUR leaders and analysts, like de la Balze, are uneasy with the effects of increased Brazilian hegemony on their economic and political autonomy, and argue that gains from anything less than an institutionalized and enforceable common market may not be in their favor.

One alternative is a unilateral, proactive position regarding the FTAA initiative, and toward free trade with the United States or other large powers. For instance, under President Carlos Menem, who proclaimed his desire for “carnal” bilateral relations with the U.S., Argentina secured associate membership in NATO. Such a strategy conflicts with the wishes of Brazil, which champions a collective regional negotiating position. Also, negotiating with the U.S. or with the EU on a unilateral basis would allow scant leverage for bargaining. This is important considering that the legal and social norms and regulations that are likely to accompany free trade, such as environmental and labor standards, could lead to the costly imposition of a variety of economic and social measures.

In his chapter, José Augusto Guilhon reviews MERCOSUR’s position within the larger scope of the global free trade effort, embodied in the GATT negotiations and, more recently, in the World Trade Organization. Strategic assessments of MERCOSUR’s costs and benefits to its member countries often disregard its potential importance as a framework for further insertion into the global economy. Guilhon argues that in recent years, the trend at the WTO, and in Europe and the U.S., of attacking non-tariff barriers and linking trade liberalization to issues such as human

rights and environmental protection, corresponds to the political agenda of the developed countries. Only in neo-liberal economic theory are economic relations immune from politics and security, and less developed nations are justified in their caution toward U.S.-sponsored rapid liberalization. Viewed in this light, MERCOSUR offers its members a strategic opportunity to define for themselves a set of regional norms and standard practices regarding these nontrade issues. If agreed upon and enforced, either at the supranational or national level, this regional body of laws and norms could serve as a powerful bargaining position within future multilateral negotiations. The members of MERCOSUR through their regional organization could become major players – “rule makers” – in the international community.

Most economic analysts suggest that integration with the U.S., or with NAFTA, is likely to offer the countries of MERCOSUR their highest overall gains. However, political complications and the undefined terms of this free trade pushes these countries to accept their next-best options, either integration on a regional basis or the pursuit of bilateral free trade. On the other hand, the FTAA option should not be overestimated. If the experiences of MERCOSUR and NAFTA represent the political difficulties of integration among three or four nations, then what is to be expected in the short- or medium-term from a project that attempts to integrate 34 countries of vastly different cultures, size, and levels of economic and political development?

With Argentina mired in an economic crisis and facing an uncertain, painful recovery process, while other partners abandon the common external tariff, and critical negotiations with the EU and FTAA underway, it is clear that MERCOSUR stands at a crossroads. Periods of crisis often offer important junctures for change, and Brazil’s helpful actions toward Argentina suggest that the trade bloc may emerge somewhat strengthened by the experience. Certainly the improved parity in value between the Argentine peso and the Brazilian real will present a better platform for macroeconomic coordination. The question whether the clamor over divergent international interests will give way to increasingly parallel domestic laws and practices, and to enhanced cooperation – perhaps even institutionalization – in interstate economic relations, is critical to the long-term form and function of MERCOSUR.

MERCOSUR IN A HISTORICAL CONTEXT

PART I

MERCOSUR: Between Skepticism and the Relaunch¹

RICARDO ROZEMBERG

INTRODUCTION

Although the leaders of the four member countries repeatedly affirm their complete faith in the integration process, the outlook for MERCOSUR has been uncertain and gloomy since Brazil devalued its currency in mid-January 1999.

The end of 1998 was dominated by the need to defuse and find new solutions for a series of trade conflicts that had arisen out of the macroeconomic fragility of the region's largest economies. In contrast, 1999 was largely marked by efforts to administer, channel, and/or resolve the successive and recurrent sources of conflict sparked by the new, post-Brazilian devaluation environment. Some of these disputes have cast doubt on the very foundations of a process begun in the mid- to late-1990s. In a climate of skepticism about the future, and with an upsurge in the presentation of doomsday scenarios as well, most of the work on issues on the internal agenda of MERCOSUR was in a state of stasis for much of 1999 in the hope that macroeconomic conditions in the region would stabilize. In theory, stability would enable the member countries to define national strategies for tackling new and complex regional conditions, and to revise the base of their new economic and trade relationships.²

The financial effects of the devaluation of the real were not as serious as first thought. There was no influx of Brazilian products into the rest of the region, as many had feared they would see.³ As it happened, the downturn in output affecting the economies of MERCOSUR member countries acted as a natural barrier to the competitive edge gained by Brazilian firms. The deterioration of fiscal, labor, and social indicators during the recession that affected the whole region in 1999 exacerbated

the sensitivity and pessimism of many sectors and actors. This pessimism reduced the field of vision of some analysts, politicians, and opinion makers, and created an environment conducive to ideas that were directly or indirectly critical of integration.

The lack of emergency sectoral mechanisms or temporary escape clauses in existing MERCOSUR agreements, which could be activated or used by some countries to counter trade imbalances in specific productive sectors, helped increase domestic pressure on governments to make unilateral decisions and prompted uncertainty about abiding by the rules of the game agreed to by the member states.

The outlook in 1999 and 2000 was not entirely negative. Despite severe business and social unease, senior officials in the four member countries repeatedly affirmed their strategic willingness to preserve and maintain the spirit of the integration process. In the end, the trade disputes that emerged during 1999 were processed to some extent, and fears of a breakdown were gradually overcome. The advent of a breath of fresh air (implicit in the changeover of governments and negotiating officials in Argentina, Uruguay, and Chile at the end of 1999 and the beginning of 2000), and signs that the Argentine and Brazilian economies were beginning to recover (evident since the last quarter of 1999), have worked to improve the prospects for finding lasting solutions to trade disputes and sectoral demands, as well as for finally resolving outstanding issues on the agenda for deepening and completing the integration process.

According to some analysts, the crisis that followed the Brazilian devaluation exposed some of MERCOSUR's structural weaknesses and the gaps in its regulatory framework. This has determined the priority of issues on future agendas: the search for greater understanding in terms of macroeconomic policy coordination, the need for mechanisms to soften the negative effects of sharp fluctuations in macroeconomic variables, the elimination or neutralization of regulatory asymmetries, completing the institutional mechanisms of the customs union, improving the system for the enactment of MERCOSUR standards as national law, and devising definitive common regimes for sectors with special treatment.

The difficulties of negotiations concerning the sensitive automotive industry in the previous two years were another source of disruption and conflict, since the sector is important both from a political and macroeconomic standpoint. The repeated failure to comply with previously

announced deadlines for designing a common trade regime and, consequently, the uncertainty about the future of national regulatory schemes in this sector were sources of concern for the region's key players.

Progress was also made in some lower-profile, although still important, topics on the regional agenda. MERCOSUR's dispute settlement system (set up by the Brasilia Protocol) was activated three times during that period. This was an important and unprecedented advance in the institutionalization of the customs union, since it established precedents for member countries to resolve, in a non-political way, disputes arising from the interpretation and practical application of agreements and rules. This was a qualitative leap in the complex (and non-linear) process of constructing a MERCOSUR that will be less dependent on the will of current officials or on presidential diplomacy; it created a channel for a more rational and efficient use of negotiating energies.

The Argentine-Brazilian understanding on the mutual recognition of quality certificates and technical requirements for a series of industrial products reached in late 1999, as well as progress on negotiating a similar agreement for trade in foodstuffs helped eliminate the costs of duplicating health and quality control procedures. It also acted as an institutional guarantee for the elimination of a recurrent source of conflicts, disputes, and differences in a particularly important sector of intra-regional trade.

Apart from this balance sheet of progress and pending issues, the regional agenda raises another important question: the likely qualitative or structural effects of the devaluation of the real. The main concern is over the changes in both the pattern of intra-zone trade and the trends in the respective bilateral balances, which threatened to become evident once MERCOSUR economies emerged from recession and recovered their growth capacity.

Lessons of the Crisis of 1999–2000

One of MERCOSUR's main achievements has been to eliminate the defensive and mutually distrustful attitude of the two largest members (evidenced by an unnatural economic and commercial disconnect throughout much of their history). Because of asymmetries and differences between the two countries – which stem from the nature of their economies, their recent history, and their socio-economic and even socio-cultural peculiarities – many actors in both Argentina and Brazil hold dif-

ferent views on their rights and obligations towards, and respect for, the other country.

An exaggerated assessment of Argentina's attitude towards Brazil would hold that various social sectors have a somewhat possessive view of the large Brazilian market. On several occasions, therefore, certain Brazilian policy decisions have been interpreted or perceived by Argentines as an attack on their natural right to exploit the trade opportunities that are derived from Brazil's size and economic characteristics. The predominant view of a large part of Brazil's political and business community is that Argentina has exploited and benefited greatly from the situation in recent years; that Brazil is not the only large market, although it is one of the few with which Argentina has a favorable trade balance (which has continued despite the devaluation); and that the benefits that Argentina has secured over the years should be considered more than enough.

Despite the progress made towards creating a new MERCOSUR culture, when regional and international crises affect the region, one of the two countries (or both simultaneously) tends to accuse the other of violating its rights or of acting improperly. This serves as a pretext for a demand for compensation (or taking retaliatory action). This conflict in perception sometimes broadens or deepens sectoral conflicts of interest or spurs the feeling on the part of one party or the other that the results obtained are always less favorable than what they should have been. This leads to situations in which the actors seek to obtain benefits or minimize losses, to the detriment of the neighbor, and creates the risk that any progress made in more favorable periods might be reversed.

In this complex and sometimes contradictory context, the nations of the region have, over the years, undertaken a learning process in which an understanding of (and the need for observance of) regional and multilateral norms and the written and unwritten rules of politics and international negotiations are gaining an increasingly important role in political, trade, and financial decision-making in MERCOSUR. An ever greater number of the region's economic and social actors are realizing (sometimes after receiving metaphoric blows) that if regional and international negotiations are to be understood as a positive sum game, these talks must not only examine who has the best arguments bolstered by the soundest reasons. On the contrary, interests ranging from the purely material to the politically important are at stake.

Some of the situations affecting MERCOSUR in 1999 (such as the July “incident” over the applicability of Latin American Integration Association (LAIA) safeguard measures to intra-regional trade) have been practical examples of the extent of this phenomenon, of the risks associated with persistent asymmetries of perception regarding what is expected from the other party, and of the responsibility that officials and policy-makers of the main member countries have to manage and harmonize legitimate general and sectoral interests.

Another of the lessons from 1999 and 2000 is that MERCOSUR cannot be more than a reflection (admittedly often amplified and/or distorted) of the virtues, flaws, and limits of internal conditions in its member countries. To claim that the integration process must be more meticulous, prolix, and predictable than its individual participants is a worthy aim and an understandable benchmark, but has little to do with the past and present circumstances of its member states. Neither does MERCOSUR appear to have been the root cause of the recurrent problems and difficulties facing the region’s economies. On the contrary, more often than not, it has helped resolve such problems in a positive way, although always within the range of the sub-optimal conditions within which these economies often operate. It is critical that we keep this in mind. Indeed, the most reasonable approach, for the purposes of a constructive and dispassionate reading of the ups and downs of the bloc in the years under study, is not to demand that the integration process (or some juridical or institutional instrument) produce a miraculous cure for micro- or macro-economic imbalances in the member countries themselves.

The often stated (but not always achieved) political commitment of member governments to MERCOSUR as a strategic, long-term option is a necessary, but clearly insufficient precondition to guaranteeing its survival, deepening, or further progress. The key is to exploit those moments in which endogenous and exogenous variables (such as macroeconomic conditions in the member countries, the international financial situation, or trends in the domestic policies of the region’s governments) foster progress in the integration process. The aim would be to create new mechanisms to facilitate the operation of the customs union, to reach new agreements, and to move towards neutralizing asymmetries. This would provide the process with the political strength and critical mass necessary to more effectively address situations where, inevitably, there are greater

differences of interests and motivations, or where contradictions are more evident.

From a more economic perspective, the crisis at the end of 1999 and the start of 2000 was a practical demonstration of the fact that macroeconomic stability and political legitimacy are prerequisites *sine qua non* for the survival and progress of the integration process. In other words, successful overall performance by the region's main economies is fundamental for the other economies (in production, the exchange rate, fiscal, and labor areas). A natural consequence of the recent crisis has been the reintroduction of macroeconomic coordination as a prioritized issue (and not as an abstraction to be considered in the future) on the negotiation agenda and in the political debate.

After the Devaluation

MERCOSUR experienced the most difficult and conflictive period of its short life in the twelve or thirteen months after the Brazilian devaluation. The countries of the region not only suffered from the effects of the devaluation but also from a sharp, simultaneous contraction in their levels of output and trade. This had already been evident in the second half of the previous year, but the situation deteriorated significantly in 1999.

However, beyond the unease that certain sectors of the member countries expressed at times about MERCOSUR, it became clear in a context of political and economic rationality that the progress made on integration throughout the last decade will be difficult to reverse. Similarly, observers realized that eliminating MERCOSUR or reducing it to a free trade zone would not prevent the spread of Brazil and Argentina's macroeconomic imbalances to the rest of the region. In other words, just as no one can rationally believe that the Brazilian economy is an irrelevant variable in the design of Argentina's trade policy (with or without MERCOSUR), a growing number of Brazilian analysts and businessmen acknowledge that Argentina is an increasingly important factor in the development of Brazil's foreign policy agenda.

Independent of the lessons learned from the crisis, and of pending tasks and obligations, it is clear that the 1999 crisis is having, and will continue to have an impact on the integration process for some time. This circumstance makes it necessary to reformulate and/or redesign the sectoral coalitions or the balance of general and specific interests (both

between and within the member countries) that were responsible for the significant commercial and political progress made between 1991 (when the Treaty of Asunción was signed) and the end of 1997 (when the Asian crisis started).

It is thus reasonable to conclude that MERCOSUR has entered a new phase in which future progress towards integration will not only require that member states demonstrate a strong political commitment, but also contribute to collective efforts that transcend the limited field of government action. This will enable them to identify the issues, the degree of commitment that each must make, and the right moments to seal strategic points of agreements in specific, concrete, and finely tuned accords.

REVIEWING MERCOSUR'S RELAUNCH AGENDA: AN INVENTORY OF PENDING ISSUES AT THE START OF A NEW STAGE

From mid-1997 onwards, as a result of various factors largely born of the complex international financial situation and of changes in the economic circumstances of the countries of the region, MERCOSUR negotiations, which have moved along steadily since its inception, lost steam. Hence, despite the efforts of the member states over the last three years to improve the free trade area and the (incomplete) customs union, the agreements reached have been limited in scope and, to a large measure, have been of little substance or practical application.

However, in 2000 the governments of the region began to push for a new phase of integration with what is termed the “relaunch of MERCOSUR,” exploiting the natural momentum stemming from the changes in government in Argentina and Uruguay, and the generally favorable outlook of the MERCOSUR economies in late 1999.

The start of 2000 thus seemed to indicate the beginning of a new phase for MERCOSUR. Since the first meeting of the year between officials of member states, the idea of the relaunch became part of the negotiating agenda, although with a scope (and implications arising from the relaunch) that remains somewhat unclear. For some Argentine officials, relaunch meant giving the process the political substance that it had in its initial stage (1986-1987).⁴ For others, it has meant giving MERCOSUR the mechanisms to manage trade and coordinate policies, with a view towards making the integration process more sustainable. For Brazil, the

relaunch seemed to mean increasing the scope of business and launching (among other initiatives) a joint infrastructure plan. Similarly, Brazil opposes the approach that Argentina appeared to favor, labeling it defensive and managed. As talks were held in early 2000 about what it would mean to relaunch MERCOSUR, business and political leaders (particularly in Argentina) publicly emphasized the sectoral tensions and trade conflicts that dominated bilateral relations.

The Brazilian government did not hide its disapproval of Argentine opposition to the integration process, but attributed the difficulties to Argentina's internal political and economic circumstances. The various attempts to give a new political thrust to MERCOSUR collided with feelings of conflict and mutual distrust shared by the member states, a situation that was accentuated by the devaluation of the real in 1999. However, the tensions that had characterized bilateral relations during the latter part of 1999 and the beginning of 2000 were lessened toward the end of the first quarter of 2000 with: the agreement, in principle, on the automotive regime; Argentina's commitment to remove textiles safeguards (thereby accepting the ruling of the arbitration tribunal); the resolution of some market access problems; and the fact that the private sectors in Argentina and Brazil seemed to reach an understanding.

It appeared that the relaunch agenda was being clarified in this period, starting with agreements reached during the meeting of coordinators of the Common Market Group (CMG) at the beginning of April, followed by the bilateral summit of Argentine and Brazilian ministers at the end of the month. Politicians, business people, and opinion makers in Argentina made many public statements about the issues to be included in the work program, and about the format and objectives of the negotiating agenda. It became clear from these statements that the substance of the relaunch was becoming assimilated into the list of actions pending from the previous administration that the new government was taking on. It is a qualitative leap that can be represented by the inclusion of certain explicit commitments to macroeconomic coordination on the agenda.

As was to be expected, important agenda issues included revision of the common external tariff (CET) and the elimination of various perforations; the need to complete and implement existing agreements on trade disciplines (rules of origin, policies of protection against unfair trade practices, temporary admission and drawback, etc.); effective means of address-

ing public policies that distort competitiveness and the location of investment; and real progress in negotiating services and public procurement. In addition, questions about the institutional environment, dispute settlement and the transposition of MERCOSUR regulations, as well as the perennial problems of external negotiations, were also included.

However, the agenda made no explicit or formal mention of the sectoral agreements and commitments, or of escape or emergency clauses that could be used in case of economic difficulty. Also left unresolved were details regarding the implementation of a regional infrastructure, which would aim to improve the supply of general services and invigorate internal regional demand. With respect to the latter issue, President Cardoso announced a regional physical integration project that would spur a new cycle of regional development during the August 2000 meeting of the South American presidents that was held in Brazil.⁵

Aside from agreements that were reached in principle alone, and to the subdued euphoria induced by the apparent conclusion of the automotive negotiations, rising international interest rates and the deteriorating world financial situation in May and June (circumstances that raised questions about the Argentine economic outlook) served to push regional negotiations onto the back burner. Moreover, the political difficulties involved in implementing a complex new fiscal adjustment in Argentina reduced the chances that the country would be able to commit to a relaunch agenda in the near future. Equally discouraging was the Brazilian government's unexpected return to several points of the automotive sector agreement that had been resolved in late-March, and their renewed pressure to include on the new regional agenda an explicit commitment to liberalize the sugar trade before the end of the presidency of Carlos Menem in Argentina (coupled with Brazil's traditional demand that Argentina eliminate intra-zone antidumping measures). In addition, attainment of an accord was hindered by Argentina's call for Brazil to explain the battery of incentives introduced into its economy, and to agree on some mechanism that ensured greater joint discipline in the future (the elimination of intra-zone antidumping became conditional upon the disappearance of the distortions). But, through the substantial efforts to complete the automotive agreement, and some progress on macroeconomic policy coordination, the end of that six-month period seemed to confirm that MERCOSUR had overcome part of the internal difficulties that had beset it at the beginning of 2000.

It was these circumstances that served as the backdrop to the meetings of the Common Market Group and the Council of Ministers that were held in Buenos Aires at the end of June 2000. These gatherings gave rise to new political momentum and a flexible and pragmatic approach on the part of the two main partners, which finally allowed an outcome that would have been hard to imagine at an earlier point.

As a corollary of the meetings, an agreement was reached on a very reasonable program for relaunching MERCOSUR. It should be kept in mind that the program negotiated was more theoretical than actual. The problem is, that while it had invaluable political significance as the starting point of a new phase in the integration process, the core was an overly ambitious plan of pending tasks and activities to be enacted over the course of the rest of the year. Many of the questions were viewed as short-term priorities were deferred (such as the removal of defects in the free trade area or perforations of the CET). In a few cases, there were commitments made to neutralize the negative effects on regional trade in five years. In contrast, complex and sensitive questions such as defining goals for macroeconomic coordination were given deadlines for resolution that would prove difficult to meet in practice.

Positive and substantive results from these meetings included ordering and clarifying the pending agenda, elucidating the different visions held by different countries on specific issues, and explicitly outlining the trade-off of possible negotiations. These are significant outcomes in light of the limitations imposed by economic and political developments in the last two years, and the negative impact of those developments on the vision and perception of the integration process in various sectors of the MERCOSUR countries. Regardless, at the beginning of 2001, the relaunch program seemed to be a revised vision of MERCOSUR that matched the Las Leñas Timetable of 1992, an ambitious but excessively willful program, and therefore subject only to partial fulfillment.

Macroeconomic Coordination: A Simple Heading or an Imperative Need?

Article 1 of the Treaty of Asunción stated that the coordination of macroeconomic policies was a central element in the construction of MERCOSUR. It established that this should be developed gradually, in concor-

dance with tariff reduction programs and the elimination of non-tariff barriers during the transition period that finished at the end of 1994. The MERCOSUR Action Plan 2000 of late-1996 further reiterated the importance of this issue as an integral component of the customs union, and of the process of deepening integration. Despite this, the exercises in coordination undertaken in these years have been insubstantial, and have generally had scant practical results. The periodic meetings of the Economy Ministers and presidents of the Central Banks, as well as the meetings of the Common Market Council (CMC), have been part of such exercises. They have not had a decisive influence on the macroeconomic conduct of member nations, but they have enhanced each member's knowledge of the performance and problems faced by the others, as well as their interactions.

During the first half of the 1990s, the international economic and financial problems and the convergence in the general alignment of Argentine and Brazilian domestic policies helped mask a lack of explicit coordination. However, the changes in international economic trends that began with the Asian crisis highlighted MERCOSUR's weaknesses in terms of macroeconomic agreements. The Asian crisis, with its impact on emerging economies and the Brazilian devaluation, were reminders that macroeconomic stability is a necessary condition for MERCOSUR's economic and institutional development. Many observers, analysts, and even governments tended to associate (and confuse) the region's economic difficulties with the absence of formal mechanisms for macroeconomic coordination.

Consequently, there was an upsurge in opinion, commentary, and suggestions that a move toward commitments of regional self-discipline was a functional and efficient tool available for the member states to better deal with events as diverse as the Asian crisis, domestic policy asymmetries, the need to differ in attitudes to other regions, or to avoid a devaluation of the Brazilian currency, among others. The earlier proposal for a single regional currency, made by President Menem at the end of 1997, is part of such thinking and perhaps provided the spark for many later initiatives. In 1997-1998, the idea of taking the long road to macroeconomic coordination (implicit in the proposal for the single currency) had few advocates in the regional market, but after the Brazilian devaluation of 1999 it won broad and generalized support.

One example occurred in June 1999, when the CMC instructed the Ministers of Economy and presidents of the Central Bank in each country to create a high-level working group that was to propose effective alternatives for macroeconomic coordination at the regional level. Similarly, statements by President Cardoso highlighting the need for a mini-Maastricht in MERCOSUR (whose initial spark was to be a commitment to joint fiscal responsibility) clearly expressed the Brazilian government's desire to move forward with negotiation of an issue that, until that time, had seemed to be of interest only to Argentina and the other partners. At the same time (mid-1999), the CMC created an ad hoc Follow-up Group on Economic and Commercial Conditions to monitor the economic behavior of the various countries and the impact of that conduct on trade flows.

In the context of the bloc's relaunch, the issue of macroeconomic coordination has become a priority on the MERCOSUR relaunch agenda since the start of 2000. The Buenos Aires Declaration, signed by the Argentine and Brazilian Ministers of Foreign Affairs, Defense, and Economy at the end of April 2000, reveals the progress made in analyzing statistics on fiscal matters, debt, and prices, and in detecting existing differences. The aim is to devise a common methodology that makes the data from the two countries comparable. On that occasion, the two governments invited their Paraguayan and Uruguayan counterparts to participate in the commitments adopted in this pact (and expressed their intention of inviting Bolivia and Chile). They decided to build a series of indicators in the areas of fiscal matters, public debt, and prices (with data up to June 2000), in order to provide basic information fostering macroeconomic convergence and coordination. The indicators chosen for this first stage were:

- Nominal fiscal result of the federal government⁶
- Primary fiscal result of the federal government
- Variation in the consolidated net debt of the public sector, excluding consolidation of debts
- Net debt of the federal government
- Consolidated net debt of the public sector⁷
- Index of consumer prices

In December 2000, the member countries established the goals for these indicators. Special attention has been paid to fiscal solvency and

price stability, and a Bilateral Macroeconomic Monitoring Group was established and placed in charge of follow-up. At the same meeting the Argentine and Brazilian ministers maintained that the existence of different exchange regimes is compatible with a strategy geared to macroeconomic coordination, as long as there are fiscal policies that ensure fiscal solvency and monetary policies that guarantee price stability.

In the June 2000 meeting of the CMC, the four countries jointly reaffirmed their commitment to fix common objectives in the areas of macroeconomics and financial services. They also restated the idea of establishing goals in the areas of fiscal matters, public debt, and prices, as well as their respective convergence schedules. They agreed on the regular publication of fiscal indicators from the end of 2000 onwards, beginning with data for 1999 and the first half of 2000. Finally, they created a Macroeconomic Monitoring Group under the aegis of the meeting of Ministers of Economy and the presidents of the Central Bank of each member nation, to assess the consistency of the statistics and to follow up the chosen indicators.

The Challenges of Macroeconomic Coordination

The internal consolidation of MERCOSUR (including economic indicators), as well as the changing international context, suggests that in this new stage it would be helpful to embark on the delicate path of policy coordination.

In this regard, three issues could block greater macroeconomic coordination in the region. First, the difference in size of the MERCOSUR member states could trigger different responses to the option of adopting greater commitments. In other words, the smaller countries have greater motivation to coordinate than the bigger members. Secondly, the countries are not very open to trade outside the region, which could lead their authorities to question coordination if external trade in general, and regional trade in particular, remains a small portion of their economic output. Finally, the historical economic instability of the member countries is, objectively, a source of uncertainty about the possible degree of compliance with any regional commitments that might be assumed.

Notwithstanding the validity of the reasons stated, and aside from the events of 1999, it is possible to discern some justification for thinking about formal rules of macroeconomic coordination:

- Strong macroeconomic spillovers induced by integration mean that the demand for macroeconomic coordination exceeds what current trade volumes could explain.
- MERCOSUR's characteristics, unlike other integration processes, mean that there is still a low level of economic interdependence between the countries. Despite this, they did not hesitate to make commitments on trade liberalization at the beginning of the decade, when the benefits were diffuse (a priori given the low level of trade). In the Treaty of Asunción and in later MERCOSUR negotiations, the differences in size and the low level of interdependence between the countries were not crucial obstacles to the adoption of commitments on issues such as trade disciplines, the common external tariff, and intra-zone free trade.
- The strategic convergence of the stabilization plans under way in the main countries make it possible and credible to adopt joint objectives for macroeconomic issues. There is some agreement in the two main MERCOSUR countries about the public benefits of an orderly handling of public accounts and low inflation, and about the problems that stem from public indebtedness, etc.
- MERCOSUR's favorable long-term prospects and regional stability make it increasingly possible to exploit the complementarities between the economies. This in turn implies new alternatives for investment location; the countries now often seem to be competing for new projects. The struggle over investment has clear macroeconomic implications that can negatively affect the performance of monetary and fiscal variables. This suggests an area of potential coordination with the aim of establishing a consistent framework for decisions about the location of capital, such that stabilization efforts are not affected.
- Authorities' search for compromise technologies; a regional institutional arrangement could help strengthen some actions by subjecting them to the approval of other countries. In this case, agreeing on policies would be related to securing external support or a lock-in that positively influences expectations of some of the aims of macroeconomic conduct.

These considerations suggest that MERCOSUR's current circumstances require a search for ways to adapt mutual macroeconomic policies. Increasing commercial interrelation, in particular greater Brazilian-Argentine interdependence, make the issue of policy coordination more relevant by the day.

The fact that the two main partners now have different exchange regimes should not be seen as an insurmountable obstacle to a strategy of macroeconomic coordination (although it is worth noting that in the 1960s and 1970s, when Germany had a free exchange system while France and Britain retained exchange controls and restrictions, they began to plan the European currency convergence). Objectively, however, it cannot be debated that maintaining these differences over time is incompatible with the objective of coordinating and effecting common disciplines in the main economic variables. The European experience is an eloquent example. It is enough to recall the large number of European initiatives throughout the years that sought to coordinate the various exchange parities, an exercise that culminated in the introduction of the euro.

Apart from these observations, the agreement made between MERCOSUR member countries to define a series of economic indicators (and the respective goal of macroeconomic discipline) and to move toward greater harmony between national fiscal policies, will make a decisive contribution to the consolidation and deepening of the customs union over the medium-term. The fate of the integration process will undoubtedly depend on the progress made in this area.

The Consolidation of the Common External Tariff

Although MERCOSUR began to function as a customs union (albeit an incomplete one) on January 1, 1995, the member states have recently faced significant difficulties in uniformly applying the protection associated with the CET – an essential and defining instrument in MERCOSUR's current integration phase.

The CET has been, and continues to be, repeatedly perforated because of the failure to complete the renegotiation of existing bilateral agreements between each MERCOSUR member state and the other LAIA countries. The fact that non-multilateral trade preferences are still in force means that products traded with much of the rest of Latin America (principally the Andean Community and Mexico) enter

MERCOSUR with tariffs that vary according to the country/ports of entry.

The persistence of various special import regimes in the member countries, and the application of drawback and temporary admission schemes for intra-zone operations, have also affected the regional agreement's structure of protection. The existence of non-multilateral free zones and special customs areas, the reduction of aliquots for supply reasons, the tariff benefits of public procurement mechanism, and the non-tariff schemes in Brazil are evidence not only of different tariffs in the various economies of the region but also of the need to apply rules of origin to intra-zone trade. A priori, however, this is incompatible with a Customs Union and makes intra-regional operations more expensive.

The perforations in the CET have also created serious difficulties in external negotiations. In talks with the other LAIA countries, for example, the MERCOSUR member states have adopted differing positions on tariff issues. This has undermined efforts to secure balanced agreements that are acceptable to all the MERCOSUR countries. Although MERCOSUR has sought to present a common position in talks with non-LAIA members, it has not shown that it has a fully consolidated CET. Concluding the re-negotiations of the agreements with the LAIA countries and progress in the elimination or harmonization of special import regimes will therefore be priorities in future negotiations.

Three further issues relating to the common external tariff must also be examined in the near future:

- a) the dual perception of the common external tariff, which clearly distorts the customs union;
- b) the existence of aliquots higher than those individually agreed by the countries at the WTO; and
- c) reviewing the protection of some sectors more than five years after fixing the general tariff structure.

The four member states have identified CET-related issues as a priority on the future agenda, and have included them in the negotiations to relaunch MERCOSUR. These talks will be further boosted by the completion of various instruments that affect the custom union's tariff structure: the convergence of the basic lists of exceptions and capital goods; the expiration of the deadline for the temporary and generalized 3% increase in the CET that was agreed in 1997; the end of the regime (created in

1995, at the high point of the Real Plan) that enabled temporary tariff reductions to be implemented for supply reasons; and the end of the agreed period for the use of drawback, temporary admission, and the general application of the regime of origin for intra-zone operations.⁸ In this context, various proposals for action were exchanged during 2000. These have thus far resulted in several specific commitments.

1. Special Import Regimes

Special import regimes have prompted several negotiations, since they distort the protection afforded by the CET. These regimes generally exempt importers from paying tariffs or allow goods to enter with reduced aliquots. In the negotiations that preceded Ouro Preto, when the CET was discussed and the elimination of both the drawback and temporary admission regimes in intra-zone trade was agreed upon, Uruguay (the main user of these mechanisms) agreed to comply only if the special import regimes were given similar treatment. Argentina, which during this phase was using different tariff exemption instruments, the most important of which concerned the industrial specialization regime and the system for the import of turnkey plants, opposed blanket treatment of these regimes. Although at Ouro Preto the MERCOSUR member states finally agreed to limit the use of temporary admission and drawbacks in intra-zone trade, they only made a vague commitment to tackle the special import regimes in the future.

This asymmetry in the treatment of regimes, which in practice has a similar impact on MERCOSUR's protective structure, might have contributed to the failure to meet several commitments made at the end of 1994, such as the agreement to limit the use of drawbacks and temporary admission in intra-zone trade. Argentina, which in 1995 was the only country to enact legislation regarding the norm agreed to previously at the MERCOSUR level, had to suspend the relevant internal resolution.

Another outcome of different regimes in the four countries has been the generalized application of MERCOSUR rules of origin to all products traded within the regional market – when these rules should only apply to products exempted from the CET. In 1997, MERCOSUR's Trade Commission sent a report to the CMG listing the special import regimes in force in each member state. Although the report revealed that a significant share of MERCOSUR imports from third party countries

were admitted under these regimes, the member states failed to make any kind of commitment on this issue at that time.

These issues were kept discreetly in the background for two years, until they were again discussed as part of the MERCOSUR negotiations in the first half of 2000. These conversations took place in the context of general talks on all trade-related issues that would alter the protection associated with the CET – drawbacks, temporary admission, free zones, etc. As a result of the bilateral Argentine–Brazilian talks at the end of April, the member countries agreed to work towards an agreement to limit the indiscriminate use of these regimes. The member states thus proposed to identify mechanisms (including the list of products included in them) that could remain in force, as long as they were compatible with the current state of the customs union. With respect to the remaining regimes, it was agreed that these should be eliminated gradually and progressively, and that the bloc should move towards a MERCOSUR common special import regime.

As a basis for this normative framework, the CMC agreed to consider eliminating the special import regimes that affect intra-zone sales as of January 1, 2006 (excluding the special customs areas), and to set up common special import regimes. However, in the end the member countries only agreed to hasten the elimination of special import regimes that were not in force on June 30, 2000. The CMC also urged the member states not to adopt new measures that could yield benefits beyond January 1, 2006. With respect to this norm, the CMC called on the CMG to include the conditions under which products originating from special customs areas should be traded within MERCOSUR.

Far from speeding up the gradual elimination of special import regimes, as had been discussed in previous meetings, the agreement will instead act as a kind of official waiver for the widespread and unrestricted use of these instruments until 2006.

2. Drawback and Temporary Admission

These special customs regimes allow the duty-free import of raw materials and intermediate goods that are then used in various productive processes and subsequently exported. In other cases, a duty is paid on the import, although this is reimbursed when the product is exported. The issue, however, is whether these should apply to intra-regional sales –

that is, to goods temporarily imported from third party countries duty free, for their subsequent export in a finished product to the other member states.

As noted earlier, at Ouro Preto it was agreed that these regimes could only apply to intra-zone trade in the case of exempted products and, broadly, those goods included in the application of rules of origin (for example, non-exempted products that use lots of exempted materials). However, these mechanisms remain widespread and unrestricted for intra-zone sales, partly because in negotiations with Chile it was agreed to continue applying these regimes for MERCOSUR trade during a transition period.

In the framework of CMC Decision 21/98 the members agreed to comply with an earlier commitment to eliminate these intra-MERCOSUR export mechanisms at the end of 2000. During Argentine-Brazilian bilateral talks held in the first half of this year, the two countries reaffirmed this commitment, agreeing to identify those products and groups of products for which the countries could retain the drawback and temporary admission during a set period of time, with a timetable for their gradual elimination. Uruguay, the main user of these instruments in intra-zone operations, proposed either to keep them until 2013, or to negotiate their elimination together with other special import regimes and all investment and export incentives in force in the other countries in the region.⁹ Drawback and temporary admission are critical mechanisms for Uruguay, as for any small economy, since it needs to import most of the raw materials and intermediate goods used in production. The elimination of these instruments would thus lead to a sharp deterioration in the competitiveness of the pricing of its exports to the region, its main market.

Despite differences of opinion, at the June 2000 meeting the CMC agreed to extend the generalized and indiscriminate use of all drawback and temporary admission mechanisms for intra-zone sales until January 1, 2006, when the end would coincide with the end of all the CET exemption programs. It is worth noting that the extension of the deadline, as well as that for all special import regimes, creates an important precedent for the rest of the negotiations on trade agreements and disciplines. Similar arguments are likely to be used to postpone all the agreements still pending on these issues until that date.

3. Reviewing the Common External Tariff

In 2001 a review of the CET took place. This was because successive, and none too orderly, changes had been made to the tariff structure; old discussions resurfaced about the level of protection for capital goods, information technology, and telecommunication products; and imbalances in the CET for certain production lines were identified. From the viewpoint of the Brazilian government, any reduction in tariffs should have taken into account the needs of productive sectors in MERCOSUR and the prospects for the international negotiations that were taking place concurrently. It was also borne in mind that the tariff structure could not be frozen indefinitely and that future reductions should not be discounted.

In the first half of 2000, Argentina expressed its interest in reviewing the CET for certain sectors (textiles, for example). During this period, the Argentine government also insisted that there should be an assessment of future changes to the levels of protection agreed for capital goods (produced both inside and outside the region), information technology, and telecommunications products.¹⁰

Countries have complied with the convergence schedule in recent years, but the Argentine government has proposed that the protections granted to goods manufactured outside the region (and some produced in MERCOSUR) should be re-assessed. The Brazilian government also appears willing to review the tariff for capital goods, but not those for information technology and telecommunications products. Uruguay proposed the creation of an ad hoc group to examine a 14% reduction in the CET for capital goods.

After reviewing the various positions on the CET, the ministers assembled at the CMC meeting at the end of June 2000 called on the Trade Commission to prepare a proposal on a common regime for capital goods produced outside the region. However, the CMC devoted only one paragraph of its report to a review of protection levels for some chains of production and to tariffs for capital goods produced in the region (there had been some preliminary agreements reached at previous meetings). "Member states that support a review of some aspect of the CET, including those for capital goods produced in the region, will present their analysis and proposals to the CMG."

During a visit by the Argentine Minister of Economy to Brazil in early July 2000, the two countries made progress and presented the idea of

reducing the CET on capital goods to a level that was compatible with the aim of facilitating and stimulating investment (3–5%). They also examined the possibility of maintaining the status quo in the convergence program for information and telecommunications products – that is, to halt tariff convergence at the level currently in force in each country (16% in Brazil and 8–10% in Argentina).

An issue that is not strictly linked to the review of protection levels, but that would make a customs union function more effectively, is that of the CET's double taxation. In this regard, the CMC instructed the Trade Commission to examine the issue of how to distribute customs revenue, and to present its findings. Progress was also made on the question of submitting an initial MERCOSUR offer to the WTO, replacing the individual presentations of each country. The option that this CET should be five points higher than the one currently in force was considered.

4. Perforations in the CET Caused by Bilateral Trade Agreements

The failure to renegotiate the LAIA bilateral agreements (mainly with the Andean Community and Mexico), as was accomplished with Chile and Bolivia, gives rise to systematic perforations of the CET. Therefore, after a new round of negotiations in the first half of 2000, the member states reaffirmed their intention that MERCOSUR should jointly negotiate with third party countries (or groups of countries). Success in this requires common strategic criteria and a deadline for ending unilateral negotiations.

Although a short deadline was possible (at the CMC meeting in April 2000, Argentina proposed as the deadline January 1, 2001), Decision number 32/00 set June 30, 2001 as the last date when the countries could negotiate unilaterally. The CMC also proposed that joint negotiations with the Andean Community and Mexico be resumed. It further stipulated that if no agreement was reached, the current preferences could only remain in effect until June 30, 2003.

Although the issue of renegotiating the LAIA agreements is as old as MERCOSUR, the problems facing the various unilateral negotiations over recent years seem to have given the governments a certain degree of confidence that the commitments will now be met in practice as well as in theory. The decision to set a medium-term deadline for eliminating bilateral preferences is a realistic and pragmatic step forward.

5. Rules of Origin

MERCOSUR's origin regime, approved in 1994, applies to all products exempted from the CET and other specific cases (such as products with anti-dumping duties and products with exempted inputs). However, the persistence of numerous regimes that perforate the CET forced the member states temporarily to extend certification of origin to the whole tariff schedule. While CMC Decision number 21/98 deferred a decision about this irregular form of limiting the free circulation of goods in the expanded market, regularization is largely linked to the treatment of some of the issues examined above (mainly special import regimes, drawbacks, and temporary admission).

Member states are currently aware of this problem, but they have yet to find a solution. At the CMC meeting in June 2000 they agreed to make some technical adjustments to MERCOSUR's origin regime, but made no reference to what will happen with the whole regime. Nevertheless, extending the use of special import regimes until 2006 makes it likely that the application of the origin regime will also be widespread until that date.

Barriers to Market Access

MERCOSUR has significantly leveled the playing field in terms of market access since the signing of the Treaty of Asunción. However, the end of the adaptation regime and increasing difficulties faced by the external sectors of member states in recent years has somewhat reversed this process of dismantling barriers to intra-regional trade.

The tariff-free zone is thus threatened by the implementation of various trade obstacles that have not only had a real and concrete impact but have also created a climate of uncertainty about whether the expanded market and unrestricted access for its members is indeed a reality. Because of this, in recent years, the member states have consistently sought to negotiate the elimination of non-tariff restrictions that hinder trade and that block the harmonization of the different technical norms and regulations.

Member states identified and classified the existing barriers according to the nature of the restriction and its impact on trade. They have worked on a schedule for eliminating or harmonizing these barriers, and have agreed in writing not to introduce new obstacles. However, none of these issues has been firmly resolved in practice. At the end of 1997 a CMG

study concluded that 350 non-tariff measures and restrictions were in force. It was decided to dismantle or harmonize these by the end of 1998, although only limited progress was made.

In mid-1999, a Trade Commission report on the state of those restrictions that were considered most critical (thirty-eight measures and four consultations) revealed that ten of these had been completely resolved. Unfortunately, resolution of the rest had been either partial or nonexistent. The April 1999 ruling of MERCOSUR's ad hoc tribunal that Brazil's non-automatic prior licenses should be eliminated was therefore an important step forward in this respect. This issue was closely examined at the bilateral and CMG coordinators meetings in the first half of 2000. In the bilateral meeting at the end of April, the countries agreed to complete the identification of obstacles and restrictions. The aim was to eliminate, by June 30, all prior licenses and all other non-tariff barriers applied to intra-zone trade that were not contemplated in Article 50 of the LAIA agreement. The June 2000 CMC meeting formally reiterated the commitment not to adopt any new measures that restricted trade. But, the member states were unable to agree jointly on the identification and elimination of non-tariff restrictions by the deadline agreed to in April at the bilateral level.

Measures to Facilitate and Simplify Border Procedures

In December 1998, the CMC decided to simplify and facilitate the administrative and operational aspects of trade in order to ease intra-zone commerce. The significant increase in trade had exposed administrative and customs weaknesses, such as the lack of harmonization in customs procedures and opening hours, border control problems, a lack of personnel and of adequate physical resources, and the great variety of procedures and documentation needed to cross borders.

The Trade Commission was given six months to submit a proposal in this regard. In mid-June 1999, the member states agreed on an action program to facilitate trade by streamlining administrative procedures (Program of Asunción). The deadline for completing the action program was set for April 30, 2000. In the first half of that year, the various alternatives to facilitate trade in the region were examined. These alternatives included: setting maximum periods for granting automatic and non-automatic licenses; eliminating sanitary and phytosanitary border inspections;

signing equivalence agreements for sanitary and phytosanitary control systems; and coordinating a methodology for exchanging customs, technical, sanitary, and phytosanitary information in real time.¹¹ Although there was consensus on many of these measures, the CMC meeting in June 2000 failed to produce an agreement on an overall program. Thus, the tasks set in the Program of Asunción are still being analyzed and assessed.

Public Policies that Distort Competitiveness

Public subsidy programs and other state support systems in member countries directly affect the competitiveness of the region. Policy asymmetries (the varying fiscal and financial treatments of investment, production, or exports) distort the market signals emitted by each country's natural condition. The need to eliminate these asymmetries has been a concern since the signing of the Treaty of Asunción, and is included in the Las Leñas Timetable, the Protocol of Ouro Preto, and the MERCOSUR Agenda 2000, but thus far, there has been little progress in efforts to level the playing field.

Continuing public policy differences have led to numerous tensions within the expanded market. As the level of reciprocal economic interdependence has increased, so too has the importance of this issue. The demands from the public and private sectors of different countries that they be resolved have grown exponentially. Policy asymmetries affect the competitiveness of companies and therefore have an impact on decisions about trade and, fundamentally, about the destination of investment resources. To remedy this problem, the MERCOSUR "complaints department" has been transferred gradually from the national sphere to the regional one. Several of the consultations presented to MERCOSUR's Trade Commission over the last few years have concerned different aspects of this issue (export subsidies, financial incentives, etc). Argentina's complaint against Brazil (which was rejected by the Arbitration Tribunal at the end of September 1999) centered on the issue of subsidies for pork production and exports.

MERCOSUR has its own juridical instrument (established in Decision number 10/94), which regulates the granting of incentives for intra-zone sales, while the issue of state assistance is covered by the Protection of Competition Protocol. However, the different interpretations of the former, and the fact that the latter is not yet in force, have

meant that their concrete effects have only been partial at best. The issue of investment incentives, for its part, was not included in any specific legal framework.

In the negotiations to relaunch MERCOSUR in the first half of 2000, Argentina proposed the creation of a high-level group to address incentives. The aim was to complement the regulations in force by deepening the commitments on production subsidies and regulating some intra-zone trade incentives, with a view to defining their scope more precisely. The Argentine proposal also included limits on federal, provincial/state, and municipal incentives.

The proposal also made the elimination of the anti-dumping and anti-subsidy regime in intra-zone trade conditional to the removal of investment incentives and other state support mechanisms. In the negotiations, Brazil argued that the Protection of Competition Protocol could be used to counter practices that distort and their impact on competitiveness at the regional level.¹² For their part, Paraguay and Uruguay agreed that a list should be drawn up for the whole range of incentives in the region, but expressed doubts about whether common discipline was necessary.

An agreement was finally reached to address investment incentives within MERCOSUR.¹³ This was an important advance, since the issue was featured as part of a community norm for the first time. However, the application of the corresponding disciplines was agreed upon as part of a range of trade-related issues (such as drawback and other special import regimes) on which differing progress has been made. The CMC therefore instructed the CMG to prepare a proposal on common disciplines in the use of investment, production, and export incentives that distort resource-allocation at the regional level. The member states agreed to draw up a complete list of incentives currently in force. On that basis the CMG would prepare a proposal on the common application of disciplines.

Unfair Practices and the Protection of Competition

Acknowledgement of the importance of a MERCOSUR norm in anti-trust matters stems from the experience of the two largest member states, which for some years have had such regulations for trade within their own borders. The expanded market is now the new setting for business development, and it is in this context that governments must focus their efforts to guarantee clean and transparent competition.

In 1996, the CMC approved the Protection of Competition Protocol, which covers issues such as restrictive behavior and practices, abuse of a dominant position, the sanctions regime, and the bodies and procedures for the application of sanctions. Argentina expected that the instrument would include specific commitments on state aid in order to guarantee the transparency of government intervention and to prevent this aid from negatively affecting competition. Brazil, for its part, only agreed to consider common norms on this particular issue, and only for two years after the protocol's entry into force. A similar timeframe was agreed upon for examining the treatment of company mergers. Only Paraguay has thus far approved the protocol, while Brazil is in the process of promulgating it. The protocol cannot enter into force unless at least two countries have ratified it. The protocol is not only an important anti-trust instrument, but has implications for intra-zone trade since it penalizes actions such as predatory pricing practices (artificially low prices that displace competitors) or distortions in regional trade arising from state aid for production and exports.

The Protection of Competition Protocol could thus limit the effects of national public policies that affect competitiveness, and counter unfair trade practices between the member countries. The Decision that approved the Protocol in 1996 makes it possible to investigate complaints of dumping in intra-zone trade according to national legislation until December 31, 2000.

With respect to this latter point, Brazil is seeking to ensure that anti-dumping and anti-subsidy policies in intra-zone trade are eliminated within the agreed deadline. Brazil has thus proposed that implementation of the protocol be sped up and the two-year deadline brought forward so that the issue of state-support can be covered. It also proposed that the legal basis for analyzing this issue be completed by the end of 2000. As previously noted, Argentina (the main user of anti-dumping mechanisms in intra-zone trade) has made the elimination of these mechanisms conditional on the eradication of the various incentives in the other countries of the region, most notably in Brazil.

In negotiations during the first half of 2000, the member countries agreed on further joint analysis of means to protect competition, protection against unfair practices in intra-zone trade, and state aid. The purpose is to identify the appropriate instruments for consolidating a genuine and

competitive common market. At last April's bilateral meeting, the two countries therefore decided that in a first phase they would examine the progress made thus far at the regional level, prevailing national laws, and possible options. Time frames and mechanisms to regulate or eliminate intra-zone anti-dumping measures would be established in a second phase, and the Protection of Competition Protocol would be adapted to the requirements attendant on MERCOSUR's current status.

At the CMC meeting of June 2000 the committee decided to instruct the CMG to draw up a proposal on how to bring discipline to the investigation and application of anti-dumping measures and countervailing duties in intra-zone trade. It also agreed to ask the MERCOSUR Trade Commission to draw up a proposal that defines the applicable instruments, with a view to the gradual elimination of anti-dumping measures and countervailing duties in intra-zone trade. These tasks were to be concluded before June 30, 2001, and sent to the CMG for consideration before December 31, 2001.

Finally, the CMC called for an institutional and regulatory framework to be designed that would counter unfair trade practices (dumping and subsidies) in imports from third-party countries. It is worth noting that although MERCOSUR has common instruments in this respect, it still has to define and regulate the quadripartite decision-making process and examine the possibility of applying these bloc-wide trade protection measures, whenever possible, on behalf of one or more member states and not the bloc as a whole.

The Negotiation of Services

The Treaty of Asunción makes reference to the fact that the common market entails not only the free circulation of goods but also of services and production factors. During the 1991-1994 transition period, it was impossible to start negotiations on this issue because there were marked differences in the degree to which the four member states had opened their markets.

An Ad Hoc Group, set up in 1995 to examine the issue, was to draft a Framework Agreement on Trade in Services. It is worth noting that the inclusion of liberalization of trade in services on the FTAA negotiating agenda drew attention to it at the regional level. Once goods could circulate freely, the opening of the services markets became a priority on the agenda

to MERCOSUR. The Protocol of Montevideo, signed in December 1997, committed the member states to liberalizing regional trade in services within ten years of the entry into force of the Protocol. The Protocol provided for annual negotiating rounds to integrate the various sectors in regional free trade by means of positive sectoral and horizontal lists.

Each member state's initial list of specific commitments, such as the sectoral provisions on land and water transport, the movement of persons who provide services, air transport, and financial services, were based on the commitments agreed by the member states with the WTO (although with some minor improvements, such as Brazil's inclusion of information services to their list) and were fixed in 1998. Nevertheless, these moves to liberalize MERCOSUR's services market have not been put into practice. The Protocol has yet to be approved by the parliaments of the member countries. The negotiations are also hampered by each country's varying degrees of trade liberalization. Argentina has agreed to a greater degree of opening of its services market to the WTO than its other integration partners have, and the other countries of the region benefit from this. This initial asymmetry therefore implies that Argentina's neighbors must initially make a greater effort if the regional talks are to advance. This issue can only be resolved politically through negotiations, since the services issue is part of a delicate overall balance involving a significant number of other agreements.

During the first round of talks in 1999 there was no significant progress on deepening the initial commitments. Brazil, Paraguay, and Uruguay presented their commitments on telecommunications, while Argentina offered to improve access to its insurance sector and to construction and engineering services. The CMG sent these offers to the CMC in November 1999, and called a second round of talks for 2000.

The issue has been part of MERCOSUR's relaunch in 2001. At the request of the CMC, the Services Group reviewed the lists from the first round, as well as the methodology and liberalization measures to be adopted for each sector in the second round. The CMC meeting in June 2000 approved the results of the first round of negotiations on specific commitments and during the December summit approved the second round. The CMG meeting of that same month approved the methodological and technical aspects of creating the conditions for the start of the third round of negotiations.

The Public Procurement System

The construction of a customs union must include some kind of common treatment of public sector procurement. Discrimination in favor of national suppliers (to the detriment of regional competitors) spawns inequalities in the conditions of competition within the expanded market. This is incompatible with the idea and objective of the integration process.

Another priority in MERCOSUR's relaunch is the negotiation of a Public Procurement Agreement.¹⁴ The aim is to commit the member states to end all forms of discrimination in the bidding processes that public bodies of the member countries use to buy goods or contract services. The agreement would also include preference rules for regional companies competing in international bids. MERCOSUR-based firms would be given a preferential 3% price margin over outside competitors.

A relevant Ad Hoc Group has been working since December 1997 to design a MERCOSUR regime that includes provisions on scope, national treatment, and rules and procedures to foster transparency. However, these activities have not as yet been formalized in a quadripartite agreement. The original deadline for completing the negotiations, December 1998, has been extended.

The existence of different public procurement regimes in the member states has hampered coordination at the regional level. Over and above the agreements already reached on non-discriminatory treatment and the banning of performance requirements, questions still to be resolved include scope of the protocol (that is, if regional regulations on procurement cover purchases made at different levels of the public administration in each country), whether concessions are included in the regime, tariff treatments, and other matters concerning the qualification requirements for suppliers. Significant progress was made by the ad hoc group in the first half of 2000, particularly in drawing up a registry of suppliers, tariff treatments, and other pending issues. Other questions are yet to be resolved, including the scope of the protocol and minimum thresholds. The latter refers to the minimum values at which governments can buy goods and contract services and be covered by the protocol, and the number and importance of the public bodies – according to the level of procurement – which will be subject to these regulations.

Talks held in late 2000 reaffirmed the resolve of the member states to complete the negotiations on the normative framework of the CMG

before the end of the presidency of Carlos Menem in Argentina. A draft agreement was completed (after two years), but was not approved because the corresponding appendices were not ready. Without these, the agreement cannot enter into force. Negotiation of these annexed materials is vital to the effective implementation of the agreement, since they define which public bodies, goods, services, and public works will be covered by the protocol. In the end, there was no consensus on whether to include concessions in the protocol. A significant share of public works projects and the privatization of various services are effected with this measure. Argentina has repeatedly proposed that concessions be included in the normative framework in order to ensure that regional companies are not discriminated against, and that processes are transparent. The other member countries, however, have opposed the inclusion of concessions in the protocol, arguing that these cannot be defined as contributions from the member states.

At its last meeting, and following the suggestion of the Ad Hoc Group on Public Procurement, the CMG created an Ad Hoc Group on Concessions to devise a specific juridical framework.

Creating National Legislation for MERCOSUR Norms

The Treaty of Asunción only gave the Common Market Council and the Common Market Group the authority to reach decisions and make resolutions on matters that aimed to foster the integration process. This proved to be a weak base for binding the compliance of countries to resolutions and decisions approved at the regional level. Special attention was given to the issue at Ouro Preto, where it was agreed that all norms in the protocol, including international mechanisms and acts passed by bodies with normative capacity, were obligatory and binding for member states, which had to incorporate them into internal legal codes. It was also agreed that quadripartite decisions must be published in MERCOSUR's *Official Bulletin*, and a mechanism was set up to allow these norms to enter into force simultaneously in the four member countries.

Since Ouro Preto, the legislative conception of norms by the member countries has faced numerous difficulties, including the incompatibility between norms devised by MERCOSUR's technical fora and the regulations already in place at the national level. Administrative, technical, and political barriers have therefore hampered the creation of national legisla-

tion that applies to MERCOSUR norms. According to MERCOSUR's Administrative Secretariat, 1,024 regulations (162 CMC decisions, 763 CMG and 99 MTC directives) have been approved at the regional level in recent years that had to be legislated at the national level. However, the Uruguayan government estimates that only 50% of these MERCOSUR norms have been enacted.

In 2000, as part of the negotiations to relaunch the integration process, the member countries agreed on the immediate need to legislate those MERCOSUR norms already approved. They also decided to introduce technical criteria for establishing norms that do not require changes in the law (either because they are related to MERCOSUR's internal organization or because there is already a national norm similar to the one created for the bloc) and mechanisms that reinforce the commitments already made on this issue.

With respect to the norms already approved, it was agreed that the National Coordinators should confirm or correct the information available in MERCOSUR's Administrative Secretariat regarding which norms have been legislated. It was also decided that the member states should identify which norms were not legislated because they concern issues related to the internal running of the integration process.

CONSTRUCTING THE INSTITUTIONAL ARCHITECTURE OF THE CUSTOMS UNION

The need to change MERCOSUR's juridical-institutional structure has prompted numerous debates and controversies in the past five years, both between analysts and officials, and between specialists in integration law. The countries have rejected any initiative that could lead, directly or indirectly, to the emergence of some supranational bureaucracy in the Brussels mold. This posture contrasted with the difficulties provoked by the apparent absence of any juridical-institutional mechanisms that could quickly and efficiently resolve the frequent problems or disputes that arose from some members' flawed application of MERCOSUR regulations.

Aside from the complex economic and commercial circumstances of the MERCOSUR countries throughout 1999 and 2000, substantial progress was made in this period via the functioning of the dispute settlement mechanisms established by the Protocol of Ouro Preto (which incorporated the Protocol of Brasilia of 1991 as a starting point for such

purposes).¹⁵ Argentina appealed to the arbitration mechanism on two occasions in 1999 (with different outcomes) when it believed its rights and interests were being affected by Brazil. The first case concerned non-automatic licenses for intra-regional trade, and the second related to domestic subsidies for pork. In 2000 the Brazilian government successfully appealed to the dispute settlement mechanism about Argentina's application of WTO safeguards against its exports of cotton fabric.¹⁶

In general terms, and beyond their concrete results, the establishment of the mechanisms agreed in the Protocol of Brasilia-Ouro Preto have been welcomed by most of the region's officials, jurists, and analysts. But this has not ended the debate over the creation of a more general institutional structure for MERCOSUR. On the contrary, it has triggered new discussion and expressions of opinion in various spheres.

Some analysts have pointed out that the existing juridical institutions work in such a way that it could be possible to resort to them more often to solve old and new disputes. Other specialists have stressed that the indirect system established by the Protocol of Brasilia (wherein only member states have the legitimacy to participate as an originating agent in arbitration) politicizes claims made by individuals. These are eventually folded into negotiations between countries, in which a legitimate sectoral request can be used (or sacrificed) as a bargaining chip by the countries in the interests of some greater good. A tribunal thus has a secondary role in the construction of MERCOSUR, and its original mandate of safeguarding compliance with the agreed rules is sidelined.

Some Argentine officials ascribed some of the region's commercial problems last year to the inadequate state of MERCOSUR's juridical instruments. Others have stressed the significant constraints involved in using juridical mechanisms at the current stage of the integration process.

Another source of debate in recent months has been the issue of supranational organisms. In early April 2000 Brazil reiterated its opposition to participation in any artificial structure whose resolutions could affect its national laws, as it has done in various international fora over recent years. According to Brazil, this would be a violation of their Constitution. Ambassador José Botafogo told the Argentine press, "we are willing to improve the dispute resolution system, but that does not mean accepting supranational courts."¹⁷

The judges' degree of stability is another point under discussion between jurists and specialists in international law. Advocates of a perma-

ment tribunal stress the advantages of greater speed in resolving cases, and the prospect of attaining greater homogeneity in the criteria of interpretation. Those who favor an ad hoc system of tribunals stress the limits of generalized knowledge and the need for each case to involve specialists in the specific issue in dispute.

The two main partners have made significant progress on two significant questions in recent months, despite debates and exchanges of opinion. Brazil quickly rejected the initial Argentine proposal to move toward the creation of a permanent arbitration tribunal.¹⁸ However, a compromise solution has been reached. This consists of a mechanism to give greater stability to judges, which it is hoped will translate into more uniform criteria for rulings and the gradual creation of MERCOSUR jurisprudence. To that end, the countries have agreed to draw up an initial joint list of eight or nine candidate-experts, from which two judges will be selected to sit on a tribunal for two to three years.

There is agreement about the need to supplement the Protocol of Brasilia with a mechanism that facilitates follow-up on compliance with the rulings and the scope of their measures. Hence, on the basis of the recently approved additional protocol on dispute resolution to ECA 35, an institution will be created to review the rulings. Its main aim will be to regulate the application of retaliatory measures when some ruling of the arbitration tribunal goes unheeded by a member country.

In line with its traditional strategy of avoiding the delegation of authority to non-governmental bodies, and with the idea of establishing an effective mechanism for the swift and uniform interpretation of norms in unforeseen or unusual circumstances, at the Buenos Aires meeting of the national coordinators in April 2000 Brazil proposed granting the Common Market Council the authority to clarify, when necessary, the scope of the arbitration rulings, or to adopt summary decisions in certain cases on the basis of existing rulings. In this regard, and mindful of the specific peculiarities of juridical issues, Decision CMC 25/00 of late-June 2000 resolved to ask the GMC to present a proposal on these issues before December 2000. Beyond such progress, however, there is still a need to address the deficiencies and problems made evident by the difficulties facing individuals in the current legal framework when they wish to make a claim against an individual in another country, or against a member state. At the moment, these matters depend wholly upon the changing political

will of their respective authorities and governments to pursue the issue (or on the capacity of the various sectors to lobby for that end). Beyond individual controversies and claims, however, it is plain that the juridical institutions cannot and should not fill negotiating vacuums, nor tackle the pending issues on the integration agenda. Similarly, and irrespective of how this could be improved, the judges can only rule on what is already agreed upon and not on issues in which the countries have yet to conclude firm agreements – as is the case with sugar, bringing discipline to the systems of investment incentives, or the applicability of antidumping regulations to intra-zone trade. In this sense, seeking to solve MERCOSUR's deficiencies and structural problems by juridical means or through arbitration (as some analysts have repeatedly argued amid the regional crisis) is simply an illusion, one that could bog down the integration process.

Juridical Voids and Trade Disputes: The Problem of the Umbrella

Amid a severe recession in the four MERCOSUR economies in 1999, the center of the political stage in Argentina was occupied by business protests and pressure on the government to tackle what was perceived as displacements in the domestic market by imported competition, particularly from Brazil.

The issue of applying the trade relief instruments foreseen in the Treaty of Montevideo (LAIA) and the WTO to intra-zone commerce spurred several heated debates among specialists, entrepreneurs, and governments. The Argentine government's use of the safeguard mechanism provided for in LAIA Resolution 70 in late-July 1999 prompted an angry diplomatic protest from Brazil and a threat to resort to the principle of an "eye for an eye." This led to what has probably been the most serious incident in the history of the integration process.

Argentina's imminent presidential succession severely limited the maneuvering room and field of vision of the officials responsible for conducting the negotiations. The member countries could only agree on an imprecise and indefinite system for monitoring the evolution of trade flows, to identify possible imbalances. The alternative of encouraging inter-company agreements on temporary and voluntary trade restraints (with the sponsorship of the governments) seemed to be a useful and reasonable instrument for dissipating tensions and responding to complex circumstances.

Such agreements are not a panacea for the problems attendant on the chronic differences in competitiveness between Argentina and Brazil in some productive sectors (particularly paper, the iron and steel industry, and footwear). They did, however, buy time before the new authorities took office and the regional recession had passed, thus spawning more favorable conditions in which to seek more lasting solutions.

Business accords were reached in the paper and footwear sectors at the end of September 1999, and Argentina imposed antidumping measures on some branches of the steel sector, as well as safeguards on textiles. The new authorities elected in October therefore suggested to their Brazilian counterparts that there was a need for some kind of umbrella mechanism to serve as juridical basis for integral solutions in the eight productive sectors that were defined, a priori, as commercially sensitive.¹⁹

Practical experience showed that while there could be a reasonable degree of compliance with such voluntary agreements in sectors that had few players (such as paper, or iron and steel), it was very hard to reach a compromise (or, when such compromises were reached, they were not fully observed) in the more expansive productive branches like textiles, poultry, and footwear. The governments were willing to persuade their business sectors that it would be helpful to agree with their peers in the region, but the absence of a legal instrument to uphold such accords in institutional terms sidelined them from the prevailing multilateral norms. That absence also inhibited the customs and commercial authorities from enforcing the agreements, while leaving them vulnerable to a private legal suit or a case in the Commission for the Protection of Competition for collusive or anticompetitive practices.

The Argentine chamber of commerce representing transnational companies in the footwear sector (CAPCICA) stated in mid-April 2000 that the sectoral agreements “are expressly forbidden by the WTO, by MERCOSUR legislation, and by Argentina’s Law for the Protection of Competition.”²⁰ Weeks later it said that the fact that “the government takes pains to enact legislation that allows it to ensure the implementation of these banned practices is hard to qualify.”²¹ In March and April 2000 the Argentine negotiators tried to reach an agreement with their Brazilian counterparts on an additional protocol to the Treaty of Asunción that could address the existing legal void in the matter. They sought a more general program to facilitate the reconversion and specialization of sensi-

tive sectors.²² Officials in the Ministry of Economy in Argentina declared a need to institutionalize government intervention in sectoral agreements at the MERCOSUR level, in order to guarantee compliance.²³ Brazilian Foreign Ministry negotiators emphatically rejected this possibility.

They insisted on the temporary nature of the problem, and on the need to use sectoral agreements to create reconversion and/or restructuring schemes that facilitate open and unrestricted competition once the agreed period of transition ended. "Comparative advantages cannot be eternally managed."²⁴

DEVELOPMENTS IN MERCOSUR'S EXTERNAL AGENDA

Given MERCOSUR's severe internal difficulties throughout the last few years, the particular turbulence in the areas of trade and international finance provoked by the outbreak of the Asian-Russian crisis, and its subsequent effects on Latin America, international negotiations entered a phase of stagnation and (in some cases) withdrawal from or non-fulfillment of agreed upon timetables and objectives.

Circumstances were made yet more complex at the end of 1999 with the failure of the WTO to launch a new round of multilateral negotiations at Seattle, and by the emergence of new groups and recalcitrant forces in the main developed countries that were resistant to the effects of economic globalization and to opening markets. Hence, the major players in the world economy had little incentive to push for progress in the complex exercise of North-South negotiations.²⁵

Beyond the significant advances made with regard to the possibility of fully integrating Chile into the customs union, little progress was made with MERCOSUR's external agenda in this period. The focus of external negotiations remained on formal and diplomatic treatments of the various issues on the agenda, the conclusion of some relatively important trade agreements, and the preservation of established routines. In this light, the challenges and prospects of the coming period are as important as they are uncertain, since most of the timetables already agreed upon assume that decisive measures and irreversible steps will be taken in the next two years (2001-2003).

Additionally, the four countries face the new challenges that arise from the decisions made by the presidents of MERCOSUR member nations at their June 2000 summit in Buenos Aires to push for an ambitious agenda

of trade negotiations with Mexico, the Andean Community countries, and South Africa, as well as to fix a strict time limit (June 2001) for reaching or extending individual agreements with third party countries that are members of the LAIA.²⁶ Those challenges of defining a common MERCOSUR position to balance out and harmonize the sometimes divergent interests of the four partners are formidable in light of the serious difficulties evident in earlier failed negotiations.²⁷

In this context, it is worthwhile to review recent developments and the status of the various issues on MERCOSUR's external agenda.

A. FTAA Negotiations Continue without Fast Track Authority

Following the decade's most complicated year, the third meeting of the FTAA's Trade Negotiations Committee (TNC) and the fifth meeting of the hemisphere's Trade Ministers was held in Toronto, Canada, at the beginning of November 1999. At this meeting, Canada handed over the chair to Argentina, marking the end of the stage of exchanging information, establishing databases, methodologies, and procedures, and approving business facilitation measures. The countries involved embarked on the stage of defining negotiating norms, disciplines, and tariff reduction schedules.

The substance of the negotiating round that was presented at this gathering was one of the most controversial issues on the table. The host country, Canada, insisted on the presentation of a preliminary, consolidated, and indicative scheme whose criteria were the objects of severe criticism. Because of this, MERCOSUR argued that it was still too early to approve the schedule, since it would condition future endeavors. Some countries, including Chile and the United States, insisted on the need to agree on specific instructions for the negotiating groups focused on market access and agriculture. However, other countries interpreted this move as an effort to bring forward agreements on tariff reductions. In the end, a general compromise was reached; the groups concerned with market access would discuss mechanisms and procedures in their respective areas. The Andean Community countries argued expressly that the agreement should include provisions on "special and differentiated treatment," a matter that spurred intense debate. It was agreed that the TNC should examine how the issue of differences in geographic size and levels of economic development should be dealt with in other fora, and that it would inform the ministers of the results of that examination.

The countries agreed that each of the groups would prepare a draft of their respective reports, which would be submitted to the TNC before the April 2001 ministerial meeting in Buenos Aires. The drafts included issues about which consensuses had been reached, as well as those where the countries still disagreed (which would be included in brackets). The groups concerned with market access issues would also start discussions on mechanisms and negotiating procedures in their respective areas. The TNC, chaired by Argentina until April 2001, would compile the draft texts of the different groups and draw up a report for the Ministers. This included the areas requiring special guidelines for the purposes of ensuring optimal fulfillment of the agreed upon mandates. The report would cover the outcome of discussions on the general structure of the agreement (general and institutional aspects), as well as how differences in size and development levels among the countries should be addressed.

At the Canada meeting a start was made on identifying business facilitation measures with the approval of an initial list of eighteen measures, including some that relate to customs procedures (eight measures) and administrative transparency (ten measures). The TNC is responsible for supervising the implementation of these measures, for extending technical assistance with their implementation (particularly in the less developed countries), and for identifying and recommending any additional measures that might be considered helpful.

Discussion of the message to be sent to the Secretary General of the WTO was an issue that prompted substantial controversy. The Caribbean countries did not agree that the message should only include agricultural issues, and the Andean countries supported them, insisting on the inclusion of the complex issue of special and differentiated treatment (although it should be noted, without making concrete proposals in that respect). The message from the Ministers concluded with a call that the multilateral negotiations have a balanced and wide-ranging agenda that includes the elimination of subsidies to agricultural exports and a ban on their reintroduction in any form; commitment to fulfillment of the obligations assumed in the Uruguay Round agricultural agreement; and implementation of additional disciplines to neutralize other practices that distort agricultural trade. At the meeting the leaders agreed to ask the WTO to pay greater attention to the sensitive issue of the interests of developing countries, to pay greater attention to affecting the principle

of special and differentiated treatment, as well as other provisions related to such countries.

Later, in mid-April 2000, the fifth meeting of the TNC (at the vice-ministerial level) was held in Guatemala under Argentine chairmanship. This meeting analyzed the progress of the discussions within the nine negotiating groups, specialized committees, and advisory groups, and approved the agenda for meetings and work programs that were set up to ensure that the first drafts would be ready before April 2001. The meeting also studied a document presented by the chair and another one from the Tripartite Committee (OAS/IDB/ECLAC) that addressed other experiences of integration processes that dealt with different sizes and development levels among member countries. Given the fact that the issue would loom on the horizon for some time, it was agreed that it be included in each of the negotiating groups, in the discussions of the TNC and other ad hoc working groups. The TNC is responsible for permanent follow-up on the matter, but there is currently no general mandate on it.

One of the most politically important moves executed at this meeting was the attempt by the United States and Canada to put issues that are directly or indirectly related to labor standards and environmental protection on the agenda, and ask that the issue be addressed in the drafts of the various working groups (especially that on investment). These issues had previously been peripheral to hemispheric negotiations, largely because of the overt opposition of the Latin American countries, which saw the initiative as an attempt to impose another obstacle to access to the U.S. market. Most countries firmly rejected this proposal, but the debate is not completely finished, and it is likely that the issue will arise again within the various negotiating groups in the coming months.

The ad hoc Group of Customs Experts presented a report on progress in the area of business facilitation, and implementation of the first series of measures on transparency was successfully marked off the list of tasks at hand. A timetable was agreed for the identification of facilitation measures other than those agreed in the July 1999 meeting of the TNC in Cochabamba, for the simplification of the list of 233 proposals presented by the countries and the Business Forum (finishing at the end of May 2000).²⁸ On that basis the chair prepared a new list of proposals in this area, to be examined at the Barbados meeting of the TNC in September 2000.

In sum, apart from the uncertainty effect that arose from the U.S. president's lack of progress in securing fast track authority from the U.S. Congress, the hemispheric negotiations have acquired their own momentum. Throughout 2000, significant progress was made in defining the agendas of each of the groups. The Ministerial meeting in Buenos Aires in April 2001 therefore signified a qualitative leap in negotiating the FTAA – given the progress made in the various working groups and the probable political conditions at that time.

As President Clinton told Congress in early May 2000, the silence of the U.S. government in the negotiation of the FTAA (after his failure to secure fast track authority in the winter of 1998 before the presidential summit in Santiago) should not be interpreted by the other countries of the region as a sign that the U.S. had less interest or lacked commitment to the issue. Clinton expressed his optimism for the future of the negotiations, pointing out that “there are no differences between [the views of then presidential candidates] Al Gore and George Bush.”²⁹ However, at the beginning of June 2000 there was an argument that played out in the press between U.S. and Brazilian officials on the issue. The U.S. Secretary of Commerce expressed doubts about Brazil's ability to work within the agreed timeline to foster the creation of a hemispheric bloc. Brazilian Foreign Minister Luiz Lampreia mentioned the need to reach internal and external consensus in order to proceed with an extremely complex negotiation. He pointed out: “in democratic societies, entrepreneurs, workers, and consumers must be listened to, and must be sure of the economic advantages that would stem from their country's inclusion in the bloc.”³⁰

The Difficult Negotiations with Chile: Economic Complementarity Agreement 35

After several years of strong growth, trade between Chile and the MERCOSUR countries fell sharply in 1999. MERCOSUR exports to Chile declined by 6% and imports by 12%, reflecting the severe contraction of output on both sides and the significant fall in the prices of most traded products. After a solid recovery in Chile by the end of 1999, and an improvement in MERCOSUR's general conditions, clear positive trends were evident in the first months of 2000; Argentine and Brazilian sales to Chile grew by 20–30%.

In the area of international negotiations, and in the framework of the MERCOSUR–Chile agreement (Economic Complementarity Agreement Number 35), throughout 2000 significant progress was made in implementing a new dispute resolution mechanism with instruments that surpass those established within MERCOSUR by the Protocol of Brasilia.³¹

However, there was virtually no progress in 2000 on deepening bilateral preferences, although negotiations should have begun in October 1998 (according to the original commitments set out in 1995). In this regard it should be noted that the continuity of the unilateral tariff reductions that Chile has been effecting since early 1999 (which establish annual cuts of 1%, to reach an average level of 6% in 2003) undermines the trade benefits that the MERCOSUR countries could secure from additional preferences with Chile, thus sharply diminishing their interest in negotiating new reciprocal concessions in this area.

During the period under analysis there were two significant developments in the framework of the MERCOSUR–Chile agreement. The first of these was the claim by Argentina against Chile in the framework of the dispute settlement mechanism originally established in ECA 35. This centered on the tariff treatment accorded to vegetable cooking oil mixtures. The other was Chile's imposition of WTO safeguard clauses on a series of agricultural products. At the end of March 1999 Chile's National Customs Service reclassified vegetable cooking oil mixtures in such a way that these ceased to pay the preferential duty of 3.7% (corresponding to a 63% preference over the MFN tariff for heading 15.17.90) and were included in the heading applied to the mixture's main ingredient. The resulting tariff was thus 10% ad valorem, to which must be added the duty arising from the application of the price band system. (The latter did not affect cooking oil mixtures but it did affect pure cooking oil, and a fall in international pricing led to increasing tariff protection). The effective tariff was therefore at a level of about 40–45% ad valorem.

A couple of weeks later, in response to the action of the Chilean customs authorities, Argentina conducted the corresponding consultations provided for in the dispute settlement system of ECA 35. This mechanism (Additional Protocol Number 21) provided for arbitration, through which the parties pledge to resolve disputes by direct negotiations that are conducive to a mutually satisfactory solution. In the case of MERCOSUR

these negotiations were conducted by the CMG's National Coordinators, and in Chile's case by the General Directorate for International Economic Relations (DIRECON), a section of the Foreign Ministry.

In light of the strictly technical basis of Chile's position, in December 1999 the Administrative Commission of ECA 35 decided to convoke a group of experts on customs classification issues who would issue a non-binding ruling on the measure's validity. Serving on the advisory group were: Milton Cevallos Rodríguez of Ecuador, the expert designated by both sides to chair the group; Augusto Aninat del Solar, the Chile's representative; and Juan José Sortheix, Argentina's expert. The group had thirty days from its first meeting in early April to reach its conclusions, but the accord's Administrative Commission would have final approval. In early May 2000 the ad hoc group of experts ruled in favor of Argentina, recommending that the National Customs Service should not effect the tariff reclassification of such products.³² In the May meeting of the Administrative Commission of ECA 35, Chile pledged to accept the verdict and to take steps to comply with it by changing the earlier customs ruling.³³ In mid-June 2000 the Chilean foreign ministry formally annulled customs decision 18/99. The tariff on the imports of cooking oil mixtures from the MERCOSUR countries and Bolivia was set at 3.7% ad valorem, rather than the 45-50% that resulted from the earlier classification.

With regards to the second issue, at the end of September 1999 the Chilean treasury began an investigation into the application of WTO safeguard measures on imports of vegetable oil and other products included in the price band system. In November, provisional safeguards were established for wheat, wheat flour, sugar, and edible vegetable oils, equivalent to the difference between the ad valorem tariff resulting from the application of the price band (from which the MERCOSUR countries had been excluded) and the level consolidated at the WTO.³⁴

At the end of January 2000, a decree established definitive safeguard clauses for one year (extendible for a further year) for imports of the aforementioned products from any source. Chile thus tried to regularize its situation in the WTO, since (as a result of the bands mechanism) the prevailing tariffs on those products substantially exceeded the levels consolidated at the WTO (reaching 61% for raw oils and 70% for refined oils, against the maximum of 31.5% allowed by Chile's WTO commitments). These measures had a particular effect on Argentine exports to Chile of all

the items mentioned (and on Bolivian exports of soya oils, although Bolivia recently won some compensation in the framework of ECA 22).³⁵ They were received with undisguised distaste by Argentine officials, who questioned the Chilean government's grounds for taking such measures and threatened to make a formal complaint to the WTO.

There instantly were difficulties arising from the change in government, the departure of the officials responsible for the matter, and the sensitivity of the issue for some regions of the country. The new Chilean authorities argued that the norm sprang from the complex circumstances faced by their farmers after the crisis in international prices of 1998-1999: projections for 2000 included a 34% decline in the area of wheat under cultivation, an 80% drop in sugar production, and a 54% fall in the output of vegetable oil.

Despite the conflicts, between the end of June and the beginning of July 2000, the issue of Chile's full absorption into MERCOSUR again occupied the center of the region's political stage. The optimistic declarations made by senior officials of both blocs (particularly those by Presidents Lagos and Cardoso during the visit of the former to Brazil) suggested that Chile might become a full member before the end of 2000. The basis for this possibility is an undefined tariff convergence scheme, the swift transposition of MERCOSUR norms, and an additional Protocol to the Treaty of Asunción. Notwithstanding the juridical and technical complexity of this undertaking, and the many obstacles that it will face (particularly in the agricultural and automotive sectors, as the two sides' policies are clearly incompatible), it is plain that Chilean membership would make an enormous political and economic contribution to MERCOSUR's relaunch.

C. MERCOSUR and the Andean Community: Modest Progress, Uncertain Prospects

The April 1998 signing of the Framework Agreement for the creation of a free trade area between MERCOSUR and the Andean Community in Buenos Aires seemed to indicate that the Brazilian yearning for a trade bloc covering the whole of South America would become a reality. Such a bloc could help balance (at least partly) the United States' greater bargaining leverage in the FTAA negotiations. However, the serious difficulties that arose in the negotiations between the two groups in the second

half of 1998 (which have repeatedly hampered compliance with the original schedules for integration and broadening preferences) curbed progress on the planned negotiation of a free trade area under the 4 + 4 format. According to initial agreements, this should have entered into force at the beginning of 2000, which has not happened.

In March of that year the Brazilian government unilaterally decided to abandon the stagnant negotiations between the blocs (which had made minimal progress in eight rounds), in part due to the serious political and economic difficulties facing MERCOSUR in the first quarter of 1999 as a result of the sudden change in Brazil's exchange parity. Brazil invited the Andean countries to negotiate a fixed preferences accord under the 1 + 4 format, with the intent that this could help re-focus the inter-bloc talks.³⁶

Brazil's decision was initially interpreted by some officials and analysts in the region as a reflection on loss of Brazilian interest in MERCOSUR.³⁷ In August 1999, Brazil and the Andean countries finally concluded a two-year partial scope agreement that covered a significant number of new tariff lines, establishing an explicit commitment to strive for the negotiation of a free trade area between the two groups (as established in the 1998 Framework Agreement).³⁸

In addition, and after several months of inactivity and uncertainty, a new phase of negotiations between Argentina and the Andean countries began in Buenos Aires at the end of October 1999. The talks used the old MERCOSUR-Andean Community negotiating plan as a point of reference. The negotiators tried to make initial progress in negotiating the traditionally traded goods and included new tariff lines in the schedule of products that would benefit from preferences. The basis used was the status quo that prevailed at the time that the inter-bloc negotiations were suspended in March 1999.³⁹

The second round of negotiations between MERCOSUR and the Andean Community were held in mid-February 2000, followed by new meetings in March that finally led to the initialing of the final agreement at the beginning of May 2000. In the text of the agreement (which was finally formalized in mid-July, and which will be in effect for two years after August 1, 2000), the countries reaffirmed their intention to continue negotiations for an Economic Complementarity Agreement between the Andean Community and MERCOSUR members, with a commitment to create a free trade area between the two regional groups. There was also

explicit agreement on the validity of the norms established in LAIA Resolution 70 on safeguards, including a dispute settlement system that establishes three levels for reaching resolutions: reciprocal consultations and direct negotiations; an Administrative Commission; and finally, the intervention of an ad hoc group of experts. Once the dispute has been analyzed, the group will communicate its conclusions and recommendations to the Administrative Commission, which will issue a definitive ruling and ensure compliance.

The agreement will maintain the conditions for market access for products that enjoy preferences under existing bilateral accords. Several bilateral preferences will continue, namely observations (items with preferences that do not include all the articles within them) and asymmetric preferences. Continuing the practice from FTAA negotiations, Ecuador was deemed to be a country with lesser relative economic development, and was therefore granted a greater allowance for preferences from its list of requests than the other Andean Community countries. In general terms, the relative level of the preferences agreed upon was not particularly significant; most ranged from 30% to 50%. Similarly, regarding the absolute quantity of beneficiary tariff items, the number of new items relative to the earlier agreements were insignificant. Of the 2,052 tariff lines in the schedule of preferences granted by Argentina, 1,330 (65%) respected the overall 1 + 4 format. Of the 1,512 lines that comprise the total preferences granted by the Andean Community, 774 (51%) conform to that format. A high percentage of the 2,600 negotiated lines were based on the notion of reciprocity: Argentina granted preferences to Colombia for 1,740 lines, to Ecuador for 1,710, to Peru for 1,604, and to Venezuela for 1,498. In turn, it received preferences for 1,229 lines from Colombia, 1,150 from Ecuador, 1,065 from Peru, and 969 from Venezuela. The limited scope of these numbers contrasts sharply with those in the partial preferences accord between Brazil and the Andean countries in mid-1999. In that agreement the region's largest economy granted preferences on 6,476 products and received tariff benefits from the Andean countries on 5,523 goods.

A more precise analysis of the preferences granted and received shows that Argentina gave more preferences than it received. In terms of traded values, however, it won export preferences worth US \$510 million (50% of its sales), while the Andean Community received preferences worth US

\$280 million. Most of the preferences won by Argentina correspond to the agro-industrial sector (particularly the cooking oil sector), while in the industrial sector the concessions were greater than the tariff benefits. Since the aim of the agreement was to lay the groundwork for the negotiation of a MERCOSUR-Andean Community free trade area, the accord stipulates that it is temporary. It would be in force until August 15, 2001, in line with the expiration date set up for the Brazil-Andean Community accord, and will expire immediately if there is an agreement on a more wide-ranging agreement under the 4 + 4 format before that date.

At the same time that Argentina and Brazil were negotiating, Uruguay was involved in 1 + 4 negotiations with the Andean countries for a similar agreement. In addition, the two sides agreed on a temporary extension of their prevailing agreements (so-called historical patrimony) until the end of June 2000. Of the MERCOSUR member nations, Paraguay alone has made no great progress on this matter, and its future agenda remains unclear.

For Brazil, Mexico's increasing commercial penetration in Colombia and Venezuela in recent years (via the G-3) has been a source of growing concern for its automotive and auto parts sector. For Argentina, the existing difficulties of access to the Andean markets in sectors such as cooking oils, meat, and cereals seem to be a significant focus of conflict. Similarly, some sectors in Argentina, Paraguay, and Uruguay would see their existing preferences eroded if the large Brazilian market were to be opened up to the Andean countries – another element to keep in mind with regard to the nature of the negotiations between the blocs.

It is plain that the political (and commercial) factors that prompted the signing of the framework agreement in Buenos Aires in 1998 are as pertinent today (or more so). It is no minor matter that in recent years the Andean Community countries have become significant recipients of Argentine and Brazilian investment capital. At the same time, it should be noted that if the value of this bilateral exchange is still low, an agreement would open the way to a sharp increase in trade in the coming years.

More generally, the apparent failure or stagnation of the WTO negotiations and the approach of the final phase of the FTAA negotiations have enhanced the premium for South American integration. In the second half of 2000, MERCOSUR formally proposed the re-initiation of bloc-to-bloc (or the 4 + 4 format in) negotiations with the Andean

Community, with a view to establishing a free trade area by 2001. That will be crucial to a clearer and more defined outlook for the future of this complex exercise.⁴⁰

D. Negotiations with the European Union: Between Diplomacy and Skepticism

Politically, in the last year, the most salient and relevant development in negotiations between the European Union and MERCOSUR was the inter-regional Summit of Heads of State held in Rio de Janeiro in late June 1999. That gathering, which paradoxically originated via an initiative by French President Jacques Chirac, was on the verge of cancellation on several occasions. Until the last moment, the European Commission faced serious difficulties establishing its mandate for the most sensitive issues in the negotiations.⁴¹

In addition to the problems coming out of Europe, in the months prior to the meeting, the Argentine government maintained the uncompromising position that the document approved at the summit should reaffirm the explicit commitments of both sides to the creation of a free trade area that fully covered the sensitive agricultural sector. This spurred the quiet mission of a senior Itamaray official to Brussels and other European capitals, in an effort to bring the two sides closer together and obviate what was seen as a serious obstacle to a successful summit.

Several meetings of European commissioners and ministers during the first half of 1999 failed to produce an agreement on the substance and scope of the European mandate for the negotiations – particularly in regards to agricultural issues. This was due to the firm opposition by France and Ireland to any strategy that might undermine the common agrarian policy of the EU. In the end, the General Affairs Council of Foreign Ministers, meeting in Luxemburg at the end of June 1999, produced a document they deemed reasonable. This work proposed that negotiations should initially address non-tariff matters, leaving the discussion of tariff issues, market access, and agriculture until mid-2001.⁴² It was hoped that the WTO negotiations would have produced specific commitments in these areas by then.

In June 1999, in Asunción, MERCOSUR's Common Market Council stressed that the negotiations had three aims: a fixed date for the start (2000) and end (2005) of the negotiations (the single most important cri-

teria for beginning talks), the inclusion of all sectors in the talks, and the overall concept of balance in the negotiations.

Amid fears that the meeting would founder or be nothing more than a photo opportunity for the leaders, the Rio Summit's final communiqué expressly omitted any concrete reference to the final aim (which had been explicit in the framework agreement of 1995); that of establishing a free trade area between the two blocs.⁴³ It actually limited the aims of the negotiations to the less resolute and somewhat diffuse objective of promoting the growth and diversification of trade by means of reciprocal liberalization, with the ultimate purpose of forming an Inter-regional Association.⁴⁴ Furthermore, no deadline was fixed for ending the negotiations. The European delegation deemed it impossible to stipulate in the documents that the negotiations could end in 2002, when the second EU and Latin America/Caribbean summit will be held. That date will depend on the outcome of the Millennium Round Table and the FTAA negotiations. The two sides did agree to hold the first meeting of the Inter-regional Cooperation Council in November 1999 in Brussels, when the negotiations formally began. They devised and exchanged proposals on the structure, methodology, and calendar of the negotiations, and agreed to set up an Inter-regional Negotiating Committee that is responsible for moving the process forward.

At the end of February 2000 the two sides held a ministerial meeting in Vilamoura, Portugal, where they agreed to put into effect mechanisms that would facilitate the participation of civil society actors in the negotiations. At the beginning of April 2000, the Inter-regional Negotiating Committee held their first meeting in Buenos Aires. The general guidelines and the structure of the groups were defined at that time, and the two sides exchanged their initial lists of requests for information (in order to update the snapshot taken of inter-bloc relations in mid-1997). Nevertheless, the substantial differences between the two sides vis-à-vis the issues to be negotiated are reflected in the inability of the parties to agree on a joint final document.

As agreed in the Rio Summit, the working agenda will include an initial stage that is focused on negotiating the non-tariff barriers to trade. In addition, from July 2001 such talks will include the methodology and timetable for negotiating the liberalization of goods and services. At the Buenos Aires meeting, the negotiators began formally to set up three

working groups on the following issues: (i) trade in goods, to cover phytosanitary and technical matters, antidumping norms, rules of origin, and customs procedures; (ii) trade in services, to cover investment and intellectual property; and (iii) unfair competition, consumer protection, trade disciplines, public markets, and dispute settlement. They agreed that the next meeting, in Brussels, would determine other technical working groups. According to Guy Legras, chief of the European delegation and Director of External Relations at the Commission, these would cover other commercial and technical issues as well as agriculture.

The document that was produced at that meeting stipulates that the talks will aim to have the relationship evolve in a single undertaking. Unlike the case of setting up MERCOSUR, the two sides agreed that no sector would be excluded from the negotiations but that account will be taken of sensitive sectors on both sides, all the while respecting WTO rules. There was significant disagreement at the end of the meeting, when the MERCOSUR countries asked that the more than sensitive issue of export subsidies be included as one of the aims of the inter-bloc cooperation in the WTO. Legras tried to indicate the differences between European and U.S. policy on this issue, pointing out that while the EU had resolved the previous year (at the Berlin Summit) to freeze the budget devoted to agricultural support, corresponding expenditure in the United States was increasing sharply.

The meeting was also the venue for the signing of draft agreements on equivalence of sanitary and phytosanitary certification between Argentina and the European Union (based on mutual recognition). It was thought that the final version could be signed before the end of the year, making agricultural trade between the two blocs more fluid and stable.

At this time the agenda for the Committee's second meeting was also defined (that gathering was held in mid-June 2000 in Brussels). It addressed the exchange of information on non-tariff barriers and technical norms in inter-regional trade, in line with the distribution of work agreed upon in April in Buenos Aires. At this time, despite the fact that this initial stage of the negotiations were to exclude market access issues until mid-2001, the main MERCOSUR spokespersons at the meeting repeatedly expressed their skepticism about the future of the exercise, particularly as regards the EU's real willingness to make substantive concessions on agriculture. According to press statements made by Argentina's Deputy

Foreign Minister after the meeting: “In October or November we will have the third meeting, and if more progress is not made than till now there will be no fourth meeting.”⁴⁵ Ambassador Botafogo has also conveyed his skepticism for the future of the negotiations, stating at the end of June 2000: “They are not willing to negotiate a free trade area with MERCOSUR. I do not think they are willing to negotiate something balanced.”⁴⁶

Progress has been made in recent years on designing and setting up the necessary institutional mechanisms for the agreement, and political relations between the two sides are excellent at this time. Despite this, trade negotiations remain the subject of rhetorical, angry declarations about the agricultural issue, especially subsidies from MERCOSUR, and Europe’s interest in devising more advanced norms on intellectual property, competition policy, and public procurement.

This hostility has ensured that unlike what is happening in the FTAA, the negotiations with the EU have no clear and defined goals as to their scope and final objectives, and no date has been fixed for their conclusion. In theory, the talks continue on an informal basis and they will end at the same time as the negotiations of the hemispheric agreement (2005). The stagnation of the WTO negotiations after the failure of Seattle, the EU’s need to concentrate all its political and negotiating efforts on the complex agenda of enlargement, and (especially) the absence of movement on fast track and the start of the hot stage of the FTAA talks are not pushing the Europeans to adopt a more defined and determined posture on the future of its commercial and economic negotiations with MERCOSUR. Hence those talks continue to evolve in the sphere of formal contact, of “wait and see” attitudes, and of a lack of definition as to their format, scope, and any deadlines they might have to accomplish something.⁴⁷

E. MERCOSUR–Mexico: The Eve of a New Era?

Mid-1998 saw the failure of efforts to secure a 4 + 1 agreement between MERCOSUR and Mexico. In October, therefore, the Argentine government agreed with Mexico on the renewal of a new partial preferences agreement for two years (including compensation from Mexico for the damage caused by its membership in NAFTA). Brazilian negotiators did not hide their objection to what they considered a lack of negotiating solidarity on the part of their partner.

Despite this, from mid-1999 onwards Brazilian Foreign Ministry officials (with the vigorous backing of the automotive sector's chambers of commerce) decided to renew negotiations with Mexico, focusing on the possibility of integration in the automotive sector. At the end of April 2000 the two sides announced that they had reached an agreement establishing a ceiling of 40,000 units a year in the first year and 50,000 in the second. Brazil's intra-quota tariffs will thus fall from the current 35% to 8%, while Mexico's will fall from 23% to 8%. Entrepreneurs from both countries hope to triple vehicle trade (a third of total trade between Latin America's two biggest economies), which in 1999 totaled US \$435 million.

One of the issues that sparked the greatest difficulties (and which almost stymied the talks at some points) concerned rules of origin for automobiles. This was largely because of Brazil's fear that an agreement with an automotive power such as Mexico would entail access to its market for vehicles assembled in Mexico with a large proportion of parts and labor from the United States, or from some East Asian countries.

Several negotiating rounds have been held, concentrating exclusively on dispute settlement, intellectual property, and safeguard mechanisms, but no significant progress has yet been made on the possible future signing of a partial but broad preferences accord like that in force until December 1998. So far, agreement has only been reached on 30-40% of the items to be negotiated (a total of some 1,400 items).⁴⁸ The two sides have repeatedly expressed their interest in a swift conclusion for the accord (with a view to subsequently resuming negotiations with MERCOSUR under the 4 + 1 format).

At the end of December 1999, Uruguay and Mexico publicly announced the conclusion of a new, ambitious Economic Complementarity Agreement (ECA 5), pending ratification by their parliaments. ECA 5 extends the elimination of tariff duties to a significant number of items. The accord goes far beyond usual standards for such initiatives, establishing overall, provisional and bilateral safeguard clauses, a dispute settlement mechanism, and laxer rules of origin than those for MERCOSUR (which in practice makes ECA 5 incompatible with the bloc's internal agreements). Mexico grants Uruguay 100% preference (zero tariff levels) on approximately 89% of its imports from Uruguay (6,200 tariff items), while the latter returned the favor for about 70% of its

purchases from Mexico (4,980 items). The two sides also agreed to eliminate tariff restrictions (with very few exceptions). If ratified, the accord will be in force indefinitely, although both countries explicitly expressed their willingness to participate in an eventual commercial understanding between MERCOSUR and Mexico, which would supercede ECA 5.

Mexico's Vicente Fox has stated his interest in closer political and commercial links with MERCOSUR, and MERCOSUR's Common Market Council has resolved to push again for the negotiation of a free trade area with Mexico under the 4 + 1 format. These developments seem to offer new possibilities in this complex area. But, despite the declared political will of both MERCOSUR and Mexico to move toward a broader and more inclusive trade agreement, it is highly unlikely that this will happen, at least for now.

THE AGENDA FOR 2000: NEW CHALLENGES AND QUESTIONS

MERCOSUR economists and officials have in agreed recent years that different exchange rate schemes in the two main countries have not hampered progress on macroeconomic policy coordination per se, and that efforts to create more austere and orderly fiscal mechanisms have fostered convergence of the general policies and strategies of the MERCOSUR countries. However, the member countries are still far from recovered from the effects of the recent economic crisis. It also remains unclear as to how commitments made will translate into creating a less volatile regional environment, one that is less susceptible to the vagaries of the world economy and international financial woes. That said, the progress made this year by Brazil and Argentina in converging their foreign and economic policies has made it easier to identify common interests and points of contact in terms of MERCOSUR's new agenda of priorities and negotiations with third party nations.

In addition to working to coordinate macroeconomic stability, another challenge of this new phase is to finalize a new regional agenda that adequately combines and balances the political and economic interests of the two main members with the demands of the two smaller economies, and which simultaneously maintains the degree of political cohesion necessary to prevent the integration process from becoming a 2 + 2 process. Similar consideration needs to be paid to the variances in the economies of the different regions within each country. These sub-regions are partially or

totally affected by the productive changes that have been created by the MERCOSUR process, which after a fashion could sustain itself exclusively along the São Paulo-Buenos Aires axis.

The significant progress made in the two previous years, in the area of the dispute settlement mechanism established by the Protocol of Brasilia, is a significant (although partial and insufficient) step forward in strengthening MERCOSUR's institutional framework. Despite recent efforts to make these mechanisms more flexible and stable, and to create institutionalized MERCOSUR jurisprudence, the differences in size between the four member states (and it turns out, their bargaining power) have sparked significant differences of perception (and interest) between the parties. These appear unlikely to be resolved in the short-term.

The persistence of structural difficulties in some production sectors in the various countries make it necessary to implement measures to resolve such situations positively and constructively and stop the chronic emergence of complaints and conflicts that have arisen throughout the integration process. One of the main challenges in this respect is to restructure those sectors in crisis and to increase intra-sectoral complementarity, in an effort to preserve the cooperative spirit signaled by the recent rapprochement between Argentina and Brazil. This would help obviate traumatic or zero-sum situations that would exacerbate pre-existing regional imbalances. It is however no less certain that the management of intra-regional trade is simply a temporary and conjectural alternative. The need is to facilitate the reorientation of the national productive structures of each country towards a regional and international environment in which an infinite range of special treatment and/or *sine die* protection mechanisms are not accepted as viable alternatives. In other words, although one logical and desired consequence of an integration process is the creation of some degree of specialization and the crossing of industries between the member countries, such intra-zone specialization would only be viable if and when no one member country has a monopoly on the most dynamic and strategically important sectors.

I believe the success of the integration process will depend largely on member states behaving and negotiating with serious intent, with intelligence, and with a strategic outlook. This would facilitate the introduction of measures on the domestic and regional levels to change and restructure productive structures, with the goal of making them more micro- and

macroeconomically efficient. Only under such circumstances would the costs absorbed by a few sectors be more than offset by the benefits to the economies as a whole – the foremost objective of integration.

The success of the relaunch or, put more simply, the revitalization of the MERCOSUR process, should mainly stem from the need to maintain a balance of interests that ensures that each member (including the relatively smaller countries) continues to view the process as politically reasonable and economically useful. In this phase, no amount of institutional engineering – or any arbitration tribunal in which members feel that one country wins and another loses – can replace the political necessity of redefining the commonly held vision about MERCOSUR's strategic direction, a vision that takes into account the implications presented by the agreements made over obligations and commitments and their affect on domestic policy in each member country.

Turning to the external agenda, the busy timetable in the 2000–2002 period (WTO talks and the FTAA and MERCOSUR–EU negotiations will enter decisive phases in this period) presents a new outward challenge and an excellent opportunity for the four members to identify common interests and objectives in different areas and disciplines. The firm and decisive anti-subsidy positions adopted by the four MERCOSUR countries in various multilateral fora during the last few months of 1999 and the start of 2000 (such as the Cairns Group meetings, the FTAA ministerial summit in Toronto, the EU–MERCOSUR mixed commission meetings and the WTO summit in Seattle) are important starting points for defining common strategies on other issues of the various negotiating agendas. In many of them agreement on trade and political issues is less apparent.

Another test of fire for the integration process, both in terms of the supra-regional FTAA and MERCOSUR's internal performance, concerns the pending issues on the MERCOSUR–LAIA agenda, particularly those relating to the Andean countries and Mexico. Although there is much progress to be made in this area, many potential obstacles arise in these areas from the persistent (and often natural) political and trade differences between MERCOSUR's four member countries.

The broadly convergent domestic agendas of the two main member countries has also made it easier to cooperate and complement their efforts, particularly in terms of fiscal policy, where the federal governments

of both countries are making serious efforts to improve the efficiency of their tax systems and to increase their control over the different state administrations. MERCOSUR is playing a useful and positive role in this area, but there is some doubt as to whether these goals can be met in practice. Such doubts spring from the performance of the international economy and financial markets, the economic and social consequences of the crisis of the preceding years, and the still fragile institutional situation in Paraguay.

MERCOSUR's future, however, is neither simpler nor more complicated than the economies and foreign policies of its member states; new proposals or magical solutions are not to be expected. On the contrary, the process is likely to continue to be marked by a "learning by doing" approach. This combines efforts to create laws at the national level to legislate the existing agreements as well as the harmonization of regulatory norms and frameworks with by-pass style solutions created wherever feasible for issues or disciplines over which a speedy consensus cannot be reached. One of the great challenges facing the various sectors of the region's societies over the next few years will be the need to make concrete and noticeable advances in this respect. This will help preserve, complete, and strengthen a strategic tool that the countries of the region can use to quantitatively and qualitatively improve their insertion into the world economy.

FUTURE PROSPECTS

An important step forward during 2000 was the significant progress made in terms of clearing the agenda of trade disputes between the member states, identifying a new series of common strategic interests, signing agreements on a number of politically and macroeconomically significant issues (such as the automotive sector agreement), and designing a short-term work program that will allow movement towards a single undertaking and takes into account the interests of all sides. In some respects, this represents a "before and after shot" in terms of the critical year of 1999. These achievements, however, should be viewed as nothing more than a starting point for a journey that is both long and complex; one that holds numerous short- and long-term risks and presents myriad challenges.

Although the agreements signed during 2000 can be viewed with some optimism, it also worth bearing in mind that the history of Latin

American integration (before and after the Treaty of Asunción) is full of pro-integration declarations, as well as ambitious timetables and commitments that eventually amounted to nothing more than rich research material for economists and historians.

At the Buenos Aires ministerial summit, Argentine Minister of Economy José Luis Machinea stated: “MERCOSUR is again an opportunity for our country and not a threat, as once seemed to be the case.”⁴⁹ This is a striking reflection of the change in climate over the last few years, and of Argentina’s new perception of the integration process. What was achieved in 2000, when MERCOSUR breathed again, is a significant positive step. However, it is not enough.

NOTES

1. An earlier version of this paper was included as part of the *Mercosur Report* No. 6 (INTAL/IADB, July 2000 – Ricardo Rozemberg and Gustavo Svarzman). The present version was finished at the beginning of 2001. It does not include the Argentine political crisis of December 2001, nor does it take into account the implications of the end of the Convertibility Plan at the beginning of 2002.

2. Although this was not the first time since the start of the integration process in the mid-1990s that one of the main member countries had devalued its currency, it was the first time that a strong fluctuation in exchange rate parity between the member states had taken place in the framework of zero tariffs for almost all tariff categories, and in an international financial and trade context that after almost two years of uninterrupted crisis was particularly unfavorable.

3. It is worth noting that apart from the fact that bilateral exchange rate values were marked by strong and sustained falls, some analysts have also noted that Argentine and Brazilian exporters were forced to accept significant reductions in the price of their products in order to maintain their respective market shares. However, while in the case of Brazil the reduction of costs in dollar terms for a significant share of its inputs and salaries made it easier to adapt cost structures to the new environment, in the case of Argentina there was a significant fall in profit margins, although with some specific exceptions. This raises an important question about the long-term viability of these trends. See Ricardo Markwald, “MERCOSUR: Aspectos comerciales de la crisis actual,” in *MERCOSUR: Una estrategia de desarrollo*, Celia Barbato, editor (Montevideo: Sociedad Internacional para el Desarrollo, TRILC: 2000).

4. “The essentially political spirit of 1986 seems to have been diluted in the integration of this region, Alfonsín, Sarney, and their collaborators thought. With

an intensity never repeated they saw that integration was a question of the future viability of Argentina and Brazil, in which economics would undoubtedly play an important role but not the only one, and not even the most important...”

Oscar Raúl Cardoso, quoted in the article he wrote, “Repoliticizar el MERCOSUR.” *Clarín* (Buenos Aires), March 25, 2000: Opinion Section.

5. “I am convinced that it is possible to do in Latin America what Juscelino Kubitschek did with the Brazilian interior.” Fernando H. Cardoso, quoted in *Jornal do Brasil* (Sao Paulo), May 3, 2000: News Section.

6. Federal government includes the central administration, the social security system, the decentralized bodies, the national state companies, and the Central Bank.

7. This also includes the assets and liabilities of the provinces and municipalities, as well as their companies.

8. In December 2000, the temporary 3% increase in the CET was reduced by only 0.5%.

9. It is worth noting that in the negotiations before Ouro Preto, Uruguay was given special treatment since it was allowed to continue applying drawback and temporary admission to intra-zone trade, but only for products traded through the Convenio Argentino-Uruguayo de Complementación Económica y del Protocolo de Expansión Comercial (CAUCE-PEC).

10. Argentina had levied zero-level tariffs on the import of these products for most of the 1990s, in order to stimulate the restructuring and modernization of its productive apparatus. Until 1994 in particular, Brazil protected its industry in capital goods and information and telecommunications products with high tariffs, although the import of goods manufactured outside the region was completely liberalized. This strategic divergence resulted in some of the most difficult negotiations between the member states in the period before Ouro Preto, when MERCOSUR’s common external tariff was being defined. It was therefore agreed to set up a gradual convergence schedule for capital goods, and another for information technology and telecommunications products. The maximum tariff for capital goods was set at 14%, with 2001 as the convergence deadline (2006 for Paraguay and Uruguay); Argentina increased tariffs and Brazil lowered them. The maximum tariff for information technology and telecommunications products was set at 16%, with convergence by 2006.

11. For more information on the issue of equivalence agreements see above.

12. This issue will be examined more closely in the next section.

13. In their meeting in April, the CMG coordinators decided to create Working Sub-Group Number 12, which would specifically examine investment subsidies in the regional context.

14. According to estimates by Brazil’s Ministry of Foreign Affairs, MERCOSUR public procurement totals some US\$20 billion a year, broken down as follows, US\$15 billion by Brazil, US\$3 billion by Argentina, and US\$2 billion by Paraguay and Uruguay together.

15. The Protocol of Brasilia establishes an initial process of negotiation and information exchange between the governments of those involved in the dispute. This is followed by arbitration before an ad hoc Tribunal.

16. At the time of writing, several disputes were in the pre-arbitration stage: Argentina's case against Brazil for the incomplete transposition of MERCOSUR regulations on phytosanitary (agro-chemical) products, and for non-transposition of the registration of pharmaceutical products; Argentina's case against Uruguay for subsidies on wool; Brazil's claim against Argentina for the mid-1999 imposition of non-automatic licenses for footwear imports and for the conflict arising from Law 24.822, which prohibits the reduction of the intra-zone tariffs on sugar (for more on the state of bilateral negotiations in this area, see section II of this chapter); and Brazil's case against Paraguay for the imposition of minimum specific duties on intra-zone trade.

17. José Botafogo in *Clarín* (Buenos Aires), April, 9, 2000: News Section.

18. "Brazil believes that it is unnecessary; today we have a mechanism that is wholly compatible with international organizations and we do not see any reason to change it ... although we admit that it could be improved." Statements by Foreign Minister Luiz Lampreia in *BAE* (Buenos Aires), April, 23, 2000: News Section.

19. These are rice, chickens, pork, sugar, footwear, textiles, paper, and steel – to which are added (at a second level) potatoes, honey, garlic, and onions.

20. Statement by the Director of CAPCICA quoted in *El Cronista* (Buenos Aires), April 13, 2000, Economic Section.

21. Statement by the Director of CAPCICA quoted in *El Cronista* (Buenos Aires), May 2, 2000, Economic Section.

22. Although the WTO agreements contemplate sectoral agreements on voluntary restraint in the areas of prices and trade volumes in sensitive sectors, there is an express prohibition on the application of fines or other forms of public intervention for non-compliance.

23. According to Debora Giorgi: "Now we can only monitor trade. The idea is to be able to intervene when the agreement is distorting." *BAE* (Buenos Aires), April 7, 2000, News Section.

24. Statement by José Botafogo quoted in *Gazeta Mercantil Latinoamericana* (São Paulo), March 5-11, 2000: Opinion Section.

25. Despite this, it should be pointed out that there are some exceptions to these rules, such as the European Union's trade agreements with South Africa and Mexico, or the culmination of China's negotiations with the EU and the United States with regard to its accession to the WTO.

26. It is interesting to note in this regard that at the Buenos Aires Summit of June 2000, Chile had informally expressed its interest in participating in the negotiations with the Andean Community countries as a de facto member of MERCOSUR. The Andean states finally decided that in practice this would be an additional obstacle to the talks.

MERCOSUR: Between Skepticism and the Relaunch

27. It is worth noting that while Argentina sought to re-start negotiations with the Andean countries and Mexico with the aim of regulating preferential trade relations, Brazil's explicit aim was to establish a free trade area.

28. It is worth noting the criteria that define the proposed measures as part of business facilitation: that they are not part of issues to be negotiated in other groups; they do not entail changes to national laws; and they do not imply endorsement to extra-hemispheric international agreements.

29. Extract of President Clinton's speech to the United States Congress. May 2, 2000. White House Press Release.

30. Luiz Lampreia in *Jornal do Brasil* (São Paulo), June 8, 2000, News Section.

31. The new mechanism calls for bilateral negotiation, after which the matter passes to the Administrative Commission and finally reaches the arbitration stage. Simultaneously, keeping in mind the experience of setting up MERCOSUR, some elements were added that were not featured in the Protocol of Brasilia. These included a chance for the parties to analyze (and refute when necessary) the rules of procedure fixed by each ad hoc tribunal.

32. It should be pointed out that some days earlier, the (binding) arbitration tribunal working within the LAIA framework, in connection with the issue of the tariff reclassification of vegetable oil mixtures, ruled in favor of Bolivia against Chile.

33. Since the same issue also affected Bolivia, another group of experts was set up within the framework of ECA 22 (Chile-Bolivia agreement). Before the Argentine case, this ruling went in favor of Bolivia. It is worth noting that, unlike the mechanism of ECA 35, compliance with the verdict of the technical group in this case was mandatory. But, it should also be noted, that at the time of writing, this measure had still not been put into effect.

34. The first two products mentioned are in a particularly sensitive sector of the Chilean economy. ECA 35 established a long timetable of tariff convergence that contemplated the granting of preferences in the fourteenth year.

35. In 1999, Argentina accounted for 100% of Chilean imports of sunflower and soya oil, 26% of wheat imports, and 82% of wheat flour imports.

36. It should be recalled that before the breakdown in negotiations, the central problem was the refusal of the parties to multilateralize certain levels of preferences, as well as the internal conflicts in several Andean countries (especially Colombia and Ecuador). The negotiation was thus restricted to a small number of tariff items comprising the historically traded goods plus a few new products, since the initial criterion was reformulated to include only those products that enjoyed a certain minimum level of trade.

37. In this regard, Itamaraty officials stated that the interests of the MERCOSUR countries in these negotiations were very different, which repeatedly blocked progress. The other MERCOSUR governments did not react favorably. On the contrary, Argentine officials did not hide their objection to Brazil's deci-

sion, and the Uruguayan Foreign Ministry sent a letter formally expressing its disagreement on the matter.

38. For a detailed analysis of the substance, scope, and implications of the agreement between Brazil and the Andean countries, see Centro de Economía Internacional, *Panorama del MERCOSUR* (Buenos Aires), No. 4., November 1999.

39. It should be noted that Argentina, Paraguay, and Uruguay were renewing their outdated preferences on a quarterly basis, pending the signing of a new agreement.

40. In this regard, CMC decision 32/00 established that if there is no agreement between the blocs, the prevailing LAIA preferences will certainly expire in June 2003.

41. It is to be stressed that, contrary to what happened in the negotiations with MERCOSUR, by mid-March and after five years of negotiations, Mexico and the EU concluded a free trade agreement (the first that Europe has reached with a Latin American country). It will enter into force on July 1, 2000. The EU commits itself to suspend 82% of the tariffs on Mexican industrial goods and to eliminate the remaining 18% in stages by 2003. Mexico will cut its tariffs on European products by 47% in 2001, another 5% in 2003, and the remaining 48% gradually between 2005 and 2007. The European Union will have preferential access to the vehicle market through the reduction of export taxes on its car exports. These will fall from 20% to 16.7% and will be eliminated in 2003. Liberalization of the trade of agricultural products will take place in four phases over the next seven years.

42. This conclusion was a compromise solution between the French desire to postpone the start of the negotiations on these issues until mid-2003, and the desire of the German president to begin such talks in December 2000, so that they could be concluded in light of the outcome of the Millennium Round.

43. For a more detailed analysis of the substance and implications of this summit, see INTAL, *MERCOSUR Report*. No. 5 (Buenos Aires : IDB-INTAL, 1998-1999).

44. A parallel MERCOSUR-Europe Business Forum (MEBF) was set up, consisting of entrepreneurs from both blocs. It aims to coordinate the dialogue between businesspeople of the two regions so as to identify barriers to goods, services, and investment, and to make recommendations for their elimination. This forum met for the first time in Rio de Janeiro in February 1999 and held a second meeting in Buenos Aires in September 2000.

45. Horacio Chiguizola in *Clarín* (Buenos Aires), June 24, 2000. Opinion Section.

46. José Botafogo in *Gazeta Mercantil* (São Paulo), June 25, 2000: Economic Section.

47. In this sense, on his stopover in Brasília before going to the Buenos Aires meeting, the head of the European delegation, Pascal Lamy, told the press that all

MERCOSUR: Between Skepticism and the Relaunch

changes to the agricultural policies of the EU would be discussed in the WTO negotiations. *Gazeta Mercantil* (São Paulo), June 20, 2000: News Section.

48. While Mexico seeks to secure preferences for the electronic sector, Brazil seeks to include meats and fine leather goods.

49. Statement by Jose Luis Machinea at the Buenos Aires ministerial summit. Press Release. June 8, 2000.

REFERENCES

- Berlinski, Julio and Ricardo Soifer. Evaluación de restricciones al comercio interno del MERCOSUR. Paper developed in the framework of Red-MERCOSUR, at ITDT in Argentina, IPEA in Brazil, and DE/FCS in Uruguay, with the support of the IDRC-CIID. Completed in May 2000.
- Bouzas, Roberto. *Las perspectivas del MERCOSUR: Desafíos, escenarios y alternativas para la próxima década*. Buenos Aires : FLACSO, 1999.
- Campbell, Jorge (ed.). *MERCOSUR. Entre la realidad y la utopía*. Buenos Aires : Grupo Editor Latinoamericano, 1999.
- Candia Veiga, João Paulo. MERCOSUL 2000: relançamento o estagnação? Working paper produced for DESEP-CUT e CSN, Mimeo in Sao Paulo in March 2000.
- Centro de Economía Internacional. *Panorama del MERCOSUR* (Buenos Aires), No. 2. March 1999.
- . *Panorama del MERCOSUR* (Buenos Aires) No. 3. July 1999.
- . *Panorama del MERCOSUR* (Buenos Aires) No. 4. November 1999.
- . *Panorama del MERCOSUR* (Buenos Aires) No. 5. Forthcoming.
- . *Panorama de la Economía Internacional* (Buenos Aires) No. 5. Forthcoming.
- Centro de Estudios para la Producción (CEP). *Síntesis Mensual de la Economía Real*, (Buenos Aires), No. 33. February 2000.
- . *Síntesis Mensual de la Economía Real*, (Buenos Aires) No. 37. June 2000.
- De la Balze, Felipe. *El destino del MERCOSUR: entre la unión aduanera y la 'integración imperfecta'*. Buenos Aires: Mimeo, 2000.
- INTAL. *MERCOSUR Report*. No. 5. Buenos Aires : IDB-INTAL. 1998-1999.
- INTAL. *MERCOSUR Report*. No. 6. Buenos Aires : IDB-INTAL. 1999-2000.
- INTAL. *Monthly Newsletter* No. 38. Buenos Aires : IDB-INTAL. July 1999.
- . *Monthly Newsletter* No. 40. Buenos Aires : IDB-INTAL. September 1999.
- . *Monthly Newsletter* No. 42. Buenos Aires : IDB-INTAL. January 2000.
- . *Monthly Newsletter* No. 44. Buenos Aires : IDB-INTAL. March 2000.
- . *Monthly Newsletter* No. 47. Buenos Aires : IDB-INTAL. June 2000.
- Rua Boiero, Rodolfo. *Intelligence Trade Report*. (Buenos Aires). No. 30. July 1999.
- . *Intelligence Trade Report*. (Buenos Aires). No. 31. August 1999.

- . *Intelligence Trade Report*. (Buenos Aires). No. 34. November 1999.
- . *Intelligence Trade Report*. (Buenos Aires). No. 39. April 2000.
- . *Intelligence Trade Report*. (Buenos Aires). No. 41. July 1999.
- Lampraia, Luis F. "A agenda externa brasileira no novo milenio." *Revista Brasileira de Comercio Exterior*. No. 62 (January-March 2000).
- Lavagna, Roberto. "Zona de livre comercio ou área de decisão brasileira?" *Revista Brasileira de Comercio Exterior*. No. 61 (October-December 1999).
- Machado, João Bosco and Fernando Ribeiro. "Mudança cambial e questões estruturais." *Revista Brasileira de Comercio Exterior*. No. 61 (October-December 1999).
- Mantilla, Enrique. "El MERCOSUR en vísperas del año 2000." *Boletín Informativo Techint* (Buenos Aires) 299 (July-September 1999).
- Markwald, Ricardo. "MERCOSUR: Aspectos comerciales de la crisis actual." in *MERCOSUR: Una estrategia de desarrollo* Celia Barbato, editor. Montevideo : Sociedad Internacional para el Desarrollo, TRILCE. 2000.
- Mayoral, Alejandro. "La Política Comercial Intra-MERCOSUR." *Boletín Informativo Techint* (Buenos Aires) 299 (July-September 1999).
- Pena, Celina and Ernesto de la Guardia. "El azúcar en el MERCOSUR: una dulce asignatura pendiente." *Panorama del MERCOSUR* (Buenos Aires) No. 4. (November 1999).
- Recupero Rubens. "Brasil: Agenda externa 2000. Há futuro para o comércio exterior brasileiro?" *Revista Brasileira de Comercio Exterior*. No. 62 (January-March 2000).

Newspapers

Ambito Financiero, BAE, Clarín, El Cronista, El Economista, La Nación y La Razón (Argentina), Folha de São Paulo, Gazeta Mercantil, Gazeta Mercantil Latinoamericana and O Estado do São Paulo, (Brazil), El Diario (Chile), El Día and El Observador (Uruguay) and The Economist.

GOVERNMENT PERSPECTIVES

PART II

The Next Stage of MERCOSUR

JAVIER O. TIZADO

The Brazilian devaluation of the real (R\$) in January 1999 led to the most conflict-ridden year in the history of MERCOSUR. For the first time in the decade of the 1990s, the principal economies of the region had to face both a marked contraction of economic activity within their borders and a drop in trade with outside partners. Because of this, the change in Brazilian monetary policy led to the first major crisis of confidence in the integration process, raising rather serious doubts about the future of the process on the part of consultants, analysts, and businesspeople. The perceived absence of traditional “escape valves” and other types of compensation, given a radical alteration in the general macroeconomic conditions of one member country, seem to have hastened a negative reaction from Argentines. The clamor they raised during negotiations in 1999 exceeded the expected levels of protest in the face of such a marked change in relative prices.

Previous shocks, such as the so-called Tequila crisis in Mexico or the Asian crisis, had come from outside the regional system. At each turn, one of the two largest economies (Brazil or Argentina) had been able to come up with solutions, through the established negotiating process, that kept the external shocks at bay. However, none of the solutions that had worked in the past seemed viable in the face of a crisis that grew from within the region rather than from outside of its borders. It should be noted that the short-term change in relative prices did not generate a significant alteration in the fluctuations of exchange nor did it seem to cause a significant change in the principal financial indicators for the economies of the region. However, it did serve to amplify a climate of ill humor on the part of decision-makers in the member countries that had been simmering under the surface prior to January 1999.

The epicenter of the tensions that surged within the bloc during 1999 was not only created by the change in the regional economic outlook, but the fact that each of the member countries adopted a different response to the problem. For its part, Argentina, led by a faction made up of influential private consultants and externally oriented organizations, signaled ex-ante that a potential devaluation would be a serious danger to the sustainability of the country's current economic status. The strategy adopted in defense alienated Argentina from its principal trading partner when the devaluation actually occurred, and many analysts saw this as a dangerous trend that could halt the deepening process of integration. In contrast, Brazil, faced with a need to stop price inflation, opted to use all of the mechanisms that membership in MERCOSUR placed at its disposal, including external tariffs. The domestic turmoil drew Brazil to turn inwards, putting itself before the success of the communal project. Thus, the surge in disputes that arose from the actions of the two partners was a manifestation of the problems that each economy was facing. For Brazil, the priority was to resolve its fiscal problems and stave off a rise in inflation. Argentina focused upon resisting being infected by the economic "virus" of its neighbor and any problems that might arise from maintaining the convertibility regime it earlier had adopted.

Discussions about the economic situation were motivated in large part by divergences in exchange policy and the problems that these created for each economy. These helped bring the focus of attention once more on the structural problems that had first come to light as a part of the problematic integration period of 1996-1997. In regional negotiations the participants admitted that the level of commitment and effort expended to improve the bloc would have to be undertaken at a different level (metaphorically speaking a new playing field would have to be found), and new communal policies and agendas would have to be developed.

After Ouro Preto, but prior to 1998, the members of MERCOSUR had declared that they wanted to systematically intertwine their economies (including modes of production), in order to transform the Southern Cone into a region that would hold a strong attraction for foreign investment. However, despite advances in negotiations for creating this entity, change was partial at best after 1996-1997, taken in only general terms and with few concrete or visible results.

THE RELAUNCH AGENDA

MERCOSUR has faced difficulties in recent years in its attempts to advance the consolidation of the integration process. However, there are issues where the member nations have reached agreement – to dismantle tariffs that affect intra-zone trade (the tariff regime) and to establish a CET (the exceptions regime). The issue of tariffs is a major obstacle that needs to be overcome in the integration process. Resolution of this conflict is critical for the evolution of a complete customs union. These agreements have signified the definitive phasing out of protections that for decades have shielded certain sectors of the Argentine economy from trade with other members of MERCOSUR. Free trade in the region in sectors such as paper, iron and steel, grains, and petrochemical products are the intended reality; something that few involved thought possible. The majority of the businessmen and analysts in Argentina who have been watching the integration process have been highly skeptical about the success of this process. They were the ones who claimed that the enactment of the accords established at Ouro Preto would cause the disappearance of heavy industrial and other basic sectors because these sectors would not be able to adapt themselves to the weight of competition with Brazil.

In a similar manner, the gradual agreement over the list of exceptions for the CET implies that once divergent industrial interests and concepts in the region have changed course and are growing closer. It is important to note that this is happening in economic sectors that are fraught with contradictory regulations, so different one from the other that it often seemed that they could never be brought into harmony with each other for a common trade strategy. Trade harmonization takes on greater relevance when one realizes that it is a critical element in the complicated process of political and macroeconomic consolidation. As slowly as progress has evolved, harmonization has moved forward even while the region has felt the effects of the Tequila crisis, the Asian crisis, and changes in governments in the region. This last point is significant because it has not merely been a case of the political players changing on a regular basis. Many of the member nations have seen a complete shift in power over the years. Opposition parties are winning in the polls and continuing the integration process begun by their rivals.

While progress is critical to success, it must be noted that MERCOSUR has lost much of its dynamism in the past few years. When the process began, negotiations over the enactment of political accords happened with greater speed and ease. If MERCOSUR is going to transform itself into a successful common market, it is critical that it first formalizes an environment of free trade and then evolves into a customs union. Consolidation, deepening, and developing an external agenda, and the transmission from a free trade zone into common market are all interdependent issues and questions. As such, they require that the focus of negotiations is balanced evenly between them rather than focusing on just one to the detriment of the others. If this occurs the process will be thrown off-balance and in the end, it will fail.

An essential element in any process of integration is that the forces in play are continually working to gain strength and agreements are consolidated. I feel it is not enough for MERCOSUR only to accomplish the free circulation of goods between member nations. It is critical that this compact extends to services, and later, to the movement of capital and people.

The members of MERCOSUR, taking advantage of the change in governments in Argentina and Uruguay and the improvement of the regional economic outlook (after the convulsions of 1999) had been working to relaunch it in 2000. The goal was to put aside the problems of 1999 and take advantage of the positive chemistry felt between leaders to refocus the energy of the integration process. MERCOSUR first started as a bilateral movement between Argentina and Brazil, expanded with the Treaty of Asunción in 1991, and was reaffirmed with the Ouro Preto Protocol in 1994. The relaunching of its agenda needs to eventually deliver commitments made in previous years, further the integration process (through a widening of the definition of what will be slated for integration), and turn attention once again to issues that have caused problems for forging external relations as a group with the Andean Community, Mexico, the FTAA, and the EU.

The relaunching of MERCOSUR has been consolidated by key settlements, such as a bloc-wide automotive regime. (Negotiations for this regime had been underway since 1997.) The accord was initiated in a bilateral manner, between Argentina and Brazil in March 2000, ratified in

quadrupartite form on July 30, 2000, and finalized at the CMC Summit in Florianópolis in December 2000. The successful completion of this outstanding issue had given life to the rest of the negotiating agenda until the crisis in Argentina during 2001. A new “upgrade” phase for the integration process has not materialized nor has led to the elimination of the remaining obstacles for regional free trade. The mechanisms and regulations that guard the stumbling blocks remain and the elimination of distortions that interfere with the CET has not been achieved. The enactment at the legislative level of policies that enable macroeconomic coordination, institutional consolidation, and the creation of a communal negotiating position for the many different international fora that the bloc participates in has been ignored. It appeared that these changes would occur after the CMC meeting in December 2000 to generate advances in macroeconomic coordination. In particular the group selected the terms and statistics to be used in establishing a methodology for consolidation. Along these same lines, it was decided to continue the negotiations to include the sugar regime in the trade union and eliminate its exemption status. While respecting the levels of production in member states, leaders recognized that it was necessary to overcome the asymmetries that arose from the different national regimes existing for the sugar trade.

Turning to the question of access to markets, a course of action has been laid out that will further the achievements begun in June 2000, through the creation of a committee that will work specifically on sanitary and phytosanitary issues and the establishment of customs processes that encompass the administration of those new norms. Continuing the efforts undertaken by the countries of the region to open trade, the decision was made to reduce the CET by 0.5%, as well as to continue negotiations on altering the CETs for capital goods, information technology, and telecommunication products produced inside and outside the region.¹ At the same time it was decided to start a detailed study of the structure of the CET, one that would lay out the distortions that have affected it, dating from its implementation on January 1, 1995. A goal of this study was to articulate the changes that occurred in the economies of the region and put them all in the proper global context. During this transition period, each member state was allowed a list of exceptions to the CET of up to 100 products for a maximum period of two years.

While working on the CET issue, members acknowledged the tensions or problems that arose because of the existence of special tariff regimes, which limited free trade. Analysis was undertaken to determine the successes – products that were already freely traded in the region. During this period, it was decided to keep the duty free zones found Manaus and Tierra del Fuego, but with controls placed on products produced in those areas. The controls guarantee the free trade of goods produced in those regions only when they comply with requisites relating to a specific origin regime. A series of disciplines were laid out for further research into the process and application of anti-dumping and intra-zone compensation measures.

This has been a delicate subject because in times of trouble, self-interest resurfaces on the part of the members of MERCOSUR. MERCOSUR needs to make sure that it builds its institutional structure in such a way that when the economic well-being of the members is threatened, they still feel that they have autonomy to maneuver in their best interests without hurting the group.

Relating to the idea of maintaining national autonomy as a member of a union, an area with a great deal of discussion, but little agreement between the members of MERCOSUR in the last few years, has been the problem of incentives for investment in modes of production and export development. The decision taken at the Ministerial Summit of June 2000 to enact the incentive discipline by the end of the first quarter of 2001 was a significant step towards resolution of this issue. In accordance with this decision, at a meeting in December 2000, the first list of active incentives for the four countries was published to serve as the platform for the reform of this discipline. Further agreement will be a significant step on the road to macroeconomic coordination and will signify a qualitative, critical advance in the integration process.

Rounding out the examination of the internal agenda, the second round of negotiations to liberalize trade in services has reached an end, and an agenda has been established for the start of a third round. The ad hoc group working on government purchasing issues has begun to negotiate the list of goods, services, public works, and entities that will be included under the protocol. These negotiations are critical to the future of the integration process because the possibility of the free trade of services between member states was one of the founding goals. It is also important to safeguard equality in competition between business in differ-

ent countries that work to provide these goods and services. Consequently, during the Florianópolis meeting a high-level group was created to study the best way to make the Arbitration Tribunal a permanent part of MERCOSUR.

THE EXTERNAL AGENDA

The consolidation of MERCOSUR's external trade policy will imply that the group can define common negotiating goals and present a unified face to third party groups or nations (using a 4 + x method of negotiation rather than the 1 + x format that is used more often than not). It will have to cease undertaking bilateral, regional, or multilateral negotiations as independent entities. This is particularly relevant if one examines the complicated external agenda that MERCOSUR faced in 2001; the Hemispheric Trade Ministers met in April as a part of the FTAA negotiating process, the WTO meetings were to be held in November, and the fourth Inter-regional Negotiating Committee (MERCOSUR-EU) meeting was in March.² There were also meetings scheduled with Bolivia, Chile, the Andean Community, Mexico, South Africa, and other countries and regions interested in establishing special ties with MERCOSUR.

It is important to highlight the need for all of these ongoing negotiations to stay consistent with the spirit of MERCOSUR: to open its member countries to the world and enable a greater penetration for their products in the various global markets. It is only for this last reason that it makes sense to have a customs union. MERCOSUR is more than a building block; it is a platform for launching the members towards significant accords with third party nations, in the search for free trade on a truly global scale. In this sense, it is important that governments of the world make greater commitments to open economies and dismantle the subsidies systems in place within different countries and among global alliances (found in the EU, the U.S., and China, among others) for the products in which MERCOSUR is to compete efficiently. Markets at the start of this millennium remain to be inexplicably distorted.

CONCLUSIONS

Despite the growing interdependence of the economies of member nations, MERCOSUR has been characterized by the constrained status

of the stage for the integration process during 1997-1999. There have been limited advances registered in the actual enactment of accords already reached and difficulties encountered in agreeing on new themes for the negotiating agenda. In other words, MERCOSUR has evolved at a far slower pace than is desirable.

The new stage that was begun in 2000 was critical because at long last macroeconomic coordination had begun on a regional scale, automotive sector negotiations had finally finished, and an inventory and agenda was established for taking care of the remaining work left in order to complete the customs union.³

In order to ensure that these objectives are met and that the negotiating process of this new stage stays dynamic, it would perhaps be useful to return again to the possibility of advancing towards the adoption of a institutional structure for MERCOSUR that has more leverage for action and greater responsibility for the application of the trade instruments and communal investments.

It is true that accomplishing the establishment of a true customs union is a process of great complexity, with advances that are not always along an easy linear trajectory. It is hoped that MERCOSUR will continue its institutional and economic integration in the coming years. Nevertheless, more important than the difficulties that the member nations have focused on in the past, it is important to note that MERCOSUR has already reached a level of importance to the major partners of the region. It has started to exist as an autonomous entity outside of personalities or partisan disputes. It is solidly established and is perhaps one of the principle economic achievements of its member nations over the past decade.

NOTES

1. The cutting of the CET started the elimination of the temporary 3% rise in the CET that was established in December 1997, and which was to continue until the end of 2001.

2. Security concerns after the September 11, 2001 attacks in the U.S. led to the cancellation of the WTO meetings [ed.]

3. Incorporating goods and services into the regional free trade area, the definition of the commercial disciplines and investments still pending, and the unfinished work needed to equalize competition in a truly free market are the issues.

MERCOSUL Past and Present: A Brazilian Perspective

AMBASSADOR JOSÉ BOTAFOGO GONÇALVES

In an examination of the current status of MERCOSUL, I believe that the distinction between past and present is a useful one. The relaunching of MERCOSUL in April 2000 and the agreement on its new agenda establishes a clear demarcation point between past and present. relaunching MERCOSUL is not mere rhetoric. It is not just another grandiloquent figure of speech or a holdover from the period of the Latin American Free Trade Association in the 1960s, which left traces of romantic influence that were still identifiable in the early stages of MERCOSUL.

The conditions that set the framework for the creation of MERCOSUL, such as liberal macroeconomic policies and political reforms, are widely known and have been extensively debated. Therefore, I will concentrate my remarks on this new phase, which came into being with the relaunching of MERCOSUL. This new era is characterized by realism, a matured stance vis-à-vis the conflicts which inevitably surface during the implementation of a free trade area and customs union. In this new phase, I believe the member countries have come to understand that differences over the details are normal, and that it is necessary to view such conflicts through the prism of reality rather than that of utopian idealism. Such issues are of limited dimension and operational in nature. What is essential and fundamental is to avoid jeopardizing the more critical strategic objectives at stake.

Indeed, it has become necessary to think big, to aim high, to look beyond routine bureaucratic responses, and to re-emphasize a strategic agenda. The concept of MERCOSUL goes well beyond trade issues alone. It involves areas such as agriculture, health, customs, finance, labor relations, consumer protection, education, and culture.

However, this complex, far-reaching and long-term strategic vision of MERCOSUL came under serious threat when member countries confronted a number of unforeseen and unfavorable economic circumstances in 1998–1999. In conjunction with the adverse international economy and its negative impact on the region, our national economies were faced with a wave of recession-producing conditions. These factors, when combined, led to a visible shrinkage of intra-MERCOSUL trade. It was a negative impact on the most obvious sign of the continuous success of the process of integration in South America. In 1998, trade among the four partners reached US\$20 billion. This represented four times the amount traded in 1991, the year the Treaty of Asunción was signed. By 1999, this figure fell to US\$15 billion, although it was still three times the amount traded in 1991. This abrupt retraction started alarm bells ringing.

At that point, it was decided that the solution to MERCOSUL's problems was not less MERCOSUL, but more MERCOSUL; an expanded, reinvigorated, and strengthened agenda that would encompass the completion of the free trade area, the enhancement and consolidation of the customs union, and the firm will to advance towards the common market.

Within MERCOSUL we have come to realize that the discussions and disagreements on specific trade matters related to sugar, automobiles, beef, poultry, and milk can and will be solved. Such differences are natural and matter far less than the strengthening of a political vision and the awareness that we are capable, and have the necessary tools to solve our economic differences.

Sustained by initiatives in the public and private sectors, the relaunching of MERCOSUL is basically centered along three axes: market access, macroeconomic coordination, and exportation to third markets. In terms of market access we are substituting the concept of a regional or an intra-MERCOSUL market for more or less open, national markets. Of course, to attain this objective we have to preserve and protect the principle of intra-zone free trade and to avoid any form of regressing from the advanced process of trade liberalization already achieved within the customs union. It is of utmost importance to continue eliminating all forms of non-tariff barriers and reducing bureaucratic practices in frontier posts. We must also promote industrial production and exports, attract new investments, and put an end to the abuse of the utilization of anti-dumping measures and compensatory rights in intra-zone trade. Working

together on these areas will allow us to define common procedures within MERCOSUL against important issues such as the unfair trade practices of third party nations.

As for macroeconomic coordination, a set of measures was adopted in June 1999 that established, among other things, macroeconomic goals to be achieved by March 2001. These goals dealt with instruments for fiscal accountability and there had been progress by late 2000 in the harmonization of the methodology for reporting statistical data from the economies of member countries. All these measures demonstrated a shared commitment and were crucial in the advance towards a common market. In terms of additional macroeconomic coordination, member countries had been negotiating fiscal goals, public debt, and price ceilings (inflation rates). Argentina, Brazil, Paraguay, and Uruguay jointly announced decisions in these areas in March of 2001. Based on a shared commitment to fiscal solvency and monetary stability, the partners had sought the integration of their capital and financial markets prior to the crisis in Argentina.

Concerning the promotion of exports to third-party countries, three main areas have been the center of focus. First, there is a desire to increase production through a better utilization of regional inputs, as opposed to national chains. Second, member countries should use sectoral production policies on an integrated, regional basis. Third, and finally, there needs to be a continuous improvement of the region's competitive capacity. In connection with the strengthening of regional production, an important step was taken at the Meeting of Presidents of South America, held in Brasília on August 31 and September 1, 2000, at the initiative of President Fernando Henrique Cardoso. It was historic meeting and remarkable opportunity for these leaders to discuss economic, political, and social issues for a region with a GNP of US\$1.5 trillion and a population of 340 million people. In a different way, it was also a unique and suitable occasion for stressing the importance of the regional integration process by focusing on areas such as infrastructure, transportation, energy, communications, and trade expansion. A parallel meeting of business leaders discussed the concerns and initiatives of the commercial sector and examined how it could contribute to the initiatives of the governments of the region to strengthen infrastructure and foster integration.

There are a number of initiatives of particular note, which will advance MERCOSUL along these three axes. We first have been working towards closer relations with the Andean Community of Nations (CAN). Together the MERCOSUL and CAN regions are responsible for two-thirds of all trade in Latin America. Second, the inclusion of Chile as a full member will add economic and political weight to MERCOSUL. Third, the Common Market Council of MERCOSUL approved the start of negotiations for a framework agreement with the Government of the Republic of South Africa that should lead to the creation of an inter-continental free trade zone (Decision 36/00). Fourth, the Common Market Council decided at its June 2000 meeting to authorize that the Common Market Group start negotiations with Mexico in order to create a free market area between MERCOSUL and Mexico (Decision 37/00). Fifth, the process of establishing the FTAA will help MERCOSUL with the stimulus and challenges of dealing with the most competitive economy in the world. MERCOSUL, in an active and constructive way, already takes part in all negotiating groups of the FTAA, seeking mutual advantage for all parties and defending principles such as single-undertaking, balance of concessions and advantages, and gradual trade liberalization. Sixth, and finally, negotiations for the establishment of a free trade agreement with the EU are underway.

These advances in both internal and external relations signal that the stage is set for a new and invigorated phase in the process of implementation and expansion of MERCOSUL.

ASSESSING MERCOSUR'S PERFORMANCE

PART III

MERCOSUR: Achievements and Challenges of a Decade of Integration

ALCIDES COSTA VAZ

INTRODUCTION

The assessment of MERCOSUR's trajectory over the past ten years, its current status, and its mid-term prospects require us first to consider its primary political objectives and the extent to which they have been accomplished. Successive trade disputes within the bloc, namely those involving Brazil and Argentina, give the impression that parochial claims and sectoral demands often seem to prevail over, or at least overshadow, its political rationale and the fundamental interests of its member states. However, MERCOSUR expresses, in its origins and nature, the high political and strategic value its members have assigned to economic regionalism in the context of a changing international system and globalized world economy. The first section of this chapter will focus on the primary political objectives as the background against which MERCOSUR's political and economic achievements can be identified and evaluated.

In the second section, economic objectives and conditions, and the bloc's performance in this field are considered. An emphasis will be given to the most relevant features of its recent course, the macroeconomic condition of its two largest economies (Brazil and Argentina), and the opportunities and restrictions derived from concurrent and non-concurrent cycles of economic growth observed between both countries in the past ten years. The third section deals with their respective responses to external crises and domestic economic constraints; the efforts aimed at achieving and preserving economic stability; their management of trade issues at the bilateral and regional level to condition, in the economic realm, the agenda and internal dynamics of MERCOSUR; and some of the defining elements for its current and future outlook.

In the fourth and fifth sections, MERCOSUR's current internal and external agendas, the prospects for relaunching it, and the incentives for policy coordination as a requirement for strengthening and deepening the bloc are discussed. In these sections I also refer to the political dilemma facing member states concerning the need to relinquish the exercise of full discretionary authority in conducting domestic economic policies to favor the intended consolidation of MERCOSUR in a context largely marked by economic asymmetries and uncertainty. Finally, the sixth section provides a brief analysis on the conditions that will allow MERCOSUR to regain internal dynamism, overcome its liabilities, and respond affirmatively to the challenges posed by its own consolidation as well as to those derived from its external relations.

The basic assumption presented in this analysis is that MERCOSUR must be regarded as a byproduct of a complex and not always coherent interaction of systemic forces and circumstantial factors operating simultaneously in global, regional, and domestic scenarios. Therefore, given the unpredictability and the uncertainties inherent in the political and economic system at each of those levels, MERCOSUR's prospects and outlook depend largely on the bloc's own ability to strengthen its institutional structures and to deepen its commercial relations. There must also be willingness on the part of the governments to relinquish their full discretion in areas directly and immediately related to the economic and normative disciplines of a common market.

THE POLITICAL UNDERPINNINGS AND OBJECTIVES OF MERCOSUR

From a broader perspective, MERCOSUR represents a political response to a three-fold challenge that the countries of the Southern Cone have faced from the mid-1980s until the present. First, consolidation of strategic and political stability has been achieved with the restoration of democracy and the final dismantling of sources of antagonism in the region. In this sense, MERCOSUR has certainly been a valuable instrument for the promotion of political stability under democratic rules and institutions. Second, both economic development, under the aegis of open economies, and the international competitiveness of domestic markets have been promoted through the expansion of trade, the attraction of foreign direct investment, and the incorporation of new technologies. Third,

there have been improvements in the international political and economic capabilities of its member countries for the sake of establishing functional international ties and negotiating the terms of their insertion into the world economy on relatively more equitable ground vis-à-vis their main economic partners. In this regard, MERCOSUR represents a negotiating platform from which its member countries can bridge asymmetries in relations with their partners in the developed world. It has become a political initiative to be carried out essentially, although not exclusively, in the economic field, encompassing trade liberalization and, subsequently, deeper forms of cooperation and policy coordination in economics as well as other domains.

Therefore, an overall assessment of its performance in the past ten years cannot be made solely on the grounds of trade statistics, no matter how impressive these might have been. It must take into account not only the progress made, but also the difficulties encountered in the attainment of its primary political objectives as mentioned above. Not surprisingly, the picture one finds in this regard is far from symmetrical or balanced although this does not mean the bloc has not succeeded in advancing in political and economic terms.

Indeed, MERCOSUR represents a successful initiative with regards to the original motivations and interests that presided at its creation, and in relation to the subsequent challenges it faced (especially in the second phase of its existence). This is despite the many risks and hindrances that are still evident, notably in political, institutional, and normative terms, as well as in several key areas of trade.

As for its main political objectives, MERCOSUR has actually been able to preclude conflict between the two most relevant strategic players in South America. It has engendered closer interactions with other regional actors and has become an authentic, pluralistic community. Moreover, it has effectively helped prevent political and institutional disruptions in Paraguay more than once. At the same time, it has assumed a higher ranking in the parliamentary agendas of the four member countries, contributing to the increased levels of attention paid to MERCOSUR by political parties, congressmen, the media, and public opinion on foreign policy, international economic issues, and their links with domestic concerns.

Economic integration has indeed become one of the most privileged areas for uniting domestic issues with trade and foreign policies. In this

sense, it has brought about closer interaction between policy makers and other political, economic, and social actors. It has engendered political commitments and cooperation in areas other than pure economics (e.g. education, culture, justice, environment, and tourism). Moreover, it has fostered some significant initiatives at the societal level, contributing to a more intense interaction and greater knowledge among societies in the region. Finally, it has been a useful and important means for enhancing the external negotiating capabilities of its member countries.

These factors certainly contribute to a positive assessment of MERCOSUR's political gains, but they should not overshadow some important risks that still persist in this realm, notably its limited and indirect impact on social schisms. Actually, despite its positive political and economic achievements, MERCOSUR has not had a meaningful impact on some of the most critical threats to democracy in the region: economic and social inequalities, exclusion, and the host of problems that have arisen from them. These include social and institutional disruptions, organized crime, drug trafficking, and urban violence, among others. The bloc's performance in this regard is still extremely modest.

It is certainly reasonable to argue that dealing with such social problems is not the immediate goal of any regional economic integration initiative, even less in the case of MERCOSUR, in which trade liberalization has been the core area of initiatives to date. However, there is a gap between the political priority and support MERCOSUR has been granted and the economic benefits and limited positive consequences there have been for the most immediate social problems. This fact highlights the lack of any direct nexus between policies expected to address social problems and efforts at regional economic integration. Democracy and integration require a permanent exercise of political reassurance at various levels, if both are to provide the fundamental conditions for implementing effective and mutually beneficial economic ties among societies. Therefore, given the type of threats against it and the continual fragility of democracy in the Southern Cone, MERCOSUR must stimulate a political cohesion around values, principles, and interests that regional economic integration can certainly engender.

By fostering economic growth and development, MERCOSUR has helped provide a fundamental pre-condition for tangible social progress. Nevertheless, direct economic benefits remain concentrated on a relative-

ly small number of economic sectors and agents, so that it ultimately reproduces or even reinforces the same pattern of social and economic inequality that prevails in each of its member countries. Moreover, the issues on the so-called social agenda of MERCOSUR are precisely the ones in which little progress has been achieved because priority has been granted to trade and economic matters. Social transformation and equality are tasks MERCOSUR has yet to fulfill more effectively.

Still, in regard to political issues it can be argued that MERCOSUR reflects a very typical distortion found in the political institutions of its member countries. The dominance of the executive branch in all of them has led to limited space and fewer channels for greater parliamentary and social participation. The democratic and social deficit of MERCOSUR can be regarded as a symptom of such distortion. In contrast, MERCOSUR has brought about a closer interaction between policy makers and other political and economic actors, although this has not led to the strengthening of its two most important institutions for political and social debate on integration issues: the Economic and Social Forum and the MERCOSUR Parliamentary Commission.

ECONOMIC PERFORMANCE AND OUTLOOK: IMPACTS ON TRADE, INVESTMENT, AND INTERNATIONAL COMPETITIVENESS

MERCOSUR has been relatively successful in its economic objectives, especially with regards to its static effects on trade. According to the General Secretariat of ALADI, intra-MERCOSUR trade grew 336% from a level of US\$4.1 billion in 1990 to US\$18.2 billion in 2000.¹ It is expected that intra-MERCOSUR trade will keep growing in the near future, and has possibly already surpassed for 2001 the record figure of 1997. This performance, however, contrasts with MERCOSUR exports to third party countries and regions. From 1990 to 2000, external sales grew only about 50%, rising from US\$42.3 billion to US\$61 billion, while imports increased 180% from US\$23.1 billion to US\$65 billion in 2000.

Such figures have underscored the argument that MERCOSUR represents an initiative of open regionalism. However, recent and more accurate analyses have demonstrated that the prevalence of trade diversion over trade creation underlies the growth of intra-MERCOSUR trade in the 1990s. This observation reflects not only the persistence of protection against imports from third party countries, but also the restrictions to intra-

regional trade that have limited the potential for trade creation. In this regard, the modest progress towards the elimination and harmonization of non-tariff barriers within the bloc itself has kept the door opened for managed trade patterns, negating to a large extent the static and dynamic benefits of trade growth. The prevalence of trade diversion also impacts the dynamic effects of economic integration. MERCOSUR has certainly spanned trade opportunities and stimulated capital attraction and economic dynamism in general – even in periods when one of its main economies, either Brazil or Argentina, faced very low or negative growth rates.²

However, it must be remembered that economic stability and the market-oriented reforms carried out in the early nineties, including large privatization programs in Brazil and Argentina, were the primary forces and sources of stimuli for foreign capital inflows and economic growth rather than economic integration itself. Regional economic integration did play a positive, but subsidiary role as long as, and whenever it directly served the purpose of achieving macroeconomic stability and opening markets. In this sense, MERCOSUR should be considered more of a channel for or a complementary source of economic dynamism. It has also played a limited role in enhancing the international competitiveness of regional production. Despite the impressive growth of intra-MERCOSUR trade, bilateral trade between Brazil and its other MERCOSUR partners still exhibits a traditional pattern, with Brazil exporting manufactured goods and importing commodities. The same pattern can be observed in MERCOSUR's exports to other countries and regions. Trade liberalization within the bloc has made Brazil the main destination for Argentina's manufactured exports. Uruguay and Paraguay have also striven to preserve and explore opportunities as in the negotiations for the bloc's automotive regime.

MERCOSUR's limited role in enhancing the international competitiveness of regional exports becomes clear when one takes into account the difficulties Brazil has encountered trying to expand its exports of manufactured goods, especially those destined for first world markets. It should be noted that Latin America represents the most dynamic market for Brazilian industrial exports and the only one that has expanded to any significant degree in the past decade. Moreover, MERCOSUR's exports still consist for the most part of commodities. Such difficulties are also related to trade barriers that affect important regional export products but

the various endogenous reasons for the lack of competitiveness of MERCOSUR industrial exports cannot be neglected. Overall, MERCOSUR has played a positive though narrowly-defined role in enhancing the international competitiveness of the economies in the region through expanded trade opportunities, investment flows, and a more efficient allocation of resources. However, this has not led to a substantial expansion of industrial exports to third party markets.

BRAZIL AND ARGENTINA IN THE FACE OF EXTERNAL AND DOMESTIC ECONOMIC CONSTRAINTS

At the same time, and due to its own scope, the further integration of MERCOSUR has been subject to externalities from shifts in the economic and trade policies of its member countries and been vulnerable to domestic macro- and microeconomic imbalances. Such vulnerability has become clear in the past two years as Brazil and Argentina have faced economic crises derived not only from turbulence in the international financial markets but also from the exhaustion of key policies which had led them to achieve, at different moments, macroeconomic stability. In spite of having succeeded in overcoming inflation, both countries continue to face increasing external debt imbalances, by-products of the economic strategies and policies pursued since the early nineties. The financial crisis that plagued the economies of Southeast Asia and Russia in 1997 and 1998, respectively, reached South America when Brazil's deepened external imbalances led to the devaluation of its currency in early 1999.

MERCOSUR's two largest economies have emerged from that crisis in contrasting ways. Brazil faced a period of adaptation to the new macroeconomic environment that followed. Economic policymakers tried to prevent domestic prices from escalating and to regain consumer and investor confidence in the Brazilian economy. The adjustment measures adopted in response to the external crisis and the huge loss of monetary reserves deeply affected the exchange rate regime that had been one of the main underpinnings of the stabilization plan set forth in 1994.

In spite of public sector imbalances and frustrated expectations with regards to the reduction of the country's mounting trade deficits, the domestic market has regained dynamism.³ This has been favored by a less restrictive monetary policy which, counterbalanced by greater fiscal austerity, has stimulated domestic consumption. At the same time, export per-

formance also has improved slightly, but not to the extent required to meet either the expectations of government officials and market agents, or the levels necessary to reduce Brazil's dependency on foreign direct investments to finance its huge external deficits. As a matter of fact, Brazil has succeeded in relying on foreign direct investments not only to expand and modernize its productive infrastructure, but also to finance its current account deficit. The vigorous flow of foreign direct investment into the Brazilian economy, most notably after the Real Plan adopted in 1994 and over the past two years, has translated into expanding economic opportunities, jobs, and resources to finance its external debt. The convergence of macroeconomic stability, a less restrictive monetary policy, growing domestic demand, increased industrial production, as well as foreign direct investment, have provided the basic conditions for shifting the Brazilian economy into a new and perhaps sustainable cycle of economic growth. This is reflected in the 4% growth rate registered in 2000 and the encouraging prospect for a 2.5% GDP expansion in 2001 despite a global economic downturn.

Argentina's economy, in turn, despite government efforts to improve fiscal performance and cut public expenditures, has faced stagnation since the current recession began in the second half of 1998. Slightly brighter prospects for 2001 have diminished, despite the US\$35 billion financial bailout package granted by the International Monetary Fund in early 2001, mostly because of the political problems that have marked Fernando De La Rúa's presidency. Argentina's trade balance has shown signs of equilibrium, basically due to the improvement of exports, the reversal of the trend of falling world commodity prices (especially oil and grains) and lower levels of imports. As a result, its trade deficit has been steadily reduced. On the other hand, difficulties in financing the current account deficit, which reached -4.1% of GDP in 2000, still persist and remain a major challenge for the economic authorities.

Such figures indicate that Brazil and Argentina have once again undergone non-coincidental cycles of economic growth. This pattern has been observed in seven of the past ten years (1991-1993, 1995, 1998-2000). Two of these periods (1995, 1998-2000) are closely related to instability in the international financial system and to its consequences for the economies of both countries. The earliest period (1991-1993) is usually associated with a different set of macroeconomic conditions and to micro-

economic imbalances. In such a context, the bloc's dynamism and stability relies largely on whichever economy is propelling MERCOSUR's growth at that moment. That was the case, for example, of the 1991- 1993 period, when Argentina's increasing rates of economic growth helped counterbalance the negative effects of the recession Brazil faced, and fueled the integration process. At the present, Brazil's economic performance is the major defining element of MERCOSUR's short- and medium-term economic outlook, as the Argentine economy has shown no signs of overcoming its economic recession.

A second aspect to consider is the capacity of national governments to isolate trade conflicts and to supply levels of policy coordination that will consolidate the customs union and gear the integration process to its ultimate goal: the establishment of a common market. In its initial stages, MERCOSUR's evolution was directly conditioned by the efforts of the Brazilian and Argentine governments to achieve and preserve macroeconomic stability. Despite the higher levels of convergence between their macroeconomic policies observed from 1994 onwards, both countries are facing a more restrictive and uncertain external environment resulting from successive financial crises (Mexico in 1995, Southern Asia in 1997, and Russia in 1998).

Therefore, and due to their increasing dependence on foreign capital, the political energy of both governments has been primarily and immediately directed to preserving macroeconomic stability and, only secondarily, to consolidating and deepening MERCOSUR. The differing approaches with which Brazil and Argentina have responded to external constraints have resulted in a less favorable context for the macroeconomic coordination within MERCOSUR, as envisaged in the Treaty of Asunción.

RELAUNCHING THE AGENDA: TOWARDS DEEPER FORMS OF INTEGRATION?

The domestic problems of member countries have created a more restrictive context for advancing towards the coordination of macroeconomic policies and have led to bilateral trade conflicts that are associated with an incomplete free trade and customs union. National governments have become increasingly susceptible to domestic pressures and demands from those sectors most directly and negatively affected by the external compe-

tion from regional integration. As a result, national governments as well as the administrative organizations of MERCOSUR (e.g. the Common Market Council and the Common Market Group) and its Commerce Commission have become entangled in the management of successive trade disputes. The direct involvement of diplomatic envoys in trade disputes has allowed for a faster resolution to problems, but also has brought about the excessive politicization of sectoral issues and has prevented the full application of the organizational mechanisms for dispute settlement.

The bloc's internal agenda has become overly focused on trade disputes and less on the consolidation and perfection of its trade disciplines. This trend has been exacerbated by the 1999 crisis, leaving the integration process with unprecedented levels of internal and external disfavor against it, precisely when its agenda is more demanding. Government authorities have been forced to spend precious energies on preserving MERCOSUR's achievements and reinvigorating it.

It is clear then that strengthening MERCOSUR requires the completion and implementation of existing trade disciplines with a minimum degree of economic policy coordination among its members. Originally the advent of new governments in Argentina and Uruguay supported by political forces and groups that were historically committed to regional integration was viewed as providing an opportunity for relaunching MERCOSUR. This proposal found immediate acceptance by Brazilian authorities for which the bloc's loss of credibility and increasing weakness was particularly troublesome given the greater strategic importance they traditionally assigned to regional economic integration. However, the deepening of Argentina's crisis into both an economic and political phenomenon has derailed the possibility for any of these advancements.

The proposed agenda to relaunch MERCOSUR reflects a common assessment of the bloc's main risks and challenges in four core areas: its institutional framework, commercial disciplines, macroeconomic coordination, and external relations. In relation to its institutional framework, the improvement of the dispute settlement system, the transfer of bloc norms into national legislation, the strengthening of the Administrative Secretariat, and a review of the functions of the Common Market Council and the Common Market Group are the issues to be addressed. The consolidation of trade concerns is expected to take care of questions regarding market access (with special emphasis on the elimination or har-

monization of non-tariff barriers), commercial defense, protection against competition, incentives for investment, production and exports, government procurement processes, and the phasing out of exemptions to the CET. With regards to macroeconomic coordination, the harmonization of economic indicators and the defining of common macroeconomic targets (e.g. nominal and primary fiscal accounts, net public sector debt, and consumer prices) have already been agreed upon. Negotiating trade preferences as a bloc and the re-starting of negotiations with the Andean Community to establish a free trade area have been the more immediate issues of its external agenda, in addition to the negotiations for a free trade agreement with the European Union and the establishment of the FTAA.

INCENTIVES AND CHALLENGES FOR POLICY COORDINATION

In contrast to earlier periods, when the willingness of governments to coordinate economic policy was severely restricted due to the idiosyncrasies in their respective approaches, their present need to exercise control over basic economic indicators (inflation rates, public debt, and current account deficits) raises the possibility for a convergence of common policies to eventually deepen MERCOSUR. In this sense, in spite of the economic difficulties that Argentina faces, there is a more favorable environment for taking the initial steps towards greater levels of economic policy coordination.

There are many difficulties blocking this goal, but there are also strong incentives for engaging in macroeconomic coordination and deepening MERCOSUR. First, there are increasing levels of economic interdependence among its members and a necessity for greater internal cohesion within the bloc to face immediate external challenges and uncertainties. The greater the economic interdependence among MERCOSUR countries, the higher are the risks and costs of not coordinating policies, particularly in those areas essential for the gradual framing of economic disciplines in a common market.

Second, it has become imperative for MERCOSUR to move beyond the management of trade issues and its commercial focus in order to isolate trade conflicts and to severely restrict their contagion of the bloc's internal agenda to preserve the political commitment of governments and societies. It must pave the way for future macroeconomic policy coordination and strengthen its internal economic agenda to serve as a positive sig-

nal to other governments, financial markets, investors, and public opinion in general. The perceptions of MERCOSUR have become inevitably strained and largely defined by trade conflicts and differences between Brazil and Argentina. Problems have been over not only macroeconomics, but also foreign policy orientation, the nature of their interests, the relative importance assigned to MERCOSUR, the extent of their commitment to the bloc's ultimate objectives, and the strategy and positions that should be sustained in the context of the FTAA negotiation process.

Third, MERCOSUR has served to help governments lock in trade policies and economic reforms, and perhaps can perform a similar role with regards to macroeconomic stability and the level of economic openness already achieved. It can reduce political and economic uncertainty and generate positive externalities in various international fora for negotiations. The main issue, however, is the extent to which national governments are willing to relinquish discretion for formulating and implementing economic policies in cases of domestic economic instability, stagnation, or high levels of volatility in international financial markets (as in the 1997-1999 period). For example, in the past (1991-1993), the political option of the Argentine government, in the face of rising trade deficits, particularly with Brazil, and of the immediate costs of economic liberalization, was to try to preserve some margin of freedom in the realm of trade. It was the only remaining area where there was room to maneuver, due to the very logic of the economic model adopted by the country in April 1991. This action raised many problems with Brazil, which were strongly felt in the context of negotiations over subsidiary trade issues within the free trade area and the CET of MERCOSUR. Brazil acted similarly at other occasions, leading to growing unilateralism and an upsurge in protectionism. These actions have constituted the main source of the commercial conflicts that have marked MERCOSUR's itinerary over the past few years.

It must also be highlighted that, with the exception of 1994 when negotiations for the basic instruments and institutional framework of MERCOSUR had culminated, joint cycles of economic growth in both countries (1996-1997) have been under-exploited as a means of paving the way to the desired macroeconomic coordination among the four member countries of MERCOSUR. On that occasion, a pragmatic perspective on managing trade issues and disputes according to the parame-

ters and instruments envisaged in the Ouro Preto Protocol prevailed, underscored by the argument that it would be necessary to perfect and consolidate both the free trade regime and the customs union before engaging in deeper forms of integration. Outside of this event, there have been not enough incentives present to further the evolution to the common market as stipulated in the Asunción Treaty.

CONDITIONS FOR REGAINING INTERNAL DYNAMISM

In the absence of endogenous stimula, the most powerful, if not the only incentive to counter the internal inertia that was in place after the Ouro Preto Protocol of December 1994, emerged from an external challenge: the possibility that the FTAA would be implemented in 2005. Since then, the strategic value of MERCOSUR has become increasingly, and almost exclusively, associated with its external links. It is seen either as a negotiating tool through which its member states can bridge and compensate for asymmetries in relation to their main economic partners, or as a connecting axis to the most dynamic poles of the world economy.

Despite this issue, MERCOSUR's internal agenda has become overwhelmingly focused on the management of trade issues and conflicts, with little progress in other economic and non-economic areas. There has been a clear disconnect between the internal and external agendas of MERCOSUR and their relationship to the bloc's ultimate objective: the free mobility of goods, services, labor, and capital. Such a gap is accentuated when governments act unilaterally to protect sectoral interests (due to sectoral pressures or macro- and microeconomic imbalances), igniting trade conflicts, and exposing the fragility of MERCOSUR trade and institutional framework. The 1999 financial crisis in Brazil exemplified this disconnect.

At the same time, further advancements in external negotiations have proven to be complex and slow, as illustrated by those conducted under the 1995 Framework Agreement with the European Union as well as those with the Andean Community. In the case of the FTAA, it clearly raises challenges that MERCOSUR countries are not fully prepared to face collectively, and even less so if the deadline for completing negotiations is set, as anticipated and intended by the United States, to 2003. In addition, intra-regional trade performance – MERCOSUR's driving force for many years – has gradually become more responsive to and

dependent upon domestic economic conditions rather than on stimuli from the bloc's own dynamics.

In this sense, MERCOSUR has gradually lost the original dynamism associated with the promotion and subsequent effects of trade liberalization under a program implemented from 1991 to 1994. The necessary elimination of non-tariff barriers (or their harmonization) and the liberalization of trade in services within the region have proven hard to achieve. As a result, the capacity of this imperfect free trade area to induce economic dynamism is also diminishing, resulting in widespread skepticism about the possibilities of gearing the bloc towards deeper levels of economic integration.

Such a condition is exacerbated by the corresponding lack of methodology and commitments that could have fostered integration even in the face of external or domestic constraints, inverted cycles of economic growth, or an overall economic recession. During the transition period, the automatic implementation of the mechanism for tariff reductions conferred a fast pace to the integration process, and led to commercial gains that worked to reverse the initial skepticism of economic actors in regards to MERCOSUR's possibilities. Having benefited from a fairly favorable external context, integration within MERCOSUR advanced despite the asymmetries and different macroeconomic conditions of the four countries. This progress occurred mainly because of the strategy implemented from 1990-1991 onwards for linear, regular, and automatic tariff reductions replacing the sectoral approach pursued in the bilateral agreements between Brazil and Argentina in the 1980s.

Given the exhaustion of the cycle of trade liberalization pursued through automatic and linear tariff reductions, which coincided with the emergence of an unstable economic environment in the mid-nineties, MERCOSUR's endogenous impulse started to fade, as did government willingness to adhere to strict integration commitments. In such a context, governments tried to preserve some freedom and maneuverability over the implementation of their own trade policies. Simultaneously, their ability to establish trade-offs and to grant side-payments through which conflicting interests could be accommodated and transaction costs lowered was also greatly reduced.

Nevertheless, governments and economic actors are not willing ultimately to sacrifice MERCOSUR's achievements or the bloc itself. MER-

COSUR has a high symbolic and strategic value. It still represents an important political and economic asset for its members, as well as a source for opportunities not yet fully exploited. It continues to be regarded as a useful instrument for the joint promotion of interests and objectives nationally defined, but regionally pursued. Therefore, the chances for reinvigorating the integration process seem to depend on the governments' willingness to abdicate their high level of discretion in the economic policies used to respond to external constraints, macro- and microeconomic imbalances, and the negative externalities of economic integration. This change will open the way for the gradual establishment of an economic agenda in which the issues related to the structuring of a common market can be effectively incorporated. Focusing on deepening MERCOSUR represents, in this sense, a high commitment to economic integration as the most viable and adequate strategy for its member countries in an international context characterized by high levels of economic uncertainty, subtle forms of protectionism, and financial volatility. It also implies the acceptance of more elaborate and complex institutional arrangements that will lead to the perfection of MERCOSUR's multilateral status.

Until now, MERCOSUR countries have had an ambiguous position with regard to these issues. On the one hand, there has been a visible intent to reaffirm their political commitment to the integration process and to the search for more favorable conditions to overcome the crisis the bloc has undergone in the past two years. This commitment is illustrated by the agenda to relaunch MERCOSUR and the decision to harmonize economic indicators, a preliminary and necessary step towards the definition of common economic goals.

Nevertheless, the recurrence of unilateral measures and the proliferation of managed trade practices, such as the voluntary export restriction and sectoral agreements, highlight the vulnerability of the free trade regime and the permeability of national governments to sectoral demands. It also reveals the difficulty governments face in trying to reconcile private interests that have benefited from benign neglect within MERCOSUR and from the flexibility exercised in the conception and implementation of the free trade regime and customs union.

Despite the widespread consensus on the narrow limits of the present framework and on the necessity for reforming it – especially the mechanism of dispute resolution – there is considerable resistance to suprana-

tional arrangements, mainly on the part of Brazil and by Argentina to a lesser extent. Current perspectives for institutional reform have been restricted to perfecting the Arbitration Tribunal and strengthening the Administrative Secretariat.

The role of smaller members and eventual newcomers like Chile also creates important institutional and political challenges for the consolidation of MERCOSUR.⁴ Two aspects in particular must be highlighted. First, the willingness of Uruguay, and to a lesser extent Paraguay, to be more assertive in the discussion of matters that had been traditionally negotiated bilaterally by Brazil and Argentina and subsequently accommodated by the other partners. This change could signal that the decision-making process will become a more complex and politicized issue. Second, there are possible implications from the eventual full membership of Chile, not only for the economic scenario of MERCOSUR, but also for its political dynamics and decision-making. The relevance of the eventual full incorporation of Chile, in particular for the credibility it will bring, is not quite clear. There will be political implications for the bloc's decision-making processes and its attempt at higher levels of policy coordination.

Therefore, the main challenges MERCOSUR presently faces are essentially political: to reassert its strategic value, to reaffirm itself as an indispensable part of a joint development strategy as well as a privileged space for policy coordination at various levels, and to restore its functionality in pursuing political and economic opportunities. As for the first aspect, effectively advancing the proposed agenda to relaunch MERCOSUR is a decisive step towards perfecting its commercial focus of a free trade regime and customs union. At the same time, deepening its trade aspects will require major policy coordination in other areas and lead to a broader internal agenda.

The external agenda also offers important opportunities. However, the full achievement of the benefits that the different negotiation initiatives might bring about are envisaged for the long-term and outside the timeline required for MERCOSUR to consolidate itself. Among the different negotiations on course, the one that seems to hold the best prospects for a more autonomous role for MERCOSUR and medium-term accomplishments is related to South America's integration. However, it is still necessary to advance regional integration in the terms defined in the 2000

South America Summit, from either a project that addresses mostly Brazilian interests or as a strategy oriented to the enlargement of MERCOSUR. The FTAA does represent a meaningful stimulus for the consolidation and the deepening of MERCOSUR. However, it also raises relevant challenges in some areas that MERCOSUR countries are not ready to face collectively since internal trade and the economic components of the bloc do not encompass them. The agenda of the FTAA is, in many respects, internally unattainable for MERCOSUR following the deadlines and terms defined in the 1998 Summit in Santiago. At the same time, negotiations with the European Union keep revealing relevant differences in the structure of interests and the scope of the agenda. Such differences may bring about difficulties in reaching effective results before the FTAA negotiations are concluded, as MERCOSUR member countries would prefer to happen.

CONCLUSION

Undoubtedly, MERCOSUR exhibits positive achievements both in political and in economic terms. Its evolution over the last ten years has not been regular though. The great dynamism seen in the transition period vanished as economic agents and national governments strived to counter the costs of trade liberalization both unilaterally and through MERCOSUR. The need to respond to domestic and external contingencies led governments to sacrifice, in different degrees and forms, commitments and objectives jointly defined, thus contributing to the gradual weakening of the integration process observed in the late nineties. Nevertheless, the positive political and economic achievements of its first decade undoubtedly differentiated MERCOSUR from any other previous regional economic integration initiative in Latin America.

MERCOSUR's greatest merit has been that it has promoted and consolidated a new paradigm for economic development in the Southern Cone and Latin America in general, which is more in line with the present international economic order. Moreover, it has also helped consolidate democracy and engendered political stability in the region. In this sense, its political benefits are certainly as expressive as the economic ones. Despite its many difficulties and risks, MERCOSUR is still considered an important and convenient instrument to promote political and economic objectives as well as the interests of its members in an increasingly interde-

pendent, global, and asymmetrical world economy. This particularly has occurred as new and more subtle obstacles to market access have arisen everywhere and competition for capital and investment has become more demanding. MERCOSUR's main objectives have been gradually accomplished, although not in a balanced manner nor with clear correspondence to the social domain. This area represents a serious and often ignored political liability that will become more important and visible as the issues related to the framing of the economic concerns for a common market start to be effectively considered.

Therefore, the best prospect and opportunities for consolidating and reinvigorating MERCOSUR lie in its own internal realm. Governments may find better conditions here for formulating a more proactive role aimed at reaffirming and strengthening MERCOSUR's strategic relevance, which has become overshadowed by its external dimension. The more its internal agenda reflects increasing levels of interdependence, the better the prospects are for MERCOSUR to regain its dynamism and to foster political stability, economic and social transformations, and international assertiveness. In the meantime, MERCOSUR is expected to evolve into a hybrid configuration of an imperfectly completed free trade and customs union that can coexist with the emerging structures of a future common market. This will certainly signal a meaningful departure from its present outlook.

NOTES

1. After hitting a high of US\$20.5 billion in 1997, intra-MERCOSUR trade decreased to US\$15.3 billion in 1999 as a consequence of the economic downturn that followed the devaluation of the Brazilian currency and its economic impact on Argentina, Uruguay, and Paraguay.
2. This situation prevailed in Brazil during the period 1990-1992 and in Argentina since 1998.
3. The trade deficit hit US\$1.3 billion in 1999.
4. Chile's full membership has been postponed but not officially jettisoned under the current negotiating process.

REFERENCES

- Bouzas, Roberto. *Las perspectivas del MERCOSUR: desafíos, escenarios, y alternativas para la próxima década*. Buenos Aires: FLACSO, 1999.
- Campbell, Jorge, ed. *MERCOSUR: entre la realidad y la utopía*. Buenos Aires: Grupo Editor Latinoamericano, 1999.
- Devlin, Robert & Ffrench-Davis, Ricard. *Towards an Evaluation of Regional Integration in the 90s*. Dissemination Paper no. 8. Buenos Aires: INTAL, 1999.
- Garnelo, Vicente. *Evolución institucional y jurídica del MERCOSUR*. Dissemination Paper no. 3. Buenos Aires: INTAL, 1998.
- Lima, Marcos C. & Medeiros, Marcelo Almeida, eds. *O MERCOSUL no limiar do Século XXI*. São Paulo: Cortez Editora, 2000.
- INTAL. *Informe Mercosul: Período 1999-2000*. Informe no. 6. Buenos Aires: Banco Interamericano de Desenvolvimento, September 2000.
- Machado, João Bosco M. *MERCOSUL: processo de integração: origem, evolução, e crise*. São Paulo: Edições Aduaneiras, 2000.
- Nagarajan, Nigel. *On the Evidence of Trade Diversion in MERCOSUR*. Brussels: European Commission - Directorate-General for Economic and Financial Affairs, 1998.
- Tirado Mejia, Alvaro. *Integración y democracia en América Latina y el Caribe*. Informe INTAL no. 8. Buenos Aires: INTAL, 1999.

MERCOSUR After Ten Years: Learning Process or Déjà-Vu?

ROBERTO BOUZAS

During the last decade, MERCOSUR has been one of the integration experiences among developing countries that has attracted the most interest from analysts and practitioners alike. The economic dimension and the regional weight of member countries, the extraordinarily rapid growth of intra-regional trade and investment flows, and the fast progress made in the elimination of tariffs are unprecedented by developing countries' standards. However, after a promising start, MERCOSUR has confronted the challenges typical of any maturation process: the removal of non-border trade barriers, the harmonization and oversight of competition-distorting domestic policies, and the enforcement of common trade policies. In these areas, achievements have been more modest.

This chapter reviews the record of MERCOSUR during the past decade and examines its current policy dilemmas. The first section presents an overview of the performance of MERCOSUR during its first ten years of existence. The second section attempts to account for MERCOSUR's contrasting economic record, identifying a number of causal factors. In the third section, some of the policy issues and challenges currently faced by MERCOSUR will be briefly discussed. Finally, a concluding section summarizes some of the major points raised in the preceding analysis.

This chapter does not aim to present a comprehensive account of MERCOSUR. Instead, it purports to highlight the major forces that potentially will shape both conflict and cooperation in the region. Given this focus, all analysis is principally directed to Argentina and Brazil, the major partners in MERCOSUR.

FIGURE 1: THE FIRST DECADE OF MERCOSUR

Phase \ Variables	Interdependence	Enforcement Gap	Degree of Politicization
1991-1994	Rising	Low	“Positive”
1995-1998	Rising	Rising	“Positive”
1998-Present	Falling/Stagnant	Rising	“Negative”

THE FIRST DECADE OF MERCOSUR: A STYLISTIC OVERVIEW

Although delimiting periods for analysis always involves an element of choice, the record of MERCOSUR in the nineties can easily be broken down into three distinct phases (Figure 1). Each phase is characterized by a particular combination of three variables that jointly provide a dynamic account of performance. These three indicators are: 1) the evolution of interdependence, 2) the enforcement gap, and 3) the degree of politicization. Each one deserves a brief explanation.

Interdependence is an indicator of the intensity of relations within a region. A ratio of interdependence can be calculated by either taking the ratio of intra-regional exports to total exports (the trade encapsulation index) or the ratio of intra-regional exports to GDP. Rising interdependence is neither a guaranteed consequence of preferential trade practices nor is it welfare improving by itself. However, a preferential trade arrangement needs to increase interdependence if it is to be meaningful for its members. Rising interdependence creates stronger incentives to cooperate and manage intra-regional relations.

In contrast to interdependence, the enforcement gap and the degree of politicization are both qualitative indicators. The former refers to the existing gap between policy decisions (commitments) and the actual implementation of them. Although effective implementation will always lag behind, and imperfectly replicate commitments, a meaningful preferential trade arrangement cannot succeed if there is an ever-widening enforcement gap. The process of regional integration will become irrelevant if decision-making organs establish rules that have no material effect on national regulations or economic agents.

Finally, the ability to gauge the degree of politicization is to capture the prevailing mood with which members deal with differences and conflicting interests. There are negative implications when differences (including technical ones) are taken into the political arena and actions are paralyzed by domestic political debates. However, this process can also be positive, as when overriding political incentives provide a rationale for compromise.

These three variables do not capture the full range of factors that influence or characterize the regional integration process, but I believe that they provide an excellent approach to MERCOSUR's record and performance.

Phase One: The Transition Period (1991-1994)

In the Treaty of Asunción of March 1991, the period lasting from 1991 to the end of 1994 was dubbed the *Transition Period*. During this phase, intra-regional trade flows increased substantially and the degree of interdependence rose, particularly between MERCOSUR's two major partners. In a period of just four years, the ratio of intra-regional exports to GDP (as well as the trade encapsulation index) increased over sixty percent. Unilateral trade liberalization decisively contributed to rising interdependence by opening up economies and enabling geographical proximity to function at its best. This is not to deny the fact that preferences also played a role.¹

During this initial phase, member countries adopted three major commitments. They decided to implement a trade liberalization program (that consisted of automatic and across the board tariff cuts), adopt a CET, and coordinate macroeconomic and sector policies. By 1995, MERCOSUR had achieved a significant reduction of tariff barriers and had agreed on a CET, but no mechanisms were defined for the coordination of macroeconomic and sectoral policies.

Within just four years, MERCOSUR made more progress towards intra-regional trade liberalization than in the previous three decades. Effectively the bulk of intra-regional trade was subject to zero tariff rates after January 1995. The exceptions were a handful of sensitive products with separate timelines for tariff elimination by January 2000 (at the latest), and two special sectors (sugar and motor vehicles), that were excluded from the free trade umbrella.² Although gains in the realm of non-tariff barriers (NTBs) were more modest, member states did agree to elimi-

nate thirteen identified NTBs (mainly prohibitions and quantitative restrictions) by December 31, 1994.

At the end of 1994, member states had also agreed on a CET and a customs code. The conflicting interests that stemmed from divergent national protection structures were accommodated by a compromise that included the maintenance of national tariff rates, subject to automatic convergence calendars for a limited number of sensitive products, plus capital goods, information, and telecommunication products. However, MERCOSUR was far from being a full customs union at the beginning of 1995. Many NTBs were still in place, common trade policy instruments were only partially implemented, and policy asymmetries retained their full potential for distorting competition in the region. These obstacles did not obscure the fact that relative to the typical regional integration process for Latin American countries, MERCOSUR had recorded significant achievements in enforcement and implementation and in a surprisingly brief period of time.

Although the transition period was not free from clashes among the participants (in particular, Argentina resented its sizeable bilateral trade deficits with Brazil), these were generally resolved by using a cooperative and flexible approach. Examples of this were Brazil's readiness to accept an increase in the Argentine statistical import tax surcharge from three to 10 percent at the end of 1992 (stimulated by the real appreciation of the peso and mounting trade imbalances) and Brazil's decision to start to purchase oil and larger amounts of wheat from Argentina in order to reduce bilateral trade imbalances.³

Phase Two: The Age of Markets (1995-1998)

As far as the performance of MERCOSUR is concerned, the 1995-1998 period was one of great contrasts. These were the years of both rising interdependence and a growing regulatory paralysis. During this period, the prevailing view was that MERCOSUR was so successful it would move forward on private sector interests alone in spite of the fact that the policy agenda lagged well behind. As later events proved, the situation was more complex, and MERCOSUR began to accumulate an ever-growing list of unfinished business.

Between 1995 and 1998, the trade encapsulation index and the intra-regional exports to GDP ratio increased by nearly 50%. In terms of trade

and investment flows, this period was a golden age, led by market incentives strong enough to ensure a dynamic increase in interactions even in the context of regulatory paralysis and a widening enforcement gap. Although member states successfully implemented the agreed upon tariff cuts for sensitive products, sugar and motor vehicles remained subject to special rules and excluded from intra-regional free trade. More importantly, almost no further progress was made in the realm of NTBs. Border and non-border NTBs remaining after the first phase of changes were left largely intact and no advancements were made in terms of either identification or transparency. The implementation of common trade policies also lagged behind. The CET was only partially implemented, new temporary exceptions were authorized, and the customs code proved inapplicable. As a result, all goods traded remained subject to rules of origin, thus eliminating one of the major benefits that a customs union has over a free-trade area. By the same token, after free-trade agreements were successfully concluded with both Chile and Bolivia, the negotiations with the Andean Community and Mexico broke down. The result was a temporary extension (or even expansion) of existing bilateral agreements that further eroded the CET.

The second phase of the agenda agreed upon in December 1995 at Montevideo (*Agenda MERCOSUR 2000*) also recorded almost no progress. The only major initiative to come out of these talks was the eventual signing of a Services Trade Protocol in 1997. However, even this protocol was no proof of progress, as it only modestly went beyond the commitments already undertaken in the World Trade Organization (WTO). Common safeguards, anti-dumping measures, and countervailing duties were agreed upon, but not enforced.

From an institutional perspective, the major innovation in this period was the creation of a commission in charge of administering common trade policy instruments. However, this trade commission ended up burdened by the administration of internal disputes rather than by the enforcement of common trade policies. Despite mushrooming conflicts, the dispute settlement mechanism (DSM) remained unused until 1999.⁴

During the period from 1995 to 1998, differences were not given as much accommodation as during the transition, or initial phase. However, national governments made concerted efforts to prevent negative political fallout in those years. Their endeavors became increasingly difficult as

contrasting interests and perceptions became both widespread and evident. As the political incentives to work together subsided, the scope for conflict and negative political interaction widened considerably.

Phase Three: Times of Turbulence (1998–Present)

The devaluation of the real (R\$) in January 1999 is generally regarded as the prelude to the diminished interdependence and rising conflict among MERCOSUR partners. However, this view is an oversimplification of the multiple factors that have shaped the recent performance of MERCOSUR. In effect, the sources of MERCOSUR's disappointing performance after 1998 are to be found in more fundamental areas than the Brazilian devaluation.⁵ While some of these reasons were already touched on in the previous section, they will be more fully developed in the following section.

Since 1998 interdependence has subsided, and the flow of intra-regional trade has fallen in absolute terms. In 1999, the decline registered was 27.6%, while the trade encapsulation coefficient returned to the level recorded for 1995. During 2000, intra-regional trade recovered by 17.6%, but these figures were equal to those registered in 1996. The trade encapsulation index still has remained stagnant, reflecting levels similar to those recorded in 1995. This lower interdependence of the region has been to a large extent the result of adverse macroeconomic conditions, but also due to policy decisions. In effect, the protracted economic recession in Argentina and the economic slowdown that followed the devaluation of the real (R\$) in Brazil have severely curtailed intra-regional trade, confirming the evidence that these flows are more sensitive to aggregate demand levels than to bilateral real exchange rates.⁶ Ad hoc trade relief measures and the official sponsorship of orderly marketing arrangements for the private sector also have depressed trade flows.

As far as enforcement has been concerned, the post-1998 period has seen a continuation of many of the trends that prevailed during the second period. The phasing-out of tariffs for sensitive products has been achieved as planned, but special sectors such as sugar and motor vehicles have remained excluded from intra-regional free trade.⁷ Moreover, the refusal of the Brazilian government to accept the adoption of safeguarding mechanisms has led to the proliferation of ad hoc protection measures (formal and informal) which are proving to be a hindrance for intra-regional trade. Discussions on NTBs have not made any progress as member coun-

tries are failing either to increase transparency or move towards their identification and removal. Steps have been taken for the mutual recognition of sanitary standards, but enforcement has been postponed until there are more detailed agreements. Lastly, the promotion of common trade policies and the second phase agenda has remained in the doldrums. While the backlog for policy implementation is not improving, a widening gap between commitments and implementation is developing in areas such as customs procedures, standards, and other regulations. Even the efficacy of the DSM has been put in doubt after the ineffectual resolution of the first case brought before it.

During this last and third phase, negative politics have dominated. Trade conflicts are mushrooming, and the devaluation of the real has amplified the readiness of national authorities to embrace private sector complaints and engage in the rhetoric of confrontation. The flame of dissent has been further fuelled by frequent foreign policy clashes. Although the four member states have agreed to relaunch the agenda (June 2001), it is still too early to bring this third stage to a close. The agenda for its relaunching is too complex and ambitious but a number of factors may favor a new dynamism on the part of MERCOSUR.

ACCOUNTING FOR MERCOSUR'S PERFORMANCE

Multiple factors have accounted for MERCOSUR's contrasting performance during its first decade of existence. However, in this section we will concentrate on three that can give an adequate account of the major reasons behind progress and stagnation (Figure 2). These factors are: 1) the revelation of national policy preferences, 2) the focus of the agenda on negotiations, and 3) the external environment.

Phase One: The Transition Period (1991-1994)

During the transition period, the performance of MERCOSUR was facilitated by a positive set of circumstances that included congruent national (microeconomic) policies, a negotiating agenda focused on hollow integration, and a favorable external environment. This set of factors proved beneficial for the progress of regional integration, particularly in its early stages.

Member countries revealed a mix of congruent national policy preferences, combined with divergent macroeconomic approaches. After two

FIGURE 2: THE CONTRASTING PERFORMANCE OF MERCOSUR

Variables Phase	Revealed Policy Preferences	Nature of the Negotiating Agenda	External Environment
1991-1994	Macro Diverge/ Micro Converge	Border barriers (tariffs) and agreements on common trade policies	Conducive
1995-1998	Macro Diverge/ Micro Converge	Non-border barriers, NTBs, implementation of common trade policies	Adverse
1998-present	Macro Diverge/ Micro Converge	Non-border barriers, NTBs, implementation of common trade policies	Adverse

hyperinflationary episodes, Argentina stabilized its economy with the Convertibility Plan in April 1991, adopting a nominal peg for the peso and a Currency Board. This regime not only wiped-out monetary discretion, but also severely constrained fiscal laxity. Limited in its ability to borrow from the Central Bank, the federal government was forced into a program of fiscal consistency which was only partially relaxed by revenues from privatization and foreign borrowing. As a result, inflation fell sharply, growth resumed at a brisk pace, and the real exchange rate appreciated. Brazil, in contrast, was at a very early stage of its process of macro stabilization: inflation was still high, fiscal accounts were fragile, and the exchange rate regime was a crawling-peg combination. Despite these divergent macroeconomic trajectories, at the microeconomic level policy preferences converged notably; structural reform, deregulation, and privatization became the rules of the day. Although this convergence was more rhetorical than substantial, both countries engaged in pro-market reforms and unilateral trade liberalization. In particular, the latter was reinforced (and in turn strengthened) by preferential trade reform in the context of MERCOSUR.

At this stage the policy and regulatory agenda of MERCOSUR was dominated by tariff cuts and the removal of border barriers to trade (e.g. hollow integration). With this objective in mind, the Argentine and Brazilian governments signed the *Acta de Buenos Aires* in 1990, adopting a linear, automatic, and across-the-board tariff reduction program that was

unprecedented by Latin American and Caribbean standards. This program, adopted by the four member states with the signing of the Treaty of Asunción (March 1991), involved a major change in focus and procedures. Once enacted by national legislatures the trade liberalization program became domestic law and was automatically enforced. The result was that the logic of intra-regional trade negotiations changed radically, as officials focused on a negative rather than positive list of concessions. This approach, made possible by the broader trade policy environment, allowed a remarkably rapid process of intra-regional trade reform.

The agreement on common trade policy instruments (particularly a CET) was also made easier by the convergence of national trade policy regimes (particularly trade liberalization in Brazil). A flexible approach for sensitive products and sectors also materialized from the allowance for extended transition periods. While the CET largely replicated the structure of protection in Brazil, these long transition periods served to smooth the conflicting interests that stemmed from heterogeneous national protection (and productive) structures.

At last, the external environment proved conducive for the rapid progress of trade liberalization. On the one hand, liquid international financial markets relaxed the major constraints on economic growth that had operated during the eighties and reduced the conflicts associated with rising bilateral trade imbalances. Moreover, the launching of negotiations for NAFTA, the declaration of the Enterprise for the Americas Initiative in 1990, and the realization of the Miami presidential summit in December 1994, all contributed to stimulating defensive measures in the region (particularly in Brazil) and to raising the stakes of the regional exercise.⁸

Phase Two: The Age of Markets (1995-1998)

During the 1995-1998 period, the major factors playing in favor of MERCOSUR were the rapid rise of intra-regional trade and investment flows and the favorable conditions created by the de facto convergence of macroeconomic policies. However, the adoption of the Real Plan in Brazil in mid-1994 was soon followed by a shift at the microeconomic policy level. In effect, the central government and sub-national authorities moved towards a pattern of sector and horizontal intervention such as the automotive regime for the Northern and Northeastern regions, the provi-

sion of development and export finance, etc.⁹ The Argentine government, in turn, continued its trajectory of very limited intervention, moved by ideological preferences as much as by institutional deficiencies. The divergent path of microeconomic policies made room for conflict, as the relatively more interventionist stance of Brazil distorted incentives for trade and investment.

At the same time, the very success of MERCOSUR's tariff cutting exercise necessitated a more demanding agenda for negotiations. Once most tariffs had been removed or made subject to timelines for their automatic elimination, the agenda shifted towards the complex issues of identifying and removing non-tariff restrictions and non-border barriers as well as how to effectively enforce common trade policies. These restrictions posed the toughest challenges to trade liberalization. NTBs and non-border restrictions lacked transparency and were enforced at times in an obstructive manner. The border between legitimate restrictions (such as those to protect health or sanitary conditions) and obstructive regulations was blurred, and there was little consensus about the optimum degree of policy harmonization. The result was a more complex and conflict-prone agenda.¹⁰

Something similar happened with the enforcement of common trade policies. Implementing such instruments had to involve a degree of positive integration, include their shared interests and preferences, and require comparable institutional capabilities. Moreover, when common policies had been the result of a compromise in an asymmetric context (as was the case with the adoption of the CET in MERCOSUR), the acceptance of the agreed upon bargain involved dynamic trade-offs that at times did not actually materialize as the process evolved.

In the end, the external environment became more adverse during the 1995-1998 period. Conditions prevailing in the international capital markets changed after the Mexican Crisis in December 1994, and worsened markedly after the East Asian Crisis (1997) and the Russian default (1998). Failure by the Clinton administration to obtain fast-track negotiating authority also relaxed the perceived pressure to develop MERCOSUR further. This was a particularly relevant consideration in the case of Brazil, which had viewed the hemispheric process largely through a strategic lens.

Phase Three: Times of Turbulence (1998–Present)

The most recent phase for MERCOSUR has resulted from a combination of negative developments in the three areas under examination. After the devaluation of the Brazilian currency in January 1999, the de facto convergence of macroeconomic policies brought about by the Real Plan has ceased to exist. The shock produced by the devaluation of the Brazilian currency not only has threatened to severely disrupt intra-regional trade flows but also, more importantly, has confirmed that policy preferences widely diverge among member states (particularly with regard to the preferred exchange-rate regime). Constrained by the currency board and the high level of dollarization of financial assets, the Argentine government has felt the Brazilian move is inconsistent with its emphasis on macroeconomic stability. Moreover, divergent preferences also have become explicit in the trade policy realm, where the expected trade-offs for the adoption of the CET have failed to materialize or secure access for third-party countries to the region's largest market.

This context has magnified existing discrepancies and poses new obstacles for the effective treatment of the pending intra-regional agenda. The worsening macroeconomic environment has led to an increase in ad hoc trade measures and has soured the political climate. As a result, issues on the unfinished agenda for market access remain untouched. They have been aggravated by these new trade restrictions, while the more demanding issues of common trade policies and the deepening of MERCOSUR have lost substance against a succession of daily disputes. The external environment has not improved either, except for the renewed progress of the FTAA that has followed the decision to effectively start negotiating the agenda adopted at the Santiago Summit of 1998.

THE FUTURE OF MERCOSUR: ISSUES AND CHALLENGES

Presently, MERCOSUR faces significant challenges. As I have argued above, the reasons for the current stalemate go far beyond the adverse effects produced by the devaluation of the real (R\$) in January 1999. In effect, MERCOSUR was displaying clear signs of a regulatory paralysis well before the foreign exchange crisis in Brazil. To solely focus on this episode provides a distorted image of MERCOSUR's current issues and policy challenges. The Brazilian devaluation has aggravated trade conflicts and exposed the regulatory problems of MERCOSUR, but it

cannot be singled out as the lone event responsible for the current state of affairs.

As has been explained, the factors that account for MERCOSUR's performance are more complex. Isolated initiatives will not lead to an end of the present stalemate behind. In this section, there are three broad issues that must be addressed more effectively if MERCOSUR is going to recover its original dynamism: 1) the challenge posed by divergent interests, perceptions, and policy preferences; 2) the problem of leadership; and 3) the need to identify and implement a cooperative agenda.

Divergent Interests, Perceptions, and Policy Preferences

The member states of MERCOSUR were not motivated by the same interests to engage in the process of regional integration. As a matter of fact, Argentina and Brazil differed in their motivations from the very beginning. The Brazilian government regarded MERCOSUR as a means for enhancing its role in the international arena, particularly in the foreign policy realm. The Argentine government was motivated by the prospect of commercial gains and domestic political considerations. This example rebukes the notion that the participating countries originally shared the same interests. Indeed, national interests usually differ. If these differences do not involve incongruent preferences, a mutually beneficial arbitrage may be possible. Ultimately, what is required is that a legitimate difference of interests can be successfully bridged by a compromise that leads to a balance in mutual gains.

The intersection of different yet congruent interests had provided the original glue for MERCOSUR but was placed into question by a divergence in policy preferences. During the nineties, the Brazilian government frequently considered its foreign policy priorities to be challenged by Argentina's decision to make U.S. alignment a cornerstone of its foreign policy. Conversely, the benefits that the smaller partners of MERCOSUR (including Argentina) expected as a result of better and more stable access to the Brazilian market failed to materialize. Policy asymmetries remained in place and MERCOSUR did not make any progress towards a rules-oriented system. The gradual dissolution of this matrix and the failure to replace it with a new one lies at the heart of MERCOSUR's stalemate.

The real or perceived discrepancies between member states have extended over several critical areas. A major one is the debate about the level and

structure of protection. The agreement on a CET was made possible in 1994 by a compromise that closely replicated the structure of protection in Brazil and allowed long convergence periods for the other partners' sensitive products and sectors. However, the prevalence of uncertain rules, a high level of discretion, and public policy asymmetries reduced the expected gains for the smaller partners (including Argentina). When timelines for convergence began to loom, the deal was placed into question by the perception that the costs associated with the previously agreed upon level and structures for protection were not adequately compensated by other gains.

Member countries also showed significant discrepancies in their preferences regarding the extent desired for activist public policies. After the neo-liberal *intermezzo* of Collor de Mello, Brazil returned to more market-friendly policies that markedly contrasted with the ideological inclinations, institutional realities, and economic capabilities of the other partners of MERCOSUR. The bloc failed to tackle the issue of competition-distorting public policies (largely due to the opposition of Brazil), resulting in conflicts over their perceived effects on trade flows and the location of investments.

As the experience of the European Union shows, fully convergent public policies are not necessarily a pre-condition for progress towards regional integration. However, some basic regulations that deal with distorting interventions must be agreed upon and enforced. The exchange rate regime is a policy arena where this divergence has been more apparent. While Argentina has in effect run a currency board with a fixed nominal peg for the peso since 1991, Brazil has adopted different regimes and has had major devaluations, such as that in 1999. Convergent exchange rate policies are unlikely to prevail in MERCOSUR in the foreseeable future. Brazil has few incentives to move towards a more rigid exchange rate system and Argentina would face great obstacles if it wanted to abandon its current regime – not the least because of the extensive dollarization of its financial assets and liabilities. Procedures to deal with shocks and their effects should be in place since MERCOSUR lacks any mechanism to handle the effects of exchange rate shocks and can only rely either on de facto convergence or on ad hoc interventions during times of stress.¹¹

Governments have also differed on their perception of the effects that arise from the external environment. The Argentine government generally regards the FTAA as a positive development by itself and a potential

catalyst for MERCOSUR but the Brazilian perspective has been that this is a threat. Such divisions are obstacles for working together and the creation of trust, one of the necessary conditions for enhanced cooperation. Whether these divergent national positions are grounded on well-defined interests or ideological biases are to a large extent irrelevant for the issue at stake.

The Problem of Leadership

A leader is needed in order to have a sustainable process of regional integration. Moreover, if integration is to survive as a voluntary agreement, leadership and hegemony must be exercised in a benign way. Since regional integration is unthinkable without the provision of collective goods, it is necessary that one or more of the participants incur the cost of supplying them. In addition, to make sure the glue that holds the partners together is solid frequently requires a long-term (strategic) view involving a trade-off with short-term priorities. MERCOSUR has not been free from this demand, but a large gap has developed between this need and an effective supply of leadership within the region. The problem of leadership in MERCOSUR is more complex than that of a lack of willingness on the part of one or more member countries. MERCOSUR has a paucity of leadership shaped by structural factors, the effects of which can only be countered by hard political decisions. Moreover, it is the result of a combination of problems (three to be exact), rather than just one.

The first one I call the Argentine problem. Briefly, it can be described as Argentina's difficulties in accepting a key role in the provision of leadership. Given the significant size of the asymmetries that prevail in MERCOSUR, it is hard to imagine a sustainable scenario in which Brazil would not play a leading role in policy formulation and in the shaping of the bloc as it did for the CET. The Argentine problem is rooted in a history of rivalry and competition with Brazil and in wide discrepancies in the national political economies of the two countries. Presently, it is not so much the result of a clash of ambitions over regional leadership and international prominence, but the existence of divergent preferences for the desired pattern of MERCOSUR's development and insertion into the world economy. The Argentine problem has weakened the foundation for strong bilateral ties and has stimulated dissent in those areas in which the Brazilian government is most sensitive about for Argentina's support, such

as in international affairs and foreign policy. It is clear that this problem has no easy answers.

The remaining two leadership problems touch more directly on Brazil, the largest partner. Although both can be seen as part of the same whole, for analytical purposes they can be separated into two distinct issues. The first one (the Brazilian Problem Number One) is related to the willingness to lead and refers to an issue of commitment. A benign hegemon needs to be committed to the provision of the collective goods required. The provision of these collective goods, such as stable and enforceable rules, usually involves a cost (e.g. loss of discretion). Political willingness to change this requires a pay-off in which the perceived benefits for bureaucrats, politicians, and other interested parties can be clearly identified. In the case of MERCOSUR, Brazil's willingness to lead is negatively influenced by two factors, one structural and the other policy-induced. The structural component is the size of the asymmetries while the policy-induced factor is the perception that the expected trade-offs have failed to materialize.

Even the willingness to lead does not suffice. In effect, a benign hegemon also needs resources to make its leadership effective. This side of the coin is what we call the Brazilian Problem Number Two. Resources tend to be scarce and they have to be allocated between alternative ends. Moreover, the resources to exert effective leadership may not even be there as has been the case with macroeconomic discipline and stability. Since the region has a problem with credible macroeconomic stability, a major contribution from a leader could be the provision of a focal point and an anchor for convergence. However, Brazil has lacked the attributes to play this role in MERCOSUR, as Germany has done in Western Europe and, by alternative means, the United States has achieved in North America. This handicap of MERCOSUR reduces the incentives for the other partners to follow the hegemon's lead.

The gap between the demand and the supply of leadership in MERCOSUR is significant. Closing that gap will demand a strong political will and an appropriate understanding of current shortcomings and their implications. Rather than making long lists of its unfinished business, MERCOSUR needs to recreate a sense of political understanding and of the shared interests that can increase the incentives for cooperation.

Setting and Implementing a Cooperative Agenda

During the last few years the internal agenda of MERCOSUR focused on the administration of conflict rather than on the fostering of a cooperative agenda. Moreover, as discussed in the first section, divergence is occasionally politicized, making an acceptable settlement more difficult. Negotiations have been undertaken on the basis of shopping lists with member states bringing together their reciprocal demands. However, this is an inadequate base to further the process of regional integration. It de-emphasizes the cooperative elements that are the foundations of regional integration. If the current phase is going to be successful, member states will have to replace the conflict-prone agenda that has been prevalent in recent years with cooperative arrangements capable of fostering common interests. This shift in focus should take place in at least three different areas: 1) the management of productive restructuring, 2) the promotion of growth and productivity, and 3) the implementation of external trade negotiations.

The issue of mitigating the negative effects from dislocations in production has received minimal systematic attention. After the elimination of safeguards at the end of the transition period, no instrument has been put in place to deal with the pressures that have emerged from shocks and the unforeseen changes in competitive conditions. This issue has become particularly critical after the devaluation of the real (R\$) in January 1999. Instead of finding common instruments to deal with the effects of that shock, member states have adopted unilateral ad hoc measures, such as a more aggressive implementation of trade remedy laws, and have favored private sector orderly marketing agreements for the dairy, paper, and steel industries, among others. Apart from these steps, MERCOSUR has not comprehensively addressed the productive restructuring of its special sectors (sugar and motor vehicles).

Private sector agreements and special trade regimes can be useful as transitory mechanisms in the context of sustainable, long-term adjustments. However, most of these programs have included no restructuring targets. They risk becoming mechanisms that foster the growth of cartels and protect particular interests at the expense of the consumers and aggregate efficiency. The alternative to this approach is not market-led adjustments because adjusting to transitory shocks may not be optimal. As expe-

rience has shown, political economic considerations make such a drastic approach difficult to implement. Instead, a better understanding of the permanent changes to competitive conditions and more transparent instruments to deal with transition costs and the effect of shocks are required. Such modifications would not necessarily include more interventionist public policies, but rather a more active role of the public sector as a coordinating agent and a supplier or disseminator of information.

A stronger cooperative approach is required to restructure and promote pro-growth policies. One of the major benefits of economic integration is the possibility to share the costs of activities with large non-divisibles (e.g. research and development) or cross-border externalities (e.g. infrastructure investment). The record of MERCOSUR has been modest in these areas that have a high potential for positive integration. A focus on long-term policy instruments that promote growth may help shift the current conflict-prone agenda towards a more cooperative one.

Lastly, while MERCOSUR has been able to maintain a unified stance in the preliminary negotiations for the FTAA and with the European Union, the basis for this cooperation seems weak. In effect, there is no systematic mechanism to identify common interests, the areas of divergence, or the necessary trade-offs that could contribute to a sustainable and unified negotiating stance. MERCOSUR lacks a forum where public officials can examine their national agendas in detail without arbitrage or differences existing. Despite the unified position of MERCOSUR in its dealings with the FTAA and the European Union, its failed negotiations with the Andean Community and Mexico suggest that a common stance is not easy to maintain when negotiations enter into the critical phase for an exchange of concessions.

A more structured mechanism to identify and implement a common strategy for external trade negotiations seems terribly needed. At this stage, it may not involve the transfer of exclusive competencies to a supra-national organ (such as the European Commission in the European Union), but the start of an incremental process that may eventually lead there. Better structured technical assistance, information gathering, and exchange of this knowledge can render fruitful results and help to identify common interests.

CONCLUSION

I have argued in this paper that MERCOSUR faces significant challenges. However, the political, economic, and technical capital accumulated in the last decade provides a strong foundation upon which to build. The agenda for its relaunching as announced in June 2000 is an ambitious one and may not be fully within the reach of MERCOSUR. However, a change of direction cannot be ruled out. I have argued that in order to change the course of MERCOSUR member states need to face various strategic issues: 1) the existence of divergent national perceptions and policy preferences, 2) the supply of adequate leadership, and 3) the identification and implementation of a cooperative agenda.

My moderate optimism is grounded upon three reasons. The first one is the significant increase in interdependence that has taken place in the last decade. The economies of the region, particularly Argentina and Brazil, are currently linked not only by trade flows but the effects that contagion has created in terms of common dilemmas and interests. Moreover, the fact that MERCOSUR has been long identified as one of the successful experiences of South-South regional integration means that a significant amount of political capital has been accumulated. National governments are most likely, and reasonably, interested in sustaining it.

The second reason is that national administrations have perceived macroeconomic convergence to be an essential requirement for the successfulness of economic integration. During 2000, member states emphasized the promotion of macroeconomic cooperation, starting with the setting of targets for a number of variables (inflation rate, fiscal deficit to GDP ratio, and public sector debt to GDP ratio). Although this exercise has produced no compulsions to continue the process, it may turn out to be a first step. It could lead to increasing the exchange of information and level of interaction between national economic agencies and central banks. The declaration that member countries are likely to maintain divergent exchange rate regimes at least in the foreseeable future has shifted the emphasis towards other areas of macroeconomic policy coordination.

Finally, FTAA negotiations will enter a key stage as the 2005 deadline approaches. This suggests that the defensive incentives for cooperation may increase, particularly if the U.S. negotiators gain credibility through the approval of fast-track authority. As in the past, Brazil's readiness to offer

concessions for its partners has been proportional to the belief that the FTAA is a credible threat. As the hemispheric integration process enters a stage of substantive negotiations, the viability of MERCOSUR will be put on trial. The ability to identify common interests and to successfully arbitrage between divergent agendas in this process will be MERCOSUR's final acid test.

NOTES

1. J. Frankel, *Regional Trading Blocs* (Washington, DC: Institute for International Economics, 1997), chapter 5.

2. Paraguay and Uruguay were given one additional year to complete tariff-cutting commitments. In Ouro Preto, member states also agreed to add the sugar sector to the free trade arrangements and enforce a common trade policy by December 2000. The trade of motor vehicles was to be run by a common regime as of January 2000.

3. Brazil was a traditional market for Argentine wheat, but Argentine exports suffered the adverse effects of competition from developed countries' subsidized exports. In turn, following a political decision the Brazilian state oil monopoly (Petrobrás) replaced part of its oil purchases from the Middle East with purchases from Argentina.

4. For a detailed discussion of MERCOSUR's institutional performance see R. Bouzas and H. Soltz, "The Institutional Performance of MERCOSUR: A Preliminary Assessment," in *Regional Integration in Latin America and the Caribbean: The Political Economy of Open Regionalism*, V. Bulmer-Thomas ed. (London: Palgrave Press, forthcoming)

5. To emphasize this point we adopt 1998 as the ending year of the second phase and the starting year of the third phase.

6. See D. Heymann, "Interdependencias y políticas macroeconómicas: reflexiones sobre el MERCOSUR," in *MERCOSUR. Entre la realidad y la Utopía*, J. Campbell ed. (Buenos-Aires: CEI-Nuevohacer, 1999).

7. Sugar should have been included in the general rules by December 2000, but member states failed to reach an agreement. The issue is still pending. A common regime for motor vehicles was finally agreed on in March 2000, but intra-regional free trade will be enforced only in 2006.

8. For a discussion of the role of defensive incentives see R. Bouzas and J. Ros, "The North-South Variety of Economic Integration. Issues and Prospects for Latin America," in *Economic Integration in the Western Hemisphere*, R. Bouzas and J. Ros eds. (South Bend, IN: University of Notre Dame Press, 1993).

9. P. da Motta Veiga, "Brasil en el MERCOSUR: política y economía de un proyecto de integración," in *MERCOSUR. Entre la realidad y la utopía*, J.

Campbell ed. (Buenos Aires: CEI-Nuevohacer, 1999).

10. The European experience shows that after years of harmonization, the adoption of the principle of mutual recognition proved the way out from the imbroglio. However, mutual recognition is only conceivable where standards and enforcement thereof display relatively limited variety.

11. The announcement of common fiscal and inflation targets in 2000 was made on the assumption that fiscal and nominal convergence will stabilize real bilateral exchange rates. Although the targets are solely indicative, and thus involve no element of coercion, they reflect awareness about the issue.

REFERENCES

- Bouzas, R. and Ros, J. "The North-South Variety of Economic Integration. Issues and Prospects for Latin America." in *Economic Integration in the Western Hemisphere*, edited by R. Bouzas and J. Ros. South Bend, IN: University of Notre Dame Press, 1994.
- Bouzas, R. and Soltz, H. "The Institutional Performance of MERCOSUR: A Preliminary Assessment," in *Regional Integration in Latin America and the Caribbean: the Political Economy of Open Regionalism*, edited by V. Bulmer-Thomas. London: Palgrave Press, forthcoming.
- da Motta Veiga, P. "Brasil en el MERCOSUR: política y economía en un proyecto de integración," in *MERCOSUR. Entre la realidad y la utopía*, edited by J. Campbell. Buenos Aires, CEI-Nuevohacer, 1999.
- Frankel, J. *Regional Trading Blocs*. Washington DC: Institute for International Economics, 1997.
- Heymann, D. "Interdependencias y políticas macroeconómicas: reflexiones sobre el MERCOSUR," in *MERCOSUR. Entre la realidad y la utopía*, edited by J. Campbell. Buenos Aires, CEI-Nuevohacer, 1999.

MERCOSUL Politics: Between Fragmentation and Integration

MONICA HIRST

MERCOSUL is the closest model of inter-democratic peace thus far achieved in South America.¹ Despite its institutional failings and political shortcomings, MERCOSUL set out to be an initiative that encouraged a sense of community in the process of democratization; a revision of the defense policies of its member states; and, a strong commitment to create foreign policies in line with its strategic regional interests. Bringing together new economic and global contexts has brought MERCOSUL rapid international visibility, which has helped to improve the agility and efficacy of its intra-regional negotiations.

At the end of its first ten years, MERCOSUL is facing problems, both old and new, related to the style and content of the multilateralism that its presence as a political actor has introduced into South America. We can identify three areas in which this association has worked as a “shaping actor” in the region: the first is in relation to the foreign policies of its member states, particularly its principal partners; the second is in the South American regional scene; and the third is in the so-called “hemispheric environment.” In order to evaluate the political development of MERCOSUL, it is a good idea to review briefly the most recent period in its evolution, examining politics as well as the political economy. In the context of the “Second Wave of Regional Integration,” MERCOSUL represents the principal associative experience in South America.

An analysis of the development of MERCOSUL in the three dimensions mentioned above allows us to contemplate two cooperative areas: the first is the associative nature that reinforces the political attributes of MERCOSUL as an enterprise, united by common interests; the second is the communal nature that emphasizes the political attributes of MERCOSUL as a community, tied together by common loyalties.

TAKING STOCK OF MERCOSUL

After a decade, we can identify both positive and negative results of MERCOSUL's development. It has been a very successful initiative in some aspects. In particular:

- 1) Trade indicators show an increase in annual intra-regional exports of 27.6% between 1991 and 1997. Intra-regional trade rose from US\$5.1 billion to US\$20 billion in the same period. This result was three times higher than the exports destined for the rest of the world.
- 2) There is a growing connection that can be observed between the expansion of foreign direct investment and intra-regional trade. In Argentina and Brazil this rose by about US\$2.4 billion during the years 1986-1991 and US\$10.6 billion during 1992-1997, reaching US\$22.6 billion in 1997. Part of this growth was related to intra-firm trade.
- 3) In a short period of time, MERCOSUL acquired notable international visibility through the construction of agendas that were both positive and negative. The negotiations with the EU, with other regional associations in Latin America, and with individual countries (Chile and Bolivia) are examples of the new positive agendas. It is also worth mentioning the growth in political weight of MERCOSUL in hemispheric negotiations. In fact, since the 1990s MERCOSUL has been the primary example of South-South integration.
- 4) A sense of community is another attribute of MERCOSUL. Since its launch, MERCOSUL has always been high on the list of the political priorities of its members. In this sense it has been the reverse of what happened in the 1960s and 1980s when regional integration was converted into a political instrument with sporadic use by the leaders of the nations in the region. For its principal members, MERCOSUL represents a state matter. Over the past ten years MERCOSUL member countries have had twenty meetings at the presidential level, channeling unprecedented political energy from Argentina and Brazil. At the same time, the process has become a source of highly valued political capital for the regional and global affairs of its members.

- 5) According to a neofunctional approach, MERCOSUL has proven its “spillover effect.” Regional integration in the Southern Cone does not only include trade issues. Currently all of the public policies of the member states are included on the regional agenda (education, culture, health, environment, public works, security, tourism, etc.). Despite the anarchic nature of the institutional structure, this expansive dynamic has been accompanied by a growing involvement of local administrations that seek to up-grade their own agendas through transborder networking.
- 6) MERCOSUL has established a direct link in the Southern Cone between the defense of democracy and regional integration. In addition, MERCOSUL aims to consolidate as a zone for peace.

Notwithstanding the accomplishments mentioned above, a parallel list can be drawn up in which the less successful aspects of the associative process are listed. Among its “non-successes” we list:

- 1) The construction of MERCOSUL as a trade union has been more accidental than originally planned. Controversies caused by backing away from commitments previously agreed upon added to protectionist interests and have generated commercial conflicts that have compromised the full implementation of a CET.
- 2) MERCOSUL lacks the necessary institutions for operating as an inter-governmental decision-making structure. For more than five years MERCOSUL has faced a trade agenda heaped with disputes, without being able to rely upon judicial instruments and institutions capable of effectively finding solutions for these controversies. This has negatively affected MERCOSUL’s credibility. In addition, this difficulty is not restricted to issues of sovereignty; it also involves limitations on human and economic resources.
- 3) There exists a “democratic deficit” in MERCOSUL. The absence of participation of more political entities, the marginal presence of labor groups, and the irrelevance of parliamentary bodies make the inclusion of MERCOSUL in the “citizen agenda” of the democracies of the region purely cosmetic.

- 4) The centralized structure of the decision-making process in MERCOSUL has led to distortions of information and a lack of clear communication for public opinion. Erroneous or incomplete information is frequently a part of “defamatory” campaigns about the impact of the process on society, which influences perceptions and leads to negative politicization. This was the case in the absence of information about the alleged “invasion” of Brazilian products in the Argentine market in 1999, and the erroneous information about the transfer of business activity based in that country to Brazil.
- 5) The oscillation between friendship and rivalry among Argentina and Brazil acts as a powerful factor in MERCOSUL’s political metabolism. The Argentina–Brazil rivalry is fed by historical memory and is evidenced by a chronic cycle of “making up and falling out.” These cycles are customarily produced by the reactions of one country to the other’s unilateral decisions regarding trade, macroeconomic politics, or foreign policy.

A BUMPY FIVE YEARS

There is a notable contrast between the first and the last five years of MERCOSUL. In 1997 a complex agenda was on the table, parts of which included: automatic tariff reductions; resolving the differences that prevented progress in the service sectors; access to financial markets; fiscal harmonization; and macroeconomic coordination. The inconsistency with which institutions imposed discipline upon its main members contributed to a rapid surge of negative politicization within the bloc.

Paradoxically, this period coincides with the most important developments of the external agenda of MERCOSUL. Among these developments were the signing of the accord with the EU, the establishment of partial membership for Chile and Bolivia, and a deepened commitment, on the part of MERCOSUL and North American leaders, to advance FTAA negotiations. However, these advances were not enough to neutralize the strength of fragmentary impulses. Argentina, as much as Brazil, worked hard to preserve its sovereignty and assumed the prerogative to engage in unilateral negotiations in the field of trade. While Argentina initiated unilateral negotiations with Mexico, Brazil did the same with the Andean Pact.

Meanwhile the business sector's influence over the negotiation process grew, particularly in relation to the automobile industry, electronics, chemical, and metallurgy products. Interestingly, the unions aligned with business interests, revealing a tendency for national coalitions rather than the growth of networks amongst similar groups within the region. It is worth mentioning that in Brazil this type of coalition coincided with the gradual reactivation of neo-protectionist policies, and that a consensus rapidly manifested between workers and businessmen.

At the end of 1999, MERCOSUL was hit hard by the changes introduced in Brazil's monetary regime. In the same year Brazilian imports from MERCOSUL suffered a decline of more than 20%, while Brazilian exports to Argentina suffered a similar percentage decline. For the first time, presidential diplomacy proved ineffective.

After suffering its worst period, in 2000 MERCOSUL initiated a new stage labeled "the relaunch." The progress made (after three years the automotive regime was ratified by Argentina and Brazil) was reversed by two circumstances, one internal and the other external. The first was the prolonged period of economic recession in Argentina, which was further aggravated by problems of governance caused by the domestic political crisis in that country. The second related to the negotiations between Chile and the United States about reaching a free trade agreement. Without much foundation for hope, Argentina, and particularly Brazil, had magnified their expectations regarding Chile's entrance into MERCOSUL. Upon reflection, therefore, it is possible to say that despite its advances, MERCOSUL's associative process revolved around three factors: the macroeconomic development of Brazil, the governing conditions in Argentina, and the FTAA prospects.

The effects of the Brazilian monetary devaluation introduced new challenges into the asymmetrical structure of MERCOSUL. In addition, events in Argentina led the country to shake its partnership with Brazil. While the government of Fernando De la Rúa worked hard to reduce the differences between the foreign relations of the two countries, it proved quite reticent in following the new steps taken by Brazil on the regional stage. Argentina observed with limited interest the Brazilian initiative to create a South American platform that would magnify and improve the strategic projection of MERCOSUL. Converting this interest into a shared action between the governments of De la Rúa and Cardoso would

have automatically given greater weight to the initiative. Historically, it is worth recalling a movement of a similar nature at the end of the 1950s with the launch of the Pan-American Act, when the Argentine government fully endorsed the Brazilian initiative. Finally, the FTAA process will be, for a long time, the factor with the greatest strength in determining the life expectancy of MERCOSUL. Benefiting from U.S. ambiguity regarding the expansion of NAFTA, MERCOSUL can step up and work to overcome the dilemmas it faces. Yet the expectations that negotiations for a FTAA or for a myriad of bilateral accords, favoring a wider liberalization of hemispheric trade, make it difficult to consolidate MERCOSUL as a customs union.

THE FAILURES OF THE PROCESS

The continuity of MERCOSUL has been constrained by two structural dilemmas—one of an economic nature and the other political. Both represent permanent sources of tension that compromise consolidation. The first dilemma is a function of the overlap of asymmetries and the economic strategies of member nations. The second dilemma is caused by the dichotomy between power and responsibility.

The tension between asymmetry and economic strategy is caused by the differences observed between a post-ISI strategy in Argentina and the reactivation of an industrialist strategy in Brazil. This difference, taken in the context of relevant asymmetries that have always been present in Brazil-Argentina relations, makes economic integration more difficult. In Brazil, the preservation and modernization of industrial sectors, such as automotive, chemical, capital goods, and information technology have strengthened the neo-developmental drive within the government and business sectors. For Argentina, the comparative advantages of its association with Brazil are concentrated in the food industry and the energy sector. Nevertheless, in Argentina, the so-called heterodox economists still expect that MERCOSUL—especially the Brazilian market—will lead to a new wave of industrialization.

The second dilemma is enmeshed in MERCOSUL's "power politics." The lack of equilibrium in the relationship between the Argentina-Brazil axis and the other MERCOSUL countries creates space for a de facto veto power that excludes the smaller members from the decision-making process. This has become a permanent source of tension that requires

accommodation and flexibility. There are even greater difficulties in Argentine–Brazilian relations. Brazil’s dominant position opens a natural space for the country to assume a leadership role, but in the context of a strategic alliance this is problematic. The balance between the refusal to assume a hegemonic posture and the responsibilities involved in intra-bloc leadership is the most sensitive political point in the Argentine–Brazilian relationship within MERCOSUL. Brazil’s position as leader brings with it costs and benefits. Hence, reciprocity and the unquestionable conviction of a common interest become the driving forces of the associative process. In order to assure the legitimacy of the associative process, members ought to construct cooperative agendas, based upon norms and “rules of the games” agreed upon by all the countries. For Brazil, MERCOSUL represents more than a new power attribute; it offers a new source of legitimacy for its presence on the international scene. For Argentina, the associative process represents an instrument by which it could renew its status on the international stage, that does not preclude the preservation of self-interests.

MERCOSUL AS A COMMUNITY

The first point that will qualify MERCOSUL as a community is that it does not involve the use of force or coercion between its member states. The political loyalty of the member states is founded upon two essential motivations: the defense of democracy and the preservation of peace. From the conceptual point of view, significant steps taken in the last decade allow us to identify MERCOSUL as an incipient Pluralistic Defense Community (PDC). The implementation of confidence-building measures, the inclusion of the democratic clause in the Treaty of Asunción, and the formalization of a Peace Zone correspond to the initiatives that are most relevant to establishing PDC status. At the same time, MERCOSUL has established some political functions that give greater value to the multilateral relationships between the member states, in South America and the hemisphere as a whole.

Recent literature on regionalism values these developments, contrasting the intra-MERCOSUL conditions with other synergies in South America. The literature differentiates between situations that fall under the concepts of a PDC, of negative peace, and of stable peace.² It is worth reviewing the parameters that turn a region into a PDC, by considering the three multi-

lateral frames in which MERCOSUL is inserted: MERCOSUL itself, particularly Brazilian–Argentine relations; South America, and the hemispheric frame; and, the FTAA negotiations. The conditions for the formation of a PDC are: 1)convergent values, 2)common policies, 3)shared diplomatic culture, 4)leadership, 5)positive economic performance, 6)economic incentives, 7)economic ties, 8)societal interaction, 9)formation of a regional elite, 10)regional peace, 11)external threats, and finally 12)ethnic or linguistic similarities. When these parameters are examined in the context of the three frames mentioned above, different results emerge.

1) *Convergent Values*. It is axiomatic that states within a region will influence the internal and external policies of each other. The dominant values that guide domestic politics within each state will help to shape regional loyalties.

- a) MERCOSUL: Democracy and peace represent common values that are mutually re-enforced. Before MERCOSUL, closer relations between Brazil and Argentina were motivated by the democratization process and shared foreign policy agendas.
- b) South America: While democracy and peace are collective goals, the countries of the region maintain different positions when faced with situations that involve domestic political crises and institutional turbulence.
- c) FTAA: Although the defense of democracy and regional security are a common goal, this has not led to the consideration of a democratic clause in negotiations.

2) *Common Policies*. This relies upon the political will of member countries to pursue the instruments and coordinated initiatives in the foreign policy, particularly when facing crisis situations.

- a) MERCOSUL: Cooperative foreign policy initiatives have yet to be created, however specific situations have led to joint action. This was highlighted by the institutional crises in Paraguay and the Ecuador–Peru war, but has yet to be seen in the Colombian crisis. In the noted cases, it was not institutional mechanisms, but presidential diplomacy that was successful.
- b) South America: There is no definition of common foreign policy objectives. The only inter–state arena for coordination is the Rio Group (which also includes Mexico, Central America and the Caribbean).

- c) FTAA: Biannual presidential summits, which focus more on free trade negotiations than political coordination, have taken place since 1995. There is also a parallel agenda for defense issues carried forward in ministerial meetings. In addition, the Organization of American States (OAS) can be relied upon to provide a collective response for the defense of democracy (as laid out in its Resolution 1080) and protection of human rights. It should be noted that asymmetries within the hemispheric community favor the weight of the U.S. and its capacity to determine agendas and condition responses.
- 3) *Diplomatic Culture*. One can appreciate the historic and cultural elements that influence collective diplomacy when contrasting the tendencies that reinforce multilateralism and those that lead to unilateral initiatives.
 - a) MERCOSUL: There are still many factors that impede a “MERCOSUL style” of diplomacy. Aside from the shared memories of rivalries dating back to colonial times, different political and institutional foreign policy structures and different twentieth century foreign policy developments must be considered.
 - b) South America: There are strong fragmentary tendencies fueled by a history of border conflicts, which coexist with important cooperative impulses as well. A tradition of legality, together with concrete experiences of peaceful conflict resolution, have contributed to fostering cooperative initiatives. However, the Luso-Brazilian culture, marked by the principle of *uti possidetis* and Hispanic juridicism, served to reinforce Brazilian isolationism until very recently. Brazil’s interest in promoting a South American cooperative agenda is still very new in the region.
 - c) FTAA: Pan-American history and past Inter-American institutions played a positive role in the formation of the “new hemispheric culture” launched by the U.S. in the 1990s. Yet hemispheric diplomacy is always combined with the pressures and expectations that result from cooperative or conflictive bilateral relationships with the U.S.
- 4) *Leadership*. Centralized decision-making, that drives the development of a community based on the concentration of power, leads to a de

facto leadership. One can point to the European experience as an alternative example, where the decision-making core was initially made up of France and Germany, and later diluted when an inter-governmental institution was created. Another example is that of NAFTA, where the dominant position of the U.S. assures hegemonic stability to the process.

- a) MERCOSUL: Since there is an unequal distribution of power within the bloc, there are really two decision-making axes. Due to differences between the major and minor partners, the Brazil-Argentina axis has driven the integration process from the beginning. On the other hand, due to the relative importance of its market, Brazil has increasingly assumed a de facto leadership role. This has affected the progress of economic integration and inhibited the formation of an institutional structure to run the process.
- b) South America: The presence of Brazil and the manifestation of its interest in building a South American zone of influence, while maintaining its own identity, has posed the question of regional leadership. However, obstacles have emerged: growing fragmentation between the Andean nations and MERCOSUL; the presence of the hegemonic power of the U.S.; and uncertainty over the future of MERCOSUL.
- c) FTAA: Uncontested U.S. leadership affects areas such as trade, security and domestic politics. For Latin American nations, the question of reciprocity is important as well as the abandonment of coercive instruments.

5) *Positive Economic Performance.* MERCOSUL's formation will be facilitated by economic stimuli previously manifested as growth indicators and stability that results in introducing new macroeconomic conditions and renewed cycles of expansion.

- a) MERCOSUL: During the first half of the 1990s, positive rates of economic growth, intra-regional trade, and foreign direct investment were registered in all of the economies of member countries. Crucial advances have also been made in the processes of stabilization and liberalization.
- b) South America: After the "lost decade," the region experienced notable growth during the 1990s, accompanied by the adoption of similar policies of economic liberalization and deregulation.

- c) FTAA: The adoption of liberal economic policies throughout Latin America coincided with support from the U.S. government. At the same time, the unprecedented expansion of the U.S. economy transformed the hemispheric scene as U.S. direct investment boomed all over the region.
- 6) *Economic Incentives*. The relationship between promised economic results and the associative process constitutes an important function of MERCOSUL. This process was facilitated by the existence of previous intra-regional networks. Spurring new economic activity through the creation of a regional market represents one of the primary incentives for regional economic integration.
 - a) MERCOSUL: During the bloc's first five years, there was a positive correlation between the growth in the national economies of the region, an increase in foreign direct investment, and an increase in the member countries' power in external negotiations.
 - b) South America: The economic incentives are rather varied for the formation of a continental bloc. In fact, the weakest area is that of projects needed to improve infrastructure, energy, and communications.
 - c) FTAA: The economic incentives for the formation of a hemispheric free trade area are high. Amongst them are improvements in the process of economic globalization, as well as ensuring that the U.S. will take a more active role in fostering growth and stability in Latin American economies. An analysis of NAFTA's positive effect on the Mexican economy endorses this kind of perception.
- 7) *Economic Ties*. The formation of regional associations is often accompanied by the intensification of both economic and commercial ties within the bloc. The impact of the associative process over the fluctuation of external trade must be greater than on its members' real levels of export growth. It is here that the sensitive theme of asymmetries arises—where the conditions of interdependence are different and/or where the conditions for market access in the bloc do not follow the same rules.
 - a) MERCOSUL: There was a notable growth in intra-MERCOSUL trade before 1997, accompanied by the expansion of business networks, especially those of transnational firms.

However, since 1998 this process has been endangered by the economic crises in Brazil and Argentina.

- b) South America: This case is best observed in the trade figures between the Andean Community and MERCOSUL. Intra-Andean trade grew less than intra-MERCOSUL trade, and the largest growth in the Andean-Southern Cone axis was primarily in exports to Brazil. The Latin American Integration Association (LAIA) has provided the institutional framework for regional transactions.
- c) FTAA: The greatest change in trade, due to liberalization, was the growth in U.S. exports to countries in the region. This growth proved crucial in negotiations for preferential status and reciprocal access to the United States market, once the trade area is implemented in 2005.

8) *Societal Interaction*. The growth in commercial ties must be accompanied by an expansion in the networks of interaction between groups with similar interests, especially among business communities. Access to the job market will later be stimulated by the increased transborder movement of professionals and workers. Also, there is often an increase in relations between regional and local governments, at the state and municipal levels.

- a) MERCOSUL: There has been a notable expansion of contacts between business sectors, NGOs, and state and municipal administrators. Regional events have stimulated the growth of new partnerships.
- b) South America: The limits on intra-Andean communication, intra-Amazonian communication, and communication between the Andean region and MERCOSUL, impede the expansion of transborder societal interaction
- c) FTAA: The growth of U.S. direct investment throughout the region has increased the presence of American businesses all over Latin America, and has contributed to the expansion of private business networks, as well as educational and cultural interaction. It is also worth noting the growth of NGO activities focused on environmental issues and the protection of human rights, which were stimulated by the greater levels of participation by local groups and organizations following the new democratic ideals of the hemisphere.

9) *Formation of a Regional Elite.* An advanced stage of the community-building process is when “community” interests overcome national cultural identities. Plural political contexts are essential, and they depend upon the efficacy of long-term educational and cultural practices that neutralize perceptions which lead to conflicts and rivalries.

a) MERCOSUL: In the economic arena, there is the gradual formation of a business sector that manages crossborder investments mostly connected to transnational companies. Nevertheless, the absence of intra-regional partisan links, and the lack of information regarding the political culture of other countries, makes it difficult to form a new elite that shares a common vision. Cultural and educational interaction, caused more by governmental initiatives than private ones, has expanded gradually. The idea is to create common cultural and intellectual interests. It is also possible that intra-bloc tourism will work as an incentive.

b) South America: The dominance of national cultures, as well as limited networks of interaction, impede the formation of a South American elite. Inter-governmental interaction via diplomatic channels has limited impact upon local elites.

c) FTAA: The creation of a hemispheric elite is subject to an asymmetry of influences and methods of assimilation. There has been a great influx of Latin American professionals emigrating to the U.S. This process has stimulated the growth of a new elite in Latin America, and the gradual expansion of a new segment in the Hispanic population in the U.S. Meanwhile, the cultural and educational influences of the U.S. have penetrated Latin America, reaching all levels of society, and hispanic culture has become a major factor in the U.S.

10) *Regional Peace.* The absence of regional conflict is critical for the formation of a regional community. Differences are overcome and defense policies are motivated by the need for a strategic cooperative agenda.

a) MERCOSUL: Conflicting agendas have been resolved thanks to the abandonment of policies stimulated by competition. Confidence-building measures (starting with the Nuclear Accord of 1990) have been implemented, and the region has carried out joint military exercises and worked to create the

policies and institutions necessary to make MERCOSUL a peace zone.

- b) South America: Areas of conflict exist in the region, such as unresolved border flare-ups and crises that cause diplomatic tension. In addition to historical tensions (Chile-Bolivia, Colombia-Venezuela, and Ecuador-Peru), new tensions are growing because of the presence of narco-guerrillas in the Andes. While South America has been classified as a “no war zone,” tensions certainly persist. MERCOSUL represents the primary source of stability on the continent.
- c) FTAA: Defense policies are the most sensitive point on the hemispheric agenda. The strategic military preeminence of the U.S. makes it difficult to devise a cooperative agenda that will prevent unilateral action. Implementing Plan Colombia accentuated hemispheric differences. Paradoxically, the presence of a hegemon favors regional stability.

11) *External Threats*. The integration process is complete when member states perceive foreign threats as common threats. During the Cold War, the idea of a common enemy was easier to construct than during the Post-Cold War period. The elimination of the possibility of regional conflict and the creation of a peace zone is one way to strengthen alliances in the face of external threats.

- a) MERCOSUL: The Southern Cone of Latin America is viewed as a marginal region when it comes to international security. This condition makes the likelihood of foreign threats rather remote, and creates a space for initiatives that are favorable for regional and world peace. Argentina, Brazil, and Uruguay have all played important roles in peacekeeping missions for the UN, and at times have allowed their troops to cooperate in such missions.
- b) South America: The absence of external enemies and the stabilizing presence of both Brazil and the U.S. favor stability in the region.
- c) FTAA: The end of the Cold War has led to a change in the definition of threats, and a realignment of U.S. security policies. Prompt involvement in local crises and the identification of more diffuse threats have allowed the region to adopt a

greater distance from U.S. defense policy. Since September 11 however, the U.S. war against terrorism has generated new expectations in U.S.-Latin American relations, which has reduced this distance.

12) *Ethnic or Linguistic Similarities*. Minor differences in culture and language favor regional communication and minimize misperceptions.

- a) MERCOSUL: The countries in the region share a similar cultural tradition (religion, history, and external influences) and linguistic differences are marginal. Since the creation of MERCOSUL, there has been significant growth in the teaching of Spanish in Brazil, and Portuguese in the hispanophone nations in the region.
- b) South America: While ethnic differences are not severe, there are cultural differences between the Andean region and MERCOSUL.
- c) FTAA: The differences in ethnic make-up between the U.S. and Latin American countries, related to the history of their very different colonial experiences, is becoming less important as the Hispanic population in the U.S. has rapidly grown. At the same time, cultural differences are becoming less important due to the globalization process, which has brought about a rapid dissemination of information and a homogenization in consumption habits. The principal differences are in the realms of political culture, access to new technology, economic opportunities, and levels of social inequality.

CONCLUSION

Despite its failures, one cannot question that MERCOSUL represents an important political actor in Latin America. MERCOSUL's economic development and its commitment to peace and democracy have already led to discussions of its role as a PDC. At the same time, one can see the rise of other areas that are "competing" for this type of role, in both South America and the hemisphere as a whole. These three examples create associative dynamics that supercede commercial goals. Over all, it would be premature to view the three scenarios mentioned in this chapter as the only options for the formation of a community in the hemisphere. It is worth mentioning however, that in comparing the three

“communities,” the South American case constitutes the most problematic option.

Currently, it is evident that the governments of Latin America and the United States are dedicated to searching for mechanisms that would avoid fragmentary and conflictive tendencies in the region. From the point of view of regional leaders, the success of these mechanisms depends upon the evolution of agendas—cooperative and/or competitive—defined primarily by the actors who influence the creation of associative initiatives. This illustrates the important roles to be played by the United States and Brazil as respective leaders of the FTAA and MERCOSUL. The fact that many of the community efforts are formed with guidelines that are not coercive, the future of intra-bloc negotiations are to play a great influence over the development of both processes.

As has previously been mentioned, the future of MERCOSUL is dependent upon the evolution of the FTAA negotiations and the manner in which compatibility between the two processes is addressed. Determining how to address hemispheric free trade without reducing the strategic importance of MERCOSUL's agenda represents the most pressing challenge for its member states.

NOTES

1. This model follows a focus adopted by the liberal literature of international Political Studies based on the Kantian conceit that sets up a positive correlation between peace, democracy, and economic integration. In particular see Michael Doyle, “Kant, Liberal Legacies, and Foreign Affairs,” part 1, *Philosophy and Public Affairs* 12 (Summer 1983): 205–235; and, Michael Doyle, “Kant, Liberal Legacies, and Foreign Affairs,” part 2, *Philosophy and Public Affairs* 12 (Fall 1983): 323–353.

2. See Arie Kacowicz, *Zones of Peace in the Third World* (Albany, NY: State University of New York Press, 1998), 177–207.

REFERENCES

- Campbell, Jorge (ed.). *MERCOSUR. Entre la realidad y la utopia*. Buenos Aires: Grupo Editor Latinoamericano, 1999.
- Doyle, Michael. “Kant, Liberal Legacies, and Foreign Affairs.” Part 1. *Philosophy and Public Affairs* 12 (summer 1983): 205–235.
- Doyle, Michael. “Kant, Liberal Legacies, and Foreign Affairs.” Part 2. *Philosophy and Public Affairs* 12 (fall 1983): 323–353.

MERCOSUL Politics: Between Fragmentation and Integration

- Grieco, Joseph. "Systemic Sources of Variation in Regional Institutionalization in Western Europe, East Asia, and the Americas" in *The Political Economy of Regionalism*, edited by E. Mansfield & H. Milner. New York: Columbia Univ. Press, 1997: 164–187.
- Hirst, Monica. "Security Policies, Democratization and Regional Integration in the Southern Cone" in *International Security and Democracy: Latin America and the Caribbean in the Post-Cold War Era*, edited by Jorge Domínguez. Pittsburgh: Univ. of Pittsburgh Press, 1998.
- Holsti, Kalevi. *The State, War, and the State of War*. Cambridge: Cambridge Univ. Press, 1996.
- Kacowicz, Arie. *Zones of Peace in the Third World*. Albany, NY: State Univ. of New York Press, 1998.

LOOKING AHEAD:
THE FUTURE OF MERCOSUR

PART IV

MERCOSUR in a Regional and Global Perspective

JOSÉ AUGUSTO GUILHON ALBUQUERQUE

CLARIFYING THE INTEGRATION PROCESS OF MERCOSUR

Before presenting some hypotheses concerning the regional and global perspectives of MERCOSUR, I would like to clarify a number of aspects related to the current process of integration in Latin America and specifically in MERCOSUR.

Latin American economic integration is not a single, continuous process but is comprised of a number of complex and diverse models varying in time and by region. First of all, we should distinguish between at least two very divergent models of integration related to periods that are different in context and in nature. The first one relates to the import-substitution model of development: the Economic Commission for Latin America and the Caribbean (ECLAC) or the *desarrollista* model. The rationale of this model is to create regional interdependence through the development of a common market to promote a unified or, at least, a regionally-integrated industrial policy.

The most conspicuous cases of this model were ALALC and its successor, ALADI, regional treaties that were adopted respectively in 1960 and 1980. They either intended to create an area of free trade (ALALC), or an organization for regional development and integration (ALADI). Both failed essentially because their member states—mostly the larger nations of the Southern Cone plus Mexico—proved unable or unwilling to negotiate either the reduction of internal barriers or the equalization of external tariffs. The former would supposedly promote regional trade and provide a local market for the desired process of industrialization. The latter would protect that incipient market from extra-regional competition in order to give immature regional industries a more equitable environment for growth.¹

Irrespective of the symbolic reference to the EU model of economic and political integration, the Latin American *desarrollista* integration process was supposed to create interdependence as a stepping-stone to economic development and political cooperation; not the other way around. It did not aim to reinforce any previously existing interdependence or to control the negative effects from increased political cooperation. While it did not deal with significant historical or potential power conflicts, it did help rectify mutual political and economic irrelevance among the countries in the region. The very idea (and practice of course) of common institutions with their implicit need for concessions of sovereignty were, and still are, strange to Latin American constitutional traditions. It is not surprising that Latin American integrationists pledged to create a common market but practiced an ill-implemented free trade area.

The Andean Pact is an example of the second model used for Latin American integration. Inspired by a new wave of *desarrollismo* brought about by a military nationalist regime in Peru, it was supposed to contrast with both ALALC and ALADI. Instead of betting on negotiations of tariffs and quotas, the Andean countries (namely Peru, Chile, Bolivia, Ecuador, Colombia, and Venezuela) focused their attention in building up common institutions. These institutions—such as a Secretariat, a Court of Justice, and a Development Bank—were supposed to generate common political objectives as well as trade and industrial policies. The pact did not survive the political crises in the region of the 1970s, when Pinochet's Chile was forced to opt out, nor did it survive the inflation and debt crises in the 1980s, when Bolivia was forced to take leave of its commitments within the Pact.

A new beginning was provided for this trade union by the willingness of some of its members to join MERCOSUR, namely Bolivia, Peru, and Venezuela. Bilateral negotiations between the two trade areas avoided the split of the Andean Pact which by the late 1990s had actually achieved a quasi-free trade area agreement among its members, with the exceptions of Peru and Bolivia.

MERCOSUR is still another approach to the Latin American integration process, and should be considered together with Mexico's decision to join NAFTA as well as the wish of Central American and Caribbean countries to jump on the bandwagon.² To this approach – the post-GATT integration process – we should add the current round of negotia-

tions for the FTAA. These trade unions all share the so-called open regionalism model and the common goal of enhancing the region's competitiveness in a globalized economy after suffering a decade of international economic irrelevance.

MERCOSUR looks very much like a perfect case study in the economic theory of integration, following step by step a whole series of ever more complex and deeper stages of interdependence. Nevertheless, the label of common market and the schedule for increasing the degree of integration – free trade area, customs union, and common market – should not be taken as more than symbolic gestures made in light of the historical precedence of the EU.

MERCOSUR countries opened their economies simultaneously intra- and extra-regionally. The growth of extra-MERCOSUR trade has been consistently higher than that of intra-MERCOSUR trade, which contrasts with the experience of the EU. Trade deficits of MERCOSUR countries as well as of the region as a whole have increased with integration and not the other way around. In terms of intra-regional openness, with Brazil aside, every member state as well as Bolivia and Chile, which hold association status with MERCOSUR, has experienced a neo-liberal adjustment in their economies. All have followed the path of deregulation that is often associated with the “Washington Consensus;” privatization, market liberalization, monetary stabilization, fiscal responsibility, etc.

The formation of MERCOSUR can be divided into two periods. The first occurred when democratic governments came to power in Argentina and Brazil after a long period of authoritarianism in both countries. The goal was to provide mutual protection for their infant democracies against the risk of new military intervention present in both countries, especially in Argentina. Presidents Alfonsín (Argentina) and Sarney (Brazil) developed a series of bilateral confidence building measures within the military, especially in the area of nuclear proliferation. They also established agreements concerning cooperation in sectoral policies, such as science and technology, transportation, and the capital goods industries. Finally, they signed a protocol aimed at the creation of a free trade area between the two countries, to be achieved within 10 years. Typically, what was clearly a political goal (the bilateral protection of democratic institutions and processes) was to be attained by enhanced economic interdependence. Economic interdependence, in its turn, was conceived as the result of

common sectoral industrial policies and macroeconomic coordination. In this sense, the Alfonsín-Sarney agreements for integration in the Southern Cone epitomized ECLAC's "desarrollista" integration in Latin America.³

MERCOSUR's second "beginning" started in 1990 with Presidents Menem and Collor de Mello in power in Argentina and Brazil, respectively. It paralleled the adoption of neo-liberal reforms by both governments. Pressed by the announcement of President Bush (Sr.) for the Initiative for the Americas, the two countries joined with Uruguay and Paraguay to formally create MERCOSUR in 1991. They promised a scheduled reduction of all tariff and non-tariff barriers within four years and for a customs union to be achieved in the same span of time, with the eventual adoption of a full-fledged common market to have a free flow of all factors of production. The nature and format of MERCOSUR's institutions were to be negotiated during this period.

MERCOSUR's goals were defined during this period and came to be associated with a general commitment to regional political and economic cooperation; open economies, both internally and externally; and the enhancement of the region's competitiveness in global markets. Non-explicit objectives, though, were much more pedestrian. Argentina's aim was to gather momentum in view of its future integration with the U.S. economy. Brazil's goals were focused on the delicate act of preventing the Brazilian economy from increased interdependence upon the U.S. while avoiding its own isolation in case of further trade integration by its neighbors with the U.S.⁴

However, MERCOSUR failed to adopt common institutions by 1995, as had been the established timeline. It remained stuck in the permanent inter-governmental negotiation process that had prevailed since the beginning. This problematic situation was complicated with the addition of an Administrative Secretariat with no power and a small budget, a consultative Social Economic Forum, and a Parliamentary Committee with ill-defined functions and no decision-making authority. Currently, every action of MERCOSUR is sent to the executive branches of the member states and is dependent upon presidential summits, held twice a year, for its final approval. Nothing could be more distant from the EU model.

This intergovernmental—or rather inter-presidential—negotiation model favors a high degree of flexibility for decision-making but also creates instability for its implementation, because decision-makers are less con-

cerned with implementation and bureaucracies are even less committed to the policies adopted. Moreover, decision-makers are also less committed to the continuity of policies while bureaucracies are less concerned with domestic demands.

Nevertheless, the political motivations underlying the creation of MERCOSUR have not been ignored. The success of MERCOSUR is grounded on its increasing ability to grant credibility to its members as a politically stable and economically sound group of nations. Democracy, economic openness, and predictability of macro-level policies have secured critical financial support for the region on five different occasions: the Mexican currency crisis of 1994, the Asian financial crisis of 1997, Russia's default in 1998, the Brazilian devaluation of 1999, and the current recession in Argentina.

POLITICAL INTERDEPENDENCE IN MERCOSUR

Prior to the creation of MERCOSUR, Uruguay and Paraguay were more circumscribed in their approach to regional interdependence than Brazil and Argentina, who had liked to define themselves as global players. The degree of interdependence between the two major countries was appallingly low before MERCOSUR.

The transition to democracy in the four member states developed almost independently of regional or bilateral relations. In contrast, in the early years of the restored democratic governments, Argentine, Brazilian, and Uruguayan civil leaders moved energetically towards cooperation to protect their new regimes. Soon Argentina and Brazil began to see economic cooperation as a means to increase interdependence; it would be a means through which they could lower the number of bilateral disputes and the vulnerability of both countries to domestic instability.

In the case of Paraguay, contrary to the three other member countries, the transition did not mean a return to a constitutional democratic tradition, but did amount to breaking an authoritarian dictatorship and the dominance of one political party. For the last 50 years, irrespective of the type of political regime and of their degree of interdependence with Paraguay, Southern Cone countries had accommodated themselves to the Paraguayan dictatorship of Stroessner. However, with the growing need to gain the external credibility that a stable region would generate, Argentina and Brazil examined Paraguay's domestic politics with greater attention.

The inclusion of Paraguay in the initial MERCOSUR talks was feared as a liability, endangering the credibility of the new regional arrangement, due to a recent coup attempt by an Army general from the inner circles of the old regime.

As recently as 1996 Paraguayan democratic institutions were threatened by a coup attempt from army commander, General Oviedo, who ironically was campaigning to win the presidential nomination in the upcoming elections.⁵ While MERCOSUR did not react officially, its member states acted immediately, and with great efficiency, supporting the elected authorities and threatening the coup leaders with retaliation. There was a fear that the end of democratic rule in Paraguay would probably result in a blow to the region's credibility, leading to a negative impact on the flow of investments to the nations of the Southern Cone. President Wasmosy of Paraguay successfully resisted the coup attempt and exactly two months later at a MERCOSUR meeting, the bloc issued a Presidential Declaration of Democratic Commitment, adopting a democratic clause for the conditions of membership.

For two years the long election process pitted Oviedo, Wasmosy, and a third candidate against each other for the incumbent Colorado Party's nomination, with a series of coup attempts originating on each side. At every occasion, MERCOSUR's intervention followed fairly identical patterns of diplomatic pressure, with identical rates of success.

Fair elections occurred eventually in 1998, but disputes persisted, leading to Congress' opposition of Cubas Grau, the newly elected president, over his involvement in freeing Oviedo from prison. The assassination of Vice-President Argaña in 1999 prompted an impeachment process against President Grau, who was supported by the faction involved in Oviedo's 1996 coup attempt (his involvement had led to his imprisonment) and implicated in Argaña's murder.⁶ Again, MERCOSUR intervened in the same general manner and eventually a constitutional succession of power was enacted, following a general compromise among all political factions that had been involved in the coup attempts, including the opposition parties.

As we can see in these events, as in other similar cases of political instability in MERCOSUR and South America, regional interdependence has affected the consolidation of democracy, by protecting democratic institutions and elected leaders against domestic threats. Nevertheless, this phase

has occurred after the transition to democratically elected governments, as has been the case not only in Paraguay, but also in Argentina, Peru, Ecuador, and Venezuela. There is no record of overt or covert regional intervention in any transition process prior to these most recent occurrences.

The case of Paraguay (a long series of coup attempts against an elected government coupled with political scandals and conflicts) and the example of Peru's recent presidential elections (the risk of electoral fraud) suggest that direct intervention and threats of retaliation have different probabilities of success when compared with warnings about the cost of isolation.

Paraguayan leaders bowed to external pressures not because they feared direct retaliation or military intervention, but because a public remonstrance from MERCOSUR would affect its credibility, implying a loss of foreign investment. Trade, especially regional commerce, depends on more or less objective factors, including commercial networks while capital flows rely on perceptions; namely the state of mind of investors and risk assessing experts. The cases of Paraguay and Peru showed that regional pressures were very effective at persuading the decisions of investors and experts around the world.

In this sense, MERCOSUR has to deal with three converging but competing objectives: economic growth, internal political stability, and a friendly external environment. The next section will attempt to tackle the mutual entanglement of these three dimensions and their impact on the need for a new agenda.

MERCOSUR: THE REGIONAL AGENDA AND THE GLOBAL SYSTEM

The outstanding question is why does MERCOSUR need a new agenda? Usually, a new agenda is posed because the previous one has been exhausted.⁷ This situation is not the case for MERCOSUR, suggesting the need for a new agenda could only be derived from the current agenda's failure to incorporate new issues. Such failure only occurs in one of two events: internal deficiency or the uniqueness of new issues that cannot be fit into the current framework.

In the case of MERCOSUR, the agenda has persistently been charged with deficiency, but this has been brushed-off as foot-dragging, a feeling

akin to “euro-skepticism” in the face of the common market and currency. As it happens, some issues may seem brand new and have provoked responses like the issue of dollarization versus a single-currency. However, they are not so radical a departure from what has been faced before that they could not be possibly absorbed into MERCOSUR’s existing agenda, as established by the Treaty of Asunción.⁸

The current MERCOSUR crisis brought on by the devaluation of Brazil’s currency has led to the idea for a relaunching of the trade bloc and has given relevance to the supposed need for a new agenda. The Argentine government, who has acted as the spokesperson against the malaise, is concerned with limiting, and preferably counterbalancing, the effects of the devaluation on its trade with Brazil for an insurance policy against future problems.

The crucial point for the Argentine representatives was not to renegotiate rules and exceptions conceived for different levels of exchange parity but to finally adopt them as inscribed in the Treaty of Asunción’s commitment for macro-policy coordination. They reiterated this at every ensuing occasion and publicly voiced other issues that were part of MERCOSUR’s built-in agenda from the beginning; not meeting deadlines set for exemptions, refusing to adopt in due time the automotive regime, and attempting to introduce new exemptions or special regimes by means of quotas.

If the current agenda is not exhausted, and new issues are not incompatible with it, then either it is time for serious negotiating (without negotiation no change in the agenda will be relevant) or there is a mistake over the nature and contents of the agenda. The fact that such lasting disputes over exemptions, exceptions, special regimes, and external tariffs are not perceived as sheer routine in the process of regional integration but, on the contrary, are viewed as a deadlock, suggests a misunderstanding of the agenda.

The deadlock involves, among other things, the failure of MERCOSUR to develop from a so-called imperfect customs union into a common market or into an economic union. A proposal to solve the impasse emerged among some of the most active Argentine diplomats and advisors involved in MERCOSUR during the Menem administration.⁹ This apparent solution consisted in drawing back MERCOSUR to a free trade area since there had been no advance in negotiations over the deadline for

exceptions and special regimes, subsidies regulations, or macro-policy coordination, which were all necessary in order to use a completed customs union as a stepping stone towards a real common market.

This controversy over advancing or withdrawing from the customs union model suggests a misconception of the relationships between theoretical models and the actual processes of regional integration. It underscores also a misunderstanding of the nature of post-GATT negotiations. Consequently, it implies that MERCOSUR has been discussing a set of pre-Uruguay Round issues in a post-Seattle agenda.

From a bilateral viewpoint, MERCOSUR actually is about growth. The four member states and the two associates of MERCOSUR expect to enhance the positive impacts of interdependence and limit the negative consequences. A number of exceptions and special regimes provide proper protection for sensitive sectors and the CET shields infant industries against competition from third party countries. However, MERCOSUR should focus more on sectoral adjustments because increasing intra-regional competition will have an important impact on less competitive industries, provoking relocations of plants and raising local unemployment. The special regimes and sectors exempted from MERCOSUR are theoretically structured to ease the adjustment process. There can be more done in this direction, combining a timetable for the adjustment of these industries with regional policies favoring worker retraining and relocation.

MERCOSUR should also give more attention to subsidizing trade deficits. For years Brazilian imports of oil and wheat from Argentina assured an Argentine trade surplus towards Brazil. On different occasions, Brazil's partners agreed upon an increase in the external tariffs in the textile, automotive, and toy industries to help the Brazilian effort to counter a rising trade deficit. The same rationale applies to the current wish of Argentina to increase the external tariffs levied on consumer goods and lower those on capital goods.

Lastly, MERCOSUR ought to focus on attracting increased FDI. Although Brazil receives more than 90% of the FDI flows to South America, their impact on MERCOSUR as a whole is significant enough for its partners to tolerate the increasing relocation of investments from member countries to Brazil.

Apart from bilateral concerns, there are broader regional perspectives that must be considered. From a regional viewpoint MERCOSUR has

been driven by the quest for growth. The South American Presidential Summit in August of 2000 announced a program of investments in infrastructure that would increase the chances for an easier integration of the economies of the Andean and Amazon regions with those of the Southern Cone. The prospects for a huge infrastructure-building program have promoted intra-regional investments, which until now have been limited to specific sectors in Brazil and Argentina. It might also increase some limited flow of transnational labor, which is important for Paraguay and Bolivia and could become critical for Colombia in the foreseeable future. With a growing flow of transnational workers, the need for compatible labor norms will become evident, responding to the claims by regional unions for a MERCOSUR Social Charter.

From a regional perspective, MERCOSUR needs to focus on further reducing external tariffs. Actual tariffs for MERCOSUR are significantly lower than the region's consolidated levels under the WTO accords. Nevertheless, the Argentine crisis has expedited the process for a general review of the external tariff system. While Argentina is pressing for lower tariffs on capital goods and higher tariffs on consumer's goods, Brazil is lobbying for exactly the opposite. The other two partners are seeking an even lower rate of external protection.

From a global perspective though, MERCOSUR is more than just about growth. Growth would only return MERCOSUR to the conditions that prevailed before the Brazilian currency devaluation of 1999. In those years, the impulse towards deepening the integration of MERCOSUR was a defensive reaction against further integration with the U.S. economy. Indeed, every effort to deepen MERCOSUR (the adoption of the Las Leñas Agenda, the Ouro Preto Protocol, and the Agenda 2000) was a response to the critical choices faced by both Argentina and Brazil of strengthening MERCOSUR, joining NAFTA, or a becoming part of the FTAA.

In a broader sense, MERCOSUR is not purely concerned with access to a regional or hemispheric market. It is about global competitiveness and compliance with some ill-defined, value-biased standard for international decorum. Nevertheless, two questions remain to be answered: why is that so and what has it to do with growth and trade?

Regional or inter-regional integration, not excluding bilateral integration, has been an alternative to multilateral liberalization. The twentieth century has witnessed two waves of regional integration of trade and of

the economy.¹⁰ The first started after World War II and paralleled the early developments of GATT. The second wave began at the end of the Cold War and coincided with the last round of GATT negotiations and the formation of a new regime of multilateral trade liberalization; the WTO. Between the two waves of economic integration there occurred substantive changes to the free trade and global agendas. The GATT regime (as defined during the early post-war decade) was not only about free trade, but the impact that trade had on international relations.

In the spirit of the Bretton Woods talks, an International Trade Organization was expected to become part of the new global institutions adopted for international stability and peace. The GATT accords, created after the failure of the International Trade Organization, were less related to free trade and more designed to limit the use of it as an instrument for power politics or discrimination.

Discrimination among trade partners, the use of power to garner trade benefits, and the leveraging of trade to gain power had long been perceived as major causes for war before World War I. It was proven between the two world wars to be a specific factor of international instability, both economically and politically. In the immediate aftermath of World War II, the global economy was not prepared for universal free trade, but also could not afford new commercial wars, which were suspected of bringing a kind of instability associated with military adventures.

Consequently, the main objectives of GATT as expressed in its charter were not to secure universal free trade but rather to assure non-discrimination among trade partners and the non-politicization of trade. The principle of non-discrimination is embedded in the rule of most favored nation status while the concept of non-politicization is related to the prohibition of non-trade related barriers to commerce.

Although there are no GATT rules preventing trade barriers per se, there are limits against barriers that discriminate among trade partners and the use of non-trade related barriers. Regional and bilateral economic integration has always been perceived as contradictory to GATT rules because both free trade and customs union accords do discriminate among partners and involve non-trade related considerations in commercial relations. This is the reason why agreements among certain GATT adhering countries, concerning specific preferences or the interference of non-trade related factors, were included as exceptions to GATT rules. For

those countries adhering both to GATT and regional trade arrangements, free trade and customs union agreements were alternatives to the GATT accords. The GATT rules of exception afforded them a limited margin of discrimination and for the politicization of trade against non-members of the regional accord.

Whether for reasons of regional proximity, similarity of economic development, or like-mindedness, specific groups of countries often have agreed to afford each other tariff preferences and a waiver for non-tariff barriers that they are not prepared to grant for all of their GATT counterparts. In this sense, regional arrangements for lower tariff and non-tariff protection have been perceived as alternatives to the implementation of such arrangements on a GATT-wide basis.

Given the context of the post-World War II period, alternatives to GATT-wide liberalization like regional integration were sought for two sets of contrasting reasons. The paramount model for regional integration, the EU, started from a level of high economic interdependence. It sought to control the liabilities of interdependence by enhancing its assets through the intensification of internal competition and the reduction of external commercial challenges. As a result, it had to adopt an alternative to GATT-wide tariff liberalization to assure such a mandate. In contrast, for Latin America, where no significant levels of trade and economic relations prevailed, regional integration was aimed at freeing its members from competition, both internal and external, in order to create a protected environment for growth and industrial development. This goal was achieved likewise as an alternative to GATT rules. In both cases of the EU and MERCOSUR, the rationale for regional integration was to grant a legitimate alternative to non-discriminatory tariff reduction and the unilateral removal of non-tariff barriers.

For this reason, internal and external tariffs, exemptions, regimes of exception, and antidumping rules, among others, have been such crucial themes in the agenda of free trade and customs union negotiations. They establish the limits for discrimination and politicization of trade afforded for regional arrangements relative to their members' obligations under GATT and have been crucial for evaluating the benefits and costs involved in choosing an alternative to GATT rules alone.

Nevertheless, the reductions of tariff and non-tariff barriers by the EU and MERCOSUR were not enough to achieve the goals of regional

integration. In the case of the EU, where a high level of interdependence already existed, non-tariff-related regulations were adopted to cope with the negative aspects of interdependence and to enhance its positive impacts. The limited discrimination granted by GATT exception rules permitted the EU not to extend to non-bloc members the benefits of these regulations, while imposing on them the discriminatory limits that the regulations involved. As a result, external partners had to pay an additional cost (in regulatory limits) for trading inside the EU, without the prize of lower internal tariffs.

The success from the non-discriminatory and exception rules of GATT allowed the EU to extend its discriminatory policies to a limited array of non-members claiming political or historical reasons. As a result, the EU became a mini-GATT, benefiting both from GATT rules and the discriminatory, politicized arrangements of the EU.

In the case of Latin America, where a rather low level of interdependence prevailed, there were fewer incentives for the adoption of any common regulatory standards. The Latin American integration experiences, such as ALALC and its successor, ALADI, were limited to tariff preferences and quotas for trade. Unable to adopt common industrial policies, signatories to Latin America's integration accords tended to adopt, on the domestic side, higher degrees of tariff and non-tariff protection and separate industrial policies. Instead of adopting common regulatory measures that would have benefited from GATT exceptions, they sought, at times successfully, to obtain a favored collective status as underdeveloped economies.

Which of these contending strategies should MERCOSUR turn to in the future? Should it be toward discriminatory tariff preferences and non-tariff related regulations admitted in the GATT exceptions such as the EU? Should its members look to high tariff protection, a regime of exemptions, and delayed implementation of rules such as those used by other Latin American countries?

In my view, neither should be chosen. As long as regional arrangements are still sought as alternatives to multilateral trade relations, they should be used as an alternative to the post-Uruguay Round agenda. In regards to the GATT principles still prevailing in the WTO charter, they are not about the discrimination and politicization of trade but rather are related to the new value-oriented global agenda. As noted above, this agenda has

little to do with commercial relations or free trade and instead is about a loosely conceived notion of fairness for international relations. In this sense, it has even less to do with questions of tariff and non-tariff barriers.

Today, the most conspicuous method of discrimination against trade partners consists of arguing non-conformity with global rights, which are supposedly imbedded in universal values such as human rights, participative democracy, and so forth. The most conspicuous way of politicizing trade has consisted of disrespecting global norms such as sound environmental protection or the promotion of bio-diversity. Increasing movements of a domestic and transnational character, including the participation of governments, are exerting pressure for the adoption of trade or trade-related sanctions against countries, or populations, that do not abide by their standards of global values.

The reasons why these types of issues have entered the multilateral agenda for trade and have become a major feature of the WTO agenda are many. One example is that discrimination against trade partners is increasingly perceived as the most effective way to advance these global rights and values. Inversely, the GATT/WTO system is about non-discrimination, or rather about limiting discriminatory practices in trade. The GATT/WTO system has proven to be able to host and effectively negotiate these new issues of the global agenda as the only international regime with force that can adopt legitimate sanctions against non-conforming partners. A growing number of countries, particularly the wealthiest nations, have pressured the WTO to implement common standards regulating the conformity of member nations to those supposedly global rights and values. With this change, the WTO agenda has been consumed by the methodological and pragmatic question of defining such common standards and their relation or, more precisely, their relatedness to trade.

Consequently, if one is to construct a regional alternative to the WTO like MERCOSUR, or the FTAA for that matter, the focus should not be on tariffs, but on the new issues that dominate the global agenda. Increasingly, regional agreements, inter-regional accords, and bilateral pacts on trade will include common standards for rights and values rather than tariff preferences alone. These accords will be pursued as an alternative to other international standards that for whatever reasons such countries cannot or do not want to endorse. As one looks at the agenda under negotiation between MERCOSUR and its extra-regional partners, one

notices that it includes limits that counter unfairness in services, investments, competition, and environmental protection, among others. On the horizon, one can make out the approaching clouds of labor standards, democracy, corruption, and human rights. However, what is MERCOSUR negotiating internally again and again: tariff and non-tariff reductions as well as increases.

Negotiations over the adoption of universal standards of fairness in international relations have not been simple tasks. Two problems arise immediately concerning the issue of universalized norms. First, there are disputes by countries, investors, or social groups, such as labor unions and NGOs, over the unilateral definition of standards. Second, there is the issue of the adoption by the great powers of rules of compatibility based on different standards. In each case, the weaker the economy, the weaker the country is in disputes while the weaker the social group, the less it has the ability to assert its own standards of rights and values.

It would be easier to achieve greater compatibility of non-discriminatory regulations and fair international behavior if there was compliance on global values and rights by like-minded countries. It should be accordingly easier to achieve such compatibility among the countries of MERCOSUR, in addition to Chile and Bolivia as well as other South American countries, than it would be for those countries to comply with standards unilaterally adopted by OECD countries for instance. If MERCOSUR implemented a regional standard of non-discriminatory regulations and compliance which defined common values and rights, the bloc would establish a stronghold from where FTAA, EU-MERCOSUR and WTO negotiations could be conducted within a less defensive and reactive environment.

The recent hemispheric talks in Buenos Aires, in early April 2001, offered a unique opportunity to negotiate both the agendas of MERCOSUR and the FTAA. The former resulted from the current Argentine crisis that prompted unilateral changes in the MERCOSUR agreements. The latter was provided by the actual accomplishment of a program previously adopted during other hemispheric summits. While the relaunching of MERCOSUR was already on the schedule and proposals had been posed for the adoption of a positive agenda, there was confusion over why MERCOSUR restricted the talks to limited points such as the revision of the external tariffs. Since MERCOSUR had been arguing for years over

the incompatibility of the agendas between the FTAA and MERCOSUR, specifically the diametric between deepening MERCOSUR or diluting its commitments into a supposedly loose hemispheric free trade area, it was difficult to understand why they did not take advantage of the talks to promote a harmonization of the agendas. Instead, MERCOSUR negotiators took a dramatically defensive stance concerning the bloc and focused exclusively on tariffs. This posture created some confusion because they had agreed upon a very open set of issues involving almost every area included in the global agenda, from fair trade legislation to labor norms.

We still do not know how MERCOSUR foresees an increasingly interdependent international system where pressures to have a convergence among values and rights, as a prerequisite for economic relations, have become a fact of life. Unfortunately, there is also doubt over whether MERCOSUR is prepared to commit itself to such common standards and whether if they do adopt them, what these may entail.

NOTES

1. For a review of pre-MERCOSUR integration arrangements, see Rubens Barbosa, "O Brasil e a integração regional: a ALALC e a ALADI (1960-1990)," in *Diplomacia para o desenvolvimento. Sessenta anos de política externa Brasileira (1930-1990)*, ed. J. A. Guilhon Albuquerque (np: Cultura/USP, 1996), vol. 1:135-169, and Paulo Roberto de Almeida, *Mercosul, resultados e perspectivas* (S. Paulo: LTR, 1998), pp. 7-81.

2. J. A. Guilhon Albuquerque, "MERCOSUR: South American Economic Regional Integration after the Cold War," in *Economic Regional Integration. Experiences and Processes*, ed. J. A. Guilhon Albuquerque (S. Paulo: USP, 1992), pp. 167-186.

3. See Raul Alfonsín, "La cumbre de las Américas y las alternativas de América Latina," in *II Foro MERCOSUR-Nafta*, ed. J. A. Guilhon Albuquerque, Cuadernos del Parlatino no. 6 (São Paulo: np, 1999), pp. 19-23.

4. J. A. Guilhon Albuquerque, "U.S. and Brazil Bilateral Relations as a Major Obstacle to Hemispheric Integration," paper prepared for the Conference *Una Gran Familia? Hemispheric Integration after the Santiago Summit*, Ottawa, October 1-2, 1998.

5. For a brief account of the coup attempt and an analysis of MERCOSUR's influence on its failure, see: J. A. Guilhon Albuquerque, "MERCOSUR:

Democratic Stability and Economic Integration in South America,” in *Regional Integration and Democracy. Expanding on the European Experience*, ed. Jeffrey J. Anderson (Lanham: Rowman and Littlefield Publishers, 1999), pp. 272-279.

6. Argaña had been the third candidate to the presidential nomination of the Colorado Party mentioned above and would succeed the current President Cubas Grau if he lost power.

7. This analysis was first developed in J.A. Guilhon Albuquerque, “A integração regional e a agenda multilateral pós-Seattle,” in *O Brasil e os desafios da globalização*, ed. Pedro da Motta Veiga, (Rio: Relume Dumará/Sobeet, 2000).

8. The international treaty signed by Argentina, Brazil, Paraguay, and Uruguay that originated the idea of MERCOSUR.

9. See Felipe de la Balze (ed.), *El futuro del MERCOSUR entre la retórica y el realismo* (Buenos Aires: Asociación de Bancos de la Argentina/CARI, 2000); see also by Jorge Campbell (ed.), *MERCOSUR. entre la realidad y la utopía* (Buenos Aires: Centro de Economía Internacional, Nuevohacer, 1999).

10. This hypothesis has been thoroughly developed in J.A. Guilhon Albuquerque, “The Cooperative Relations Between East Asia and Latin America in a Post-Seattle Perspective,” paper presented at the Symposium for Intellectuals of East Asia and Latin America, Tokyo, February 20-21, 2001.

REFERENCES

- Alfonsín, Raul. “La cumbre de las Américas y las alternativas de América Latina,” in *II Foro MERCOSUR-Nafta*, edited by J. A. Guilhon Albuquerque, Cuadernos del Parlatino series no. 6. São Paulo: np, 1999.
- Barbosa, Rubens. “O Brasil e a integração regional: a ALALC e a ALADI (1960-1990),” in *Diplomacia para o desenvolvimento. Sessenta anos de política externa Brasileira (1930-1990)*, edited by J.A. Guilhon Albuquerque. np: Cultura/USP, 1996.
- Campbell, Jorge (ed.). *MERCOSUR. entre la realidad y la utopía*. Buenos Aires: Centro de Economía Internacional, Nuevohacer, 1999.
- de Almeida, Paulo Roberto. *MERCOSUL, resultados e perspectivas*. S. Paulo: LTR, 1998.
- de la Balze, Felipe (ed.). *El futuro del MERCOSUR entre la retórica y el realismo*. Buenos Aires: Asociación de Bancos de la Argentina/CARI, 2000.
- Guilhon Albuquerque, J.A. “The Cooperative Relations Between East Asia and Latin America in a Post-Seattle Perspective.” Paper presented at the Symposium for Intellectuals of East Asia and Latin America, Tokyo, February 20-21, 2001.

_____ “A integração regional e a agenda multilateral pós-Seattle,” in *O Brasil e os desafios da globalização*, edited by Pedro da Motta Veiga. Rio: Relume Dumará/Sobeet, 2000.

_____ “MERCOSUR: Democratic Stability and Economic Integration in South America,” in *Regional Integration and Democracy. Expanding on the European Experience*, edited by Jeffrey J. Anderson. Lanham: Rowman and Littlefield Publishers, 1999.

_____. “U.S. and Brazil Bilateral Relations as a Major Obstacle to Hemispheric Integration.” Paper prepared for the Conference *Una Grán Familia? Hemispheric Integration after the Santiago Summit*, Ottawa, October 1-2, 1998.

_____ “MERCOSUR: South American Economic Regional Integration after the Cold War,” in *Economic Regional Integration. Experiences and Processes*, edited by J. A. Guilhon Albuquerque. S. Paulo: USP, 1992.

The Future of MERCOSUR: Argentina's Options

FELIPE DE LA BALZE

At the end of the year 2000, Argentina faced a difficult and complex negotiation about the future of MERCOSUR. In order to evaluate the alternatives that Argentine negotiators confronted during the year 2001, we will analyze the pros and cons of three alternative scenarios. Such scenarios do not exclude other combinations, but because of their characteristics, they will assist us in analyzing the main variables and organizing the discussion.

The three scenarios we will address are: (i) the implementation of a Genuine Customs Union, (ii) the transformation of MERCOSUR into a Full Free Trade Zone and, (iii) the updating of the current status quo (designated here as the Imperfect Integration model).

These three scenarios would have different consequences on Argentina's growth rate during the coming years, on the quality of the country's economic and political integration into the global scene and, on the dynamics of Argentina's relations with Brazil, Chile, and the other regional partners. We will present the three scenarios in the order of our preferences, although the third one is most probable at present: maintaining an updated status quo, or the model of Imperfect Integration. In the conclusion we will discuss in greater detail some measures Argentina might consider introducing to compensate for the negative effects that the Imperfect Integration model will have on trade and investment flows and on the quality of the country's integration into the world economy.

THE THREE SCENARIOS

The first scenario involves progressing towards the implementation of a Genuine Customs Union. This is the alternative we consider preferable, both for its economic rationality and for its political advantages.

Nevertheless, this is also the most difficult to implement, because it requires significant changes in Brazil's economic policy: a greater openness towards the global economy, a more genuine inclination to view globalization as a challenge rather than a threat, and an enhanced political will to restrain protectionist lobbies and to gradually eliminate the numerous subsidies still present in that country's economy that adversely affect investment and trade flows within MERCOSUR. This scenario requires a decision on the part of the Brazilian administration to limit its freedom of action and its discretionary implementation of some of its economic policies (in particular in the areas of industrial, agricultural, and foreign trade policies), through the creation of permanent regional, and in some cases, supranational institutions.

For the Genuine Customs Union to work, at least three permanent regional institutions would have to be created, while simultaneously assuming a responsible political commitment to eliminate subsidies gradually and regulations that distort competition. These three indispensable regional institutions are: a Permanent Court of Dispute Settlement, a Standing Negotiating Commission, and a Macroeconomic Coordination Commission.

The first institution would be a supranational Permanent Court of Dispute Settlement. Without a clear, transparent dispute settlement system, easily accessible to the private sector, the regional integration project will remain dominated by excessive insecurity and a lack of legal certainty. Uncertainty adversely affects business decisions and distorts trade and investment flows which has a disproportionate negative impact on smaller countries, and it also postpones the indispensable process of MERCOSUR's consolidation.

A Standing Negotiating Commission, whose function would be to prepare and negotiate MERCOSUR's trade policy towards the rest of the world. In the current situation, MERCOSUR has not yet created a negotiating unit to formulate and articulate the region's interests. In actual fact, intergovernmental coordination has functioned in defensive situations, as is the case for the FTAA, but has been extremely ineffective in situations that require an assertive negotiating stance, such as negotiations with the Andean Community, with Mexico, the WTO Round, the negotiation of the clause allowing China to join the WTO, etc.

For some time now, Brazil, as well as occasionally Argentina and the other partners, have negotiated independently of MERCOSUR. The

very same officials, who declaim the advantages of joint negotiation, in actual fact negotiate bilateral trade agreements. In the European Union, neither France, nor Denmark negotiates with the U.S.A. or with Russia. Those negotiations are conducted by a supranational Commission, on behalf of all the members. This situation represents a serious anomaly, because the two essential characteristics that differentiate a customs union from a free trade area are the existence of a common external tariff and the existence of joint supranational negotiating capability for all issues concerning international trade negotiations.

A Macroeconomic Coordination Commission, intergovernmental in scope, is also needed that would play a role similar to that played by the OECE (the predecessor to the current OECD) in the process of European integration during the 1950s and 1960s. This intergovernmental forum made it possible to harmonize national accounts, to consolidate statistical data, to exchange information among the economic teams of the different countries, and to perform studies that later facilitated reaching agreements on subjects as varied as subsidies, investment policies, foreign investment status, capital markets liberalization, etc. Representatives of the member countries' Ministries of Finance and of Foreign Affairs, and of the Central Banks, as well as permanent representatives of the Inter-American Development Bank (IDB), the World Bank, and the International Monetary Fund (IMF), would be full members of this Commission. Representatives of associated countries (Chile and Bolivia) could participate as observers, together, perhaps, with delegates of the U.S.A. Federal Reserve Bank and the European Union Central Bank.

Basically, this Commission would have one objective and two main functions. The objective would be to consolidate the macroeconomic stability of the region's countries, based on the European experience relevant for current circumstances in the region, which are not those of the Maastricht Treaty (as is naïvely alleged), but rather those of Western Europe during the twenty years after the Second World War. During those decades, the great challenge for European countries was to stabilize their economies, to strengthen their domestic currencies, to reduce intervention by the State in productive activities, and to gradually open to world trade and free capital flows. It is worth recalling that at this time Germany was coming out of a period of hyperinflation (1948), that France suffered serious and repeated external crises until 1956 (Mendes France Plan), and

that Great Britain and Italy had profound macroeconomic crises at the beginning of the 1960s, which they solved with the help of the IMF.

The two main functions of the Macroeconomic Coordination Commission would be the following: First, it would be responsible for monitoring the Stability Pact (see details in the third scenario), and in doing so, it would have to develop a homogeneous statistics system and a system of consultation meetings that would give an actual foundation to the monitoring activity. Second, in the case of significant fluctuations in real bilateral exchange rates, it would be responsible for approving the compensation proposals made by affected countries. It would be previously agreed that said compensation proposals will be temporary (when they restrict trade or capital flows within the region) and that, as far as practicable, they will tend to liberalize trade and inter-regional capital flows. For instance, after the 1999 devaluation in Brazil, the Commission would certainly not have approved the implementation of protectionist measures by the other countries, but instead would certainly have insisted on the need for Brazil to adopt a compensatory package of measures to liberalize trade, such as an immediate elimination of its subsidies to exports within the area and an accelerated dismantling of its many non-tariff barriers towards its regional partners.

Furthermore, for the Customs Union to function, all member countries must assume a firm commitment to immediately reduce export subsidies that affect trade among MERCOSUR countries and a medium term commitment to gradually eliminate (or harmonize) subsidies and internal regulatory policies that distort competition within the region and generate an inadequate allocation of resources and investments. Argentina and Uruguay have often insisted on the need to carry out a detailed analysis of the deviations of trade and investments generated by subsidies and by restrictive regulations introduced by Member Countries. Unfortunately, for the time being, Brazil has shown little enthusiasm for this analysis.

In my opinion, a Genuine Customs Union requires, in terms of trade defense, the complete elimination of safeguard clauses, compensatory rights, and anti-dumping rights, which often facilitate abusive trade restrictions, and their replacement with a law of defense of competition and the rights of the consumer. Such a law, if enforced in earnest, could be the most suitable instrument to progress in the process of eliminating distortions within the framework of competition within the region.

However, the compensatory rights mechanism would have to survive during a transition period, while subsidies and regulatory policies that distort competition among countries in the region are gradually eliminated. Disputes arising concerning the application of said compensatory rights, should be settled by the Permanent Court mentioned above.

From the perspective of its international integration, a Genuine Customs Union would generate considerable advantages for the countries in the region. A significant advantage would be to develop the "critical mass" needed to access other markets on a more favorable footing than each country could negotiate separately.

From the standpoint of economic theory, a Genuine Customs Union is the most advantageous scenario, since it will maximize the opportunities offered by an enlarged regional market (in particular the economies of scale and of specialization). Reliability in access to markets by member countries and a reduction of the asymmetries that make it impossible to have a "level playing field" will lead to a reasonably equitable distribution of economic profits generated by integration.

International experience about customs unions is quite conclusive, showing that a set of common policies is indispensable to legitimize the existence of a Genuine Customs Union. Therefore, a comprehensive project of energy integration within the region, that would include exports of natural gas from Argentina to the south of Brazil, could become one of the pillars for the development of a common regional set of policies. Moreover, Argentina and Brazil should be ready to support the creation of special programs that would specifically benefit the two smaller partners: Paraguay and Uruguay. These programs should not be developed in a perspective of protectionism or mercantilism (e.g., higher tariffs or subsidies), but rather in a liberalizing approach (such as the authorization to implement a liberal system of *maquila* for certain products and/or the elimination of non-tariff barriers that hinder the growth of these countries exports into the Argentine and Brazilian markets).

The risk of MERCOSUR becoming a closed and introspective regional bloc is present, in view of the protectionist record of the country members, and in particular, because of the vague fears that still survive in important sectors of the region's elite concerning globalization and international competition. However, it seems obvious that the Genuine Customs Union scenario will be much less exposed to protectionist and

interventionist pressures than the scenario of Imperfect Integration, which we will discuss below.

Unfortunately, the Genuine Customs Union scenario is, from a political and diplomatic regional perspective, the hardest to implement in the current circumstances due to the predictable resistance of Brazil's government and important elite business sectors to anything they think will limit their freedom of action concerning specific industrial, agricultural, and foreign trade policies. Brazil has a deeply rooted tradition of applying active regional or sector oriented policies, which conspire against the construction of a genuine extended regional market. Further, the government of Brazil has considerable resistance to accept supranational community standards and to delegate sovereignty in supranational institutions.

The second scenario involves transforming MERCOSUR in a Full Free Trade Area, unlike ALADI, but following the in-depth integration model implemented in NAFTA.

Free trade areas, in terms of economic integration, although no less important than customs unions, are slightly different. In particular, current free trade areas (such as NAFTA), differ from the classical schemes of GATT (1947 version) that were applied to the ALALC and ALADI agreements, in the Latin America of the 1960s and 1970s. In in-depth integrated free trade areas, negotiations of instruments, and commitments to guarantee access to markets by member countries are more important than traditional negotiations of preferential tariff margins. The point is to negotiate stipulations that minimize the imposition of unforeseeable restrictions (such as sanitary, technical, financial, or customs restrictions) that hinder or prevent access to markets that are already interdependent.

For a Full Free Trade Area to really work, each country in the region must clearly define its national interests, establish its priorities, and after negotiations, fully comply with the commitments it has made, both concerning free access to its domestic market and with regard to restrictions to said access. Along these lines, there is considerable work still to be done to attain this scenario, because MERCOSUR is not yet a customs union, but neither is it a free trade area, since assured access to national markets is not duly guaranteed.

Moreover, if a country has problems in defining its priorities in the framework of a free trade area negotiation, it would be a mistake to think that the problem will disappear by betting on the creation of a more

ambitious imperfect customs union, where the ongoing negotiation is synonymous with tensions and uncertainties that negatively affect the investment process, the allocation of resources and economic growth. The free trade area scenario (only a second best) is preferable to maintaining the status quo (the Imperfect Integration scenario), since the negative effects on economic growth would be partially offset by the opportunities open to Argentina, Paraguay, and Uruguay to unilaterally reduce their levels of protection vis-à-vis the rest of the world. Undoubtedly, a free trade area would promote growth in a country such as Argentina, more inclined, and in a better position than Brazil, to decrease its levels of protection vis-à-vis third party countries.

Furthermore, from the economic standpoint, establishing a free trade area is more compatible with the conditions that characterize the economies of the region that still face serious problems of macroeconomic stability. Moreover, a free trade area does not require, like a customs union, either investments or contributions to a set of common policies (which according with available evidence, the countries in the region cannot afford), nor does it force them to harmonize their trade policies vis-à-vis the rest of the world, which this far they have been unable to do successfully.

From the regional standpoint, the Full Free Trade Area would favor a speedy incorporation of Chile to MERCOSUR, since it would remove the main obstacle: the high level of the common external tariff. If the common external tariff is eliminated, this scenario would restore a significant leeway to member countries in the field of foreign trade policy.

This situation has the advantage of moving forward in the process of regional integration without requiring immediate significant changes in those policies in which Brazil is reluctant to decrease its autonomy and freedom of action. Thus, the free trade area would set the basis for a less conflictive regional understanding, from where it would be possible to progress, on a firmer foundation, to a subsequent phase of a more comprehensive regional integration.

In the matter of defensive trade policies within MERCOSUR, as long as some countries in the region maintain mercantilist policies that distort the competitive context within the area, the other countries in the region should be able to enforce compensatory rights to level the playing field, or to negotiate specific compensations in terms of easier access to alternative regional markets.

From the standpoint of international integration, the Full Free Trade Area would eliminate almost all risk of creating a closed regional bloc, since it would favor the negotiation of a whole series of free trade agreements with other countries and other regions.

The third scenario, the Imperfect Integration is the least desirable but appears nowadays as the most probable. It consists of an attempt to reestablish the status quo that preceded the grave crisis that began with the devaluation of the real (R\$) in January 1999. The point is to regain political initiative and to return to the situation prior to the crisis, but without resolving the political and institutional central problems that underlie the current crisis.

This scenario could incorporate certain institutional improvements, such as a dispute settlement mechanism more effective than the present one. However, most likely the dispute settlement court would not be supranational and would not offer guarantees of direct access to the private sector.

In addition, macroeconomic coordination among countries could also be enhanced by homogenizing economic statistics compiled by each country. Then, a Stability Pact could be implemented, under the supervision of an intergovernmental commission. The goal of this Pact would be to jointly set a series of macroeconomic objectives (both fiscal and monetary) to consolidate stability and to decrease the economic volatility of the main economic variables in each country of the region (inflation rate, real exchange rate, fiscal deficit, level of public indebtedness, etc.). This goal is commendable and would confer a regional political dimension to objectives that the member countries have already individually pledged to the IMF. But unfortunately, compliance with those pledges would remain purely voluntary, with no negative consequences for the remiss country, except those already in force, that result from the discipline imposed by financial markets and the conditional agreements signed with the Fund.

In addition, some new issues would be raised, such as the future negotiation of an agreement on government procurement (only at the federal government level), advances in the construction of certain important projects related to physical integration (canals, highways, bridges), to power supply in the region, and discussion of the possibility of simplifying the burdensome procedures to obtain a visa that are imposed on Argentine entrepreneurs who want to do business in Brazil. (Although we have not mentioned them explicitly, all these issues would also be included in

negotiations conducive to a Genuine Customs Union – the first scenario – or to a Full Free Trade Area – the second scenario). The result would be a *sui generis* combination of an incomplete free trade area and imperfect customs union, with a low institutionalization and the *de facto* preeminence of Brazil in the affairs of the region.

In the end however, MERCOSUR's basic problems would not be adequately resolved. I am referring in particular to the lack of legal certainty; the lack of assured access to markets; the recurring risk that a member country (under the pressure of corporate lobbies) might introduce discretionary measures of trade defense or subsidies; and to the eventuality that a macroeconomic crisis in Argentina or Brazil would generate a massive devaluation with grave consequences for the economic stability and growth prospects of the other member countries.

The status quo of MERCOSUR anticipates an attractive but unstable future for some segments of Argentina's agribusiness, managed commerce for the automobile sector, and integrated planning, albeit with some unexpected shocks, for multinationals established in both countries. Nevertheless, as long as an adequate institutional framework is not implemented, MERCOSUR will fail to favor the development of industries and other Argentine activities that manufacture the same products that are made in Brazil. We will have to content ourselves with agribusiness development and a rationalization process by multinationals, which will feel increasingly tempted to locate their new investments in Brazil.

With regard to the mechanisms of trade defense within the region, subsistence in this third scenario of excessive levels of legal uncertainty and bureaucratic discretion will generate a defensive reaction on the part of the smaller countries, who will want to protect themselves from the consequences of possible protectionist and/or mercantilist practices that a partner might feel tempted to introduce in the future.

From the standpoint of future economic growth in Argentina, the Imperfect Integration scenario is the least attractive. The association of an imperfect customs union, with frequent infringements of the common external tariff, and sectors not yet incorporated to free trade within the region, will fatally create grave distortions in relative prices, significant deviations of trade, a decrease in the quantity and quality of new investments, and as a consequence, inadequate resource allocation, leading in the medium term to a sub-optimal level of economic growth.

Moreover, this scenario benefits Brazil more than the other member countries. Economic theory is conclusive on this subject. In a regional integration project, the flows of new investments will tend to go to the largest market in order to take maximum advantage of economies of scale and to reduce transport costs.

In the case of other successful projects of regional integration, these tendencies were compensated by market mechanisms or by mechanisms politically negotiated among the partners. For instance, in the case of NAFTA, compensation takes place through the market. The substantially lower salaries prevailing in Mexico in comparison with the U.S.A. have attracted an important inflow of foreign direct investment and have transformed Mexico into an important exporter (currently 90% of Mexican exports are manufactured products, and only 7% are oil derived). In the case of the European Union, from the very beginning, the partners agreed on compensation policies as illustrated by the common agricultural policy and the regional development programs.

In the case of MERCOSUR, the natural asymmetry resulting from the difference of scale is compounded by other asymmetries caused by the legal and institutional fragility. Uncertainty concerning access to the main partner's market encourages the relocation of investment flows toward the market of that partner. Subsidies granted to exports and/or to the production and investment of specific sectors further consolidates that tendency to the detriment of other partners competitiveness and generates an unfair distribution of costs and benefits in the integration process.

In the perspective of international integration, the Imperfect Integration scenario will keep up the appearance of "putting the house in order," although basic doubts concerning MERCOSUR's stability will remain hovering in the air. The fragility of the region's supranational institutions and the underlying discretionary handling of affairs will confirm the suspicion of Foreign Affairs Ministries and large multinational companies that a future economic storm (such as an unforeseen devaluation) could easily endanger the future of the regional project. The limited credibility of an agreement with fragile institutions can only weaken the negotiating position of the region and of the individual countries on various international forums. Progress in trade negotiations with the U.S.A. and with Europe will become very arduous. Also the Imperfect Integration scenario will promote protectionism within MERCOSUR

that might gradually transform the region in a closed bloc and abandon, implicitly, the intention of creating an open regional project integrated into the world's economy.

The greatest advantage of implementing the Imperfect Integration scenario is (at the regional political and diplomatic level) the easy reestablishment of a fruitful and comfortable relationship with Brazil. This scenario fits in with Brazil's natural preferences, since that country wishes to consolidate its regional leadership without binding itself with commitments or incurring substantial political or financial costs.

From the perspective of Paraguay and Uruguay, this scenario will be initially resisted and later certainly resented. In the end, in all probability, the weight of circumstances will force them to accept, albeit reluctantly, the proposed framework. The growing opposition of Paraguay and Uruguay to the high level of effective protection incorporated into the automobile industry agreement by Argentina and Brazil explains their decision to lower their national tariff to 20%, although the agreed common external tariff is 35%.

From Chile's perspective, this scenario definitely postpones its possible entry to MERCOSUR as a full member, although some progress could be made at the level of political and diplomatic cooperation.

In this third scenario MERCOSUR survives, but the rules of the game are not balanced and the institutional framework is inadequate to insure the minimal levels of certainty and stability of rules required by the private sector to function effectively. Argentina pays a cost that can be quite high in terms of decreased economic growth. Brazil, the largest economy, benefits more from the status quo than the other countries, but as the gap between agreements and reality gradually widens, the partner's commitment to the regional project will dissolve, and, little by little, MERCOSUR could become irrelevant. The sustainability of this scenario in the short term will basically depend on the region's economic performance, which in turn is highly dependent, on the one hand, on the continuity of macroeconomic stability in Brazil and Argentina, and on the other, on the availability of international financing to fund the significant current account deficits that characterize the balance of payments of the member countries.

This scenario is unfortunately the most tempting one for the region's governments, since it allows them to defer and to postpone behind some

rhetoric announcements and some novel initiatives, the negotiation of those fundamental issues that affect the growth potential and the quality of integration of the region's countries (including Brazil) into the world stage at the dawn of the twenty-first century.

CONCLUSION

Behind the well-meaning declarations, the joint statements, the presidential summits, and the signature of a long list of agreements, hides a grave political inability to move forward in the solution of essential issues and to develop a common view of the future. The reasons of this political inability lie, in my opinion, in three fundamental causes that, although of different origin, tend to reinforce each other.

The first cause is of a cyclical nature, and relates to the weakening of the executive power in both Brazil and Argentina since 1996. In Brazil, the attempt by President Cardoso to be reelected, which began in 1996 and was achieved in 1998, was followed by a serious financial and exchange rate crisis in 1999, that diverted the attention and weakened the capability of Brazil's central government to seriously make headway in the regional agenda. Something similar happened in Argentina, with the attempt by President Menem to get reelected, the delay in implementing second generation structural reforms as of 1996, and the presidential election campaign, prematurely launched during 1998. Finally, President De la Rúa's new government, which took office at the end of 1999, has also taken its time to organize its teams and evaluate the complex circumstances faced by MERCOSUR. Moreover, the emerging markets crisis during 1997 and 1998, the Brazilian devaluation in January 1999, and the decline in capital inflows into the region have added a further measure of uncertainty and have contributed to inflame conflicts among sectors within the region, and to divert the attention of governments to more urgent fiscal and exchange rate problems.

The second cause is economic and structural in nature. The fifty years of closed economies and extreme protectionism in place in the region, in particular in Argentina and Brazil, have not been in vain. In spite of the opening of the economy implemented during the last decade, Argentina and Brazil still are relatively closed economies, insufficiently integrated into the world economy. If we review the World Bank's statistics for 1998, and we calculate the openness of the economy ratio (exports + imports

divided by 2 and divided by the GDP), we discover that this ratio is 9% for Argentina and 7% for Brazil, compared to 21% in Australia, 27% in Chile, 26% in Spain, and 22% in Mexico. Local lobbies involved in trade liberalization issues that are under discussion are not only powerful, but they also increase their lobbying influence inversely to the weakness of the central governments political power, which we mentioned above. Moreover, the downturn in the price of many industrial and agricultural commodities and the appreciation of the dollar during 1999 and the first ten months of 2000, prevented Argentina and Brazil from significantly decreasing their balance of payments current account deficit, in spite of the ongoing recession. This association of an economic recession and a current account deficit has contributed to aggravating protectionist and mercantilist pressures within the region.

Unfortunately, the low degree of integration of the region's countries into world trade flows after the Second World War, has generated within political systems structures of economic power where the predominant sectors are those that compete with imports, and are therefore opposed to international competition. At present, this situation is more evident in Brazil than in Argentina, for reasons that we will analyze below.

In the case of Argentina, the hegemony of sectors that compete with imports has clearly waned during the 1990s (except in the case of a specific sector, such as the automobile industry). This change was partly caused by privatization, which created a new pole of private enterprises, independent from the State, that are less exposed to international competition and that value, above all, macroeconomic stability and growth.

The convertibility rule stabilized the rules of the game, and, in spite of the growing appreciation of the peso, promoted a significant expansion of exports. Between 1991 and 1998, exports grew at an average annual rate of 12% and the number of export companies increased by almost 80%. Exporters also demand an open economy in order to obtain, at competitive prices, the inputs and capital goods required to expand their activities. Growth and diversification in the composition of Argentine exports are still modest, but they represent an historical shift in the traditional trend and they have much stronger roots than is generally believed. In addition, this has been achieved without the granting of significant subsidies, by taking advantage of gains in productivity generated by the process of opening the economy, greater stability, and structural reforms.

In the case of Brazil, the process was different. On the one hand, the process of privatization and structural reforms was slower and less in-depth than in Argentina and, on the other hand, the attraction of a larger domestic market and a more successful experience with protectionism (which generated high growth rates during almost 30 years, until the middle of the 1980s) have helped to perpetuate a preeminence of the import competing sectors in the design of foreign trade and industrial promotion policies.¹

It is reasonable in my opinion to say that the dominant view in Brazil concerning the country's integration into the new global economy (both in its negotiations with WTO, as in regard to FTAA, and the European Union) is essentially of a defensive nature and emerges from the perception that in general, costs associated to a more open economy are greater than its potential opportunities.

As to MERCOSUR, the predominant view is that, although the benefits of the regional project are significant (exports to MERCOSUR represent approximately 15% of total exports, but they have a substantially greater added value component vis-à-vis the rest of Brazilian exports), they do not seem sufficient to justify "tying one's hands" in terms of domestic economic policies.

These positions are based on the strong hegemony of the imports oriented sectors, compared to exports oriented sectors on the definition of economic and trade decisions. The weight of protectionism on the cost structure of Brazil's economy is quite substantial, as demonstrated by the low growth of exports in that country between 1991 and 1998 (Brazilian exports grew at an average annual rate of 6%, much lower than in Argentina). In this sense, the modest performance of Brazilian exports after the devaluation at the beginning of 1999 is illustrative. The increase in the use of installed capacity and the substitution of imported inputs by domestic ones are the most notorious characteristics of Brazil's economic recovery and the most obvious cause of the balance of trade improvement. Although Brazil has left behind its past autarchic protectionism, its industrial and trade policies clearly discriminate in favor of import substitution sectors.

The third cause is both of a political and structural nature. I am referring to the rather defensive profile of Brazil's foreign policy, strongly influenced by a clear resistance to the delegation of sovereignty in supranation-

al regional institutions; often dominated by an agenda of domestic economic and political problems.² Brazil's resistance to delegating sovereignty comes from two traditions, deeply rooted in the mindset of some sectors of that country's elite. On the one hand, there is a legal tradition that establishes a preeminence of national laws over international treaties and is reluctant to accept the creation of supranational common institutions.³ On the other hand, there is in Brazil a generalized opinion held among the elite that envisions their country becoming a major player in the world scene based on its economic, political, and military leadership in South America. These sectors perceive the regional integration process as a privileged mechanism to institutionalize such a regional leadership. In this view, MERCOSUR is a platform for relaunching on a wider scale a project of autonomous economic development, not devoid of strategic objectives. Brazil's integration policies in South America are focused on extending markets for its industrial products, resolving balance of payments problems, and exercising leadership to leverage its negotiating power vis-à-vis developed countries, in particular the U.S.A. Along these lines, President Cardoso made a suggestive statement (State of São Paulo, March 27, 2000), where he describes MERCOSUR as the pawn (the chess piece that opens the game) in Brazil's foreign policy.

The foreign policy that results from this view evolves from the premise that preservation of certain spaces of autonomy (e.g., negotiation of terms of Brazil's participation in international schemes such as FTAA, the WTO's Round, international agreements on nuclear and missile issues, its participation as a permanent member of the Security Council, and so on) positions the country not only as the largest and economically most important country in the region but also as its leader. In this strategic vision, in the next 20 years the world would tend towards a multi-polar scenario, in which "pivot countries" would acquire particular relevance. The assumption is that, in addition to China, these countries might be India, Russia, Indonesia, and Brazil.⁴

In summary, we might say that predominant segments of the domestic business sector and the state bureaucracy in Brazil have concluded (since at least 1964) a long term cooperation agreement that includes industrializing and protectionist policies at home and autonomist policies at the international level. Even though this agreement has not generated, as of 1983, any outstanding results in terms of stability, growth, or international

positioning, the foundation of this agreement (which has been adapted in response to the impact of globalization, to accept privatization of public utilities) is still in force when it comes to the definition of industrial and international trade policies and the general guidelines of foreign policy.

Nevertheless, in order to seriously assess Brazil's position and its effects on the future development of MERCOSUR, it is necessary to make a historical review of the conditions that have determined the success or failure of regional integration processes from the German Zollverein of the nineteenth century, to the European Union and NAFTA in the twentieth century. Historical experience indicates that successful consolidation of a regional integration project happens in one of two circumstances that I will describe below. Regional projects that do not benefit from at least one of these favorable circumstances must moderate their ambitions or confront serious predicaments.

The first circumstance is present when the largest country has the necessary material resources and the political will to exercise, with responsibility, a constructive leadership role, even at the cost on occasion, of sacrificing its immediate national interest. In this context, responsible leadership on the part of the strongest partner makes it possible to endure problems and crises and to continue advancing in the regional integration project. For example, the decision of West Germany's Prime Minister Helmut Kohl to exchange the currency of the former East Germany for the Deutschemark of West Germany, in favorable conditions for the holders of that currency, propitiated the reunification of both Germanys, although it generated a heavy cost in terms of fiscal deficit and increased inflation rate. The massive financial support offered by the U.S.A. to Mexico after the so-called Tequila crisis, is a further contemporary example of this scenario.

Unfortunately, in the case of MERCOSUR, the largest country, Brazil, faces a complex economic and political internal agenda that prevents it from exercising constructive leadership regarding the regional project. An impartial analysis would also lead us to think that Brazil, although bigger than Argentina, does not possess sufficient attributes of power to exercise a leadership role unshared with the other partners in determining the future of MERCOSUR. This is why the second set of circumstances, that we will discuss next, is the more realistic to optimize the integration of the region's countries, including Brazil, into the world scene.

The Future of MERCOSUR: Argentina's Options

The second set of circumstances is present when the members of the regional project are ready to create a tissue of common and cooperative institutions and promote a shared integration project that limits discretionary actions of each one of the members (including the bigger ones), with the goal of creating a new entity that encompasses all of them in a new paradigm of cooperation and solidarity. The classical contemporary example is the European Union, which has created a vast network of common institutions in pursuit of the common objective of creating a European economic space.

In my opinion, this is the preferable route to insure a stable and fruitful future for MERCOSUR. A balanced integration with Brazil fits with the best interests of Argentina. Said integration must be carried out in an adequate institutional framework that includes a set of standards and rules observed by all members of the regional group. The limits on unilateral action that would be imposed by the institutional framework would be the best guarantee of the regional integration project's continuity and legitimacy.

Undoubtedly, the governments of MERCOSUR's countries will have to face during the coming months key decisions concerning the economic, institutional, and political future of the regional project. Consolidation of MERCOSUR requires that the governments of member countries confront with economic discernment and a firm political resolve the complex challenges that we have already identified. In particular, the government of Brazil must define, as the largest partner, the degree of commitment it is ready to assume for the future of MERCOSUR. What is at stake is not a return to the past, in terms of a recrudescence of immoderate protectionism or a recurrence of old geopolitical rivalries. Strategic agreements already concluded concerning weapons of massive destruction, the characteristics of the current international environment, the dense tissue of intra-regional economic interests, the profound changes that have occurred in the region's public opinion, and the indisputable advantages offered by regional economic integration, are an acquired common heritage, from which there is no going back.

Governments in the region will have to decide if they really want to move forward in the establishment of a Genuine Customs Union. This is the most attractive scenario, but also one that will require the greatest political effort on the part of member states, in particular Brazil, that will

have to accept the creation of an institutional framework with some supranational components, as well as to commit to comply with a set of community rules that will restrict its freedom of action. The project of constituting a real Customs Union that could later become a Common Market entails some conceptually very attractive components, but also some risks for the countries of the region.

Firstly, from a strictly economic point of view, it is undoubtedly more attractive to implement a customs union than a free trade area, since the latter requires a complex negotiation followed by the establishment of the so-called “rules of origin.” These rules of origin enable nations to determine the tariff preference that must be allocated to goods coming from third party countries that are then processed in one of the member countries of the free trade area. Moreover, free trade areas exclude by definition the possibility of eliminating customs among member countries and do not promote the establishment of a unified single market. Secondly, from a political standpoint, the establishment of a customs union potentially increases the negotiation power of the new grouping vis-à-vis third party countries or regions. In an economic world that is becoming increasingly global but also regional, if MERCOSUR countries negotiate jointly they might increase the possibility of optimizing international integration for each individual country.

There is always the risk that, if the new regional group has a predominant partner – who is not ready to accept a framework of community institutions and rules – this country might impose a de jure or de facto hegemony, and have its interests prevail, through unilateral actions, over the interests of the other partners. In this scenario, only an explicit and viable agreement among the parties, the incorporation of new partners to help balance power within the bloc, and the creation of supranational institutions could restrict the potential discretionary attitude of the largest partner.

In addition, if one of the member states lacks the political will to build a stable institutional framework and to consolidate a new economic culture it would be preferable to accept pursuing at this stage the less ambitious goal of creating a free trade area that would require lesser commitments and would enable each country to face in a more independent manner the challenges of the global economy. The economic advantage offered by a Full Free Trade Area is that it allows each member country to

choose its agenda for liberalization. Moreover, it does not force countries that have low tariffs on some products to increase them to comply with the highest agreed upon common tariff (this is the case, for instance, in Argentina regarding capital goods, telecommunication, and computer equipment).

The idea is to advance the regional integration through an in-depth liberalization, not only in the trade of goods, but also in the field of services and government procurement. This scenario would also require negotiating a set of rules to ensure easy access to the regional markets (e.g., sanitary and phytosanitary issues, technical standards, customs operation, etc.). This scenario would gain weight if important but postponed issues, such as sugar, textiles, double customs taxes, and the numerous remaining non tariff barriers were negotiated with the clear intent of agreeing on an agenda to liberalize trade flows within the region.

It is true that, *prima facie*, Brazil favors the Imperfect Integration scenario. However, if progress cannot be seriously made in the establishment of a Genuine Customs Union, Argentina must firmly promote *vis-à-vis* its partners and regional public opinion the need to move forward towards transforming MERCOSUR into a Full Free Trade Area.

What are Brazil's essential arguments to oppose such dialogue? It would be obviously false to contend that the Free Trade Zone is already established and that this scenario would represent a step back for the regional integration project. After all, the most perturbing element of the current circumstances is precisely the constant change in the rules of the game through practices that restrict intra-regional trade and subsidies that distort investment and trade flows.

Those who claim that the proposal of a free trade area is a way of clinging to the unsuccessful models of the 1960s and 1970s, in particular to the experience of ALALC and ALADI, forget that those covenants failed because, behind a language of free trade, they hid managed trade agreements, with endless limitations and market reserves.

Additionally, it is impossible to sustain the allegation that the negotiation of this scenario might lead to the disappearance of MERCOSUR, which would inevitably generate a deterioration in our relationship with Brazil, leading in turn to Argentina being isolated from the rest of the world. This opinion does not represent a judicious assessment of the proposal's costs and benefits for the parties involved, but rather an emotional

reaction. Moreover, it is important to recognize that a bad economic agreement will not provide the foundations to progress in the development of a political and strategic relationship with a wide scope.

It would also be a grave mistake to think that a bad agreement for MERCOSUR is preferable to nothing and that renegotiating is a leap in the dark. In terms of trade, Brazil is as dependent on the Argentine market as Argentine exports are on Brazil.

The conclusion of this brief analysis is that negotiation of a free trade area will not generate more serious trade tensions than those we have already experienced in recent months, nor significant market losses, because affected private interests both in Argentina and Brazil will do whatever is necessary to prevent it. Quite the opposite, putting in order regional agreements will contribute to reestablish trade flows that have suffered in recent months from the adverse impact of increased uncertainty.

In this scenario of a Free Trade Area, Brazil could manage its external tariff with great autonomy and could promote, through subsidies or market reserves, strategic sectors of its economy. Inclusion in the free trade agreement of a clause routinely extending the most favored nation principle would ensure that Brazil would automatically obtain all concessions offered by its regional partners to third countries. It could also independently negotiate free trade agreements with other countries, as long as it extended to its regional partners the concessions offered to said countries. Argentina and the other members of MERCOSUR would be submitted to the same discipline and would be in danger of being displaced from the Brazilian market by other exporters, in as much as preference margins within the region would be eroded by concessions made by Brazil (which after all represents 65% of the regional market) to those third countries. Argentina and Brazil could maintain good and fruitful trade and economic relationships and would continue to increase bilateral trade flows, but would not share a common external tariff.

Will the governments of Brazil and Argentina be capable of transcending the rhetoric of high-flown political declarations and instead focus on the genuine options they confront? Will Brazil be prepared to consolidate MERCOSUR in a determined fashion, and to implement a less unilateral, less defensive, and more cooperative foreign policy with its neighbors? Can Chile be incorporated as a full partner of MERCOSUR, and will the member countries show enough flexibility to lower the level of the exter-

nal tariff? Will the defensive trade views that seem to predominate today prevail in Brazilian policy, or is Brazil's executive capable of mobilizing a coalition of interests powerful enough to domestically impose on the more protectionist and pro-state sectors the necessary concessions to create, not just on paper, but in actual reality, a genuine regional integration?

Consolidation of MERCOSUR requires that the countries of the region confront with responsibility the option we have just described. If governments do not choose one of these two scenarios (the Genuine Customs Union or the Full Free Trade Area) and are distracted by dilatory and pseudo reformist policies, they will most likely condemn the regional project to repeat, on another scale and in other times, the frustrations of integration projects that were attempted as of 1960, first with ALALC and later with ALADI.

In this case, the regional project will slide down the slippery road to Imperfect Integration, which would perpetuate a barely altered status quo. Distortions in relative prices, deviation of trade flows, and economic and legal uncertainty, so predominant in Imperfect Integration, will generate strong demands for compensation on the part of less favored sectors, this will lead in the end to increased levels of protection and state intervention in the economy.

Brazil's predilection for favoring import substitution on the regional scale, instead of privileging a greater economic openness and the transformation of MERCOSUR into an exports platform oriented to the world market, is understandable, in view of its large population and the vague misgivings, shared by vast segments of its elite concerning globalization and the limited possibilities of accessing world markets with its products. Yet, in my opinion, this model is condemned to failure in the medium term in an increasingly globalized world, where MERCOSUR represents only 3% of Gross World Product and 1.5% of total world trade. Besides, MERCOSUR is not, and cannot be for a considerable time (at least until it catches up with the technology of more advanced countries) a region that can generate world class technological and scientific innovations, and its potential for a quantum leap forward, in terms of economic growth, is closely dependent on its ability to take advantage of opportunities offered by the process of world economic integration.

It is obvious that increasingly the key to sustained and fast growth is the quality of investment and the allocation of resources, and this quality basi-

cally depends on successful integration into the world economy. All countries, with no exception, that have achieved sustained growth and have decreased the productivity gap that separated them from developed countries after the Second World War (such as Spain and Italy in Europe, and Japan and the Asian Tigers in Asia) were capable of implementing successful strategies to integrate into the world economy. In this sense, it would be useful to launch a debate among the region's countries and Brazil on policies successfully implemented by such diverse countries as China, Japan, and Mexico (all of them countries with large populations), that have been able to harmonize growth with openness to the world economy and the creation of jobs.

But unfortunately, in the short term, maintaining the status quo is both convenient and advantageous for Brazil. An Imperfect Integration model keeps tariffs high, favors preferentially foreign investment in that country, and allows it a great freedom of action to instrument its main economic policies, included exchange policies, as was shown by the events of the last fifteen months.

But, Argentina cannot remain inactive, waiting for Brazil to modify its spreadsheet and see the benefits and costs MERCOSUR can bring it. Without breaking with MERCOSUR, Argentina must implement a battery of measures to compensate the adverse effects of the Imperfect Integration model on its growth potential and on the quality of its international integration.

The first course of action is that Argentina must vigorously endeavor to diversify its international trade. It should follow the example of Brazil and launch a proactive policy of bilateral trade negotiations, oriented to obtaining, through free trade negotiations, more access for its products to the rest of Latin American countries. Along these lines, it is worth mentioning the comments made by President F. H. Cardoso on the initiatives Brazil is taking vis-à-vis the Andean Community, Mexico, South Africa, and Venezuela on an individual basis: "This does not mean MERCOSUR is not a priority for us, but today we must simultaneously create a substantial bilateral rapprochement with other countries, with whom we will have free trade agreements in the future."⁵

Argentina should also progress rapidly towards achieving various free trade areas with a selected group of countries such as Australia, Canada, South Africa, and New Zealand among others.⁶ These countries have not

been selected randomly, but rather represent medium sized countries, with a tradition of fulfilling their commitments and with a strong basis of agricultural, energy and mining resources together with a medium industrial development. Differences in efficiency between the Argentine economy and that of these countries are significant enough to stimulate competition, but not so great as to generate a competitive challenge that might internally freeze a fast track negotiation of such free trade agreements.

Likewise, Argentina should make efforts to negotiate agreements of comprehensive integration with other members of MERCOSUR, including associate members Bolivia and Chile. The idea is to duplicate the system that was successfully implemented in the European Union, of two-speed integration: some countries, those more committed to regional integration, progress faster and with greater depth in the negotiation of certain issues, while the other partners may join the agreement at a later date.

Undoubtedly, several countries in the region are favorably disposed towards speedy bilateral negotiations for trade liberalization on specific issues (non-tariff barriers, financial services, insurance, air transport and shipping, and government procurement). There is also an open negotiation forum to go ahead with bilateral agreements that contribute to a level playing field among some countries in the region, in particular on issues such as subsidies and regulatory discrimination that distort competition and the attraction of investment capital.

The second course of action is that Argentina should implement an assortment of economic policies to level the playing field and to obtain a reasonable share of new investments oriented to fulfill the regional market's needs, in particular those from abroad. In this course of action, Argentina should develop four important initiatives:

Argentina should renegotiate the common external tariff immediately to reduce to zero its tariffs for import of capital goods, communication, and information technology. Acquisition of the best equipment and capital goods at the lowest possible cost must be the first priority of the country's economic policy.

Argentina should also favor a gradual decrease of the common external tariff, in order to increase its economy's productivity and to integrate more rapidly into the world economy, following the successful examples of Chile and Mexico during the last decade.

Likewise, Argentina should consider granting an income tax exemption (for a period to be determined) to all new projects involving foreign direct investment in fixed assets to be located in the country during the next three years. Several member countries of the European Union (e.g. Belgium and Ireland) have granted this type of benefit to compensate for the diseconomies of scale present in smaller countries.

Finally, Argentina should develop a more assertive trade policy to defend the access of its exports in its regional partner's markets. Although it is true that in the Imperfect Integration project progress toward the institutionalization of MERCOSUR is limited by Brazil's reticence, in any case it is possible to proceed towards a more effective dispute settlement system, to accelerate the incorporation of MERCOSUR rules into the legislation of countries in the region, and the signature of a macroeconomic Stability Pact. The measures adopted will probably prove insufficient but they will be oriented in the right direction.

The third course of action is that Argentina must promote an acceleration of the negotiation agenda planned for the projected hemispheric free trade area (FTAA). An agreement that includes the U.S.A. and Canada would provide a more predictable political and institutional framework for the process of regional economic integration. Negotiation of a hemispheric free trade area agreement will likely be brought about by extending to the rest of the continent the rules and procedures already negotiated in the framework of NAFTA. Said rules and procedures will limit the high level of governmental discretion that characterizes MERCOSUR today.

The truth of the matter is that Brazil feels comfortable with the current Imperfect Integration scenario. Reactions of its regional partners to the grave consequences of its devaluation have only confirmed the impression among its leading groups that they have great freedom of action and that the regional project can continue to move forward without substantial commitments on their part in terms of rules and institutions. The rest of the partners in the regional project must endeavor to convince Brazil that it is necessary to develop a serious and balanced project, whether it is called a Genuine Customs Union or a Full Free Trade Zone. Unless they do so, MERCOSUR would end up like most failed regional integration projects: formal agreements would subsist, but gradually the regional agreement would fade into irrelevance while rhetorical declarations and lack of compliance would prevail.

The Future of MERCOSUR: Argentina's Options

If Brazil prefers to develop the Imperfect Integration project Argentina must implement the compensatory measures that I have outlined above. A firm Argentine stance of not accepting passively a scheme that clearly goes against its interests might be capable, in time, of generating a change in Brazil's position. Should this not happen, Argentina would in any case avoid the most perverse effects of Imperfect Integration, and would implement without openly confronting Brazil, a policy of greater integration into the world economy, while it hopefully awaits a U.S.A. initiative to extend NAFTA to the rest of the continent.

NOTES

1. Pedro da Motta Veiga, "Brasil: mudanças domésticas e agenda comercial. Fatores condicionante, percepção dos atores e estratégia de negociação." Paper presented while at CEPAL/UNCTAD, at FLASCO Buenos Aires in July 1998.
2. José Augusto Guilhon Albuquerque, "A nova geometria do poder mundial nas visões argentina e brasileira." Paper presented at the fifth Encounter of the Capítulos Argentino-Uruguaio e Brasileiro do Conselho de Empresarios da América Latina, held at CEAL July 30, 1999 in Buenos Aires.
3. Luiz Olavo Baptista, "Pautas viáveis para um desenvolvimento institucional do Mercosul." Paper presented at the Foro Sur Conference August 31, 1999 in Buenos Aires.
4. R. Mota Sandenberg, "Panorama estratégico brasileiro," *Parcerias estratégicas* 5 (September 1998).
5. *La Nación*, February 25, 2000.
6. Elvio Baldinelli, *Consideraciones acerca de la conveniencia de establecer una "zona de libre comercio entre la Argentina y Australia"* (Buenos Aires: Mimeo, 2000).

REFERENCES

- Baldinelli, Elvio. *Consideraciones acerca de la conveniencia de establecer una "zona de libre comercio" entre la Argentina y Australia*. Buenos Aires: Mimeo, 2000.
- Baptista, Luiz Olavo. "Pautas viáveis para um desenvolvimento institucional do Mercosul." Paper presented at the Foro Sur Conference August 31, 1999 in Buenos Aires.
- Blanco, Juan Carlos, Irusta Michelson, João Guillermo and Grandino Rodas. "Communication Decex No. 37 and Secex No. 7". Work presented by the Laudo Arbitral of the First Ad Hoc Tribunal, on 28 April, 1999 in Montevideo.

- Bouzas, Roberto. *La perspectivas del MERCOSUR: desafíos, escenarios, y alternativas para la próxima década*. FLACSO: NP, 1999.
- Cavagnari Filho, Geraldo Lesbat. *Estratégia e defesa (1960-1990), dos direitos humanos à política nuclear*. São Paulo: Mimeo, 1999.
- Cardoso, Fernando H. and Mario Soares. *O mundo em português, Um diálogo*. NP: Editora Paz e Terra S.A., 1998.
- da Motta Veiga, Pedro. "Brasil: mudanças domésticas e agenda comercial. Fatores condicionante, percepção dos atores e estratégia de negociação." Paper presented while at CEPAL/UNCTAD, at FLASCO Buenos Aires in July 1998.
- _____. *¿Por quién suenan las campanas?* Buenos Aires: Archivo del Presente, Fundación Foro del Sur, 1999.
- _____. "El futuro del MERCOSUR: se acerca la hora de las decisiones," *Carta Internacional* (São Paulo), II, no. 79 (September 1999): 4-5.
- _____. *Argentina y Brasil enfrentando el siglo XXI*. NP: ABRA/CARI and Ediciones Manantial, 1995.
- _____. MERCOSUR at the Crossroads: Agenda for the year 2000. Paper presented at America's Insight conference held at the Institute of the Americas, December 1999 in San Diego, California.
- Delgado, Ricardo R. *Una propuesta OMC-plus para los mecanismos de defensa comercial contra las prácticas desleales en el mercado ampliado*. Buenos Aires: Comisión Nacional de Comercio Exterior, 1999.
- Giordano, Paolo and Javier Santiso. *La course aux Amériques: les stratégies de investisseurs européens en Argentine et au Brésil*. Les Études du CERI no. 52, NP: Fondation Nationale des Sciences Politiques, 1999.
- González, Flavio Floreal. *Organos y procedimientos regionales contra las prácticas desleales de comercio. Análisis del MERCOSUR y la experiencia comparada*. NP: Comisión Nacional de Comercio Exterior, 1999.
- Guilhon Albuquerque, José Augusto. "A nova geometria do poder mundial nas visões argentina e brasileira." Paper presented at the fifth Encounter of the Capítulos Argentino-Uruguaio e Brasileiro do Conselho de Empresarios da América Latina, held at CEAL July 30, 1999 in Buenos Aires.
- Ikenberry, G. John. Globalization, "Regionalism, and the Future of the World Economy." Paper presented at the ISEN conference September 21, 1998 in Buenos Aires.
- IRELA. "Las perspectivas de un acuerdo de libre comercio UE-MERCOSUR y las opciones para la política de EEUU." Paper presented at a conference held November 1, 1999 in Madrid.
- _____. "Relaciones económicas entre el MERCOSUR y la UE: Perspectivas para la nueva década." Paper presented at a conference held November 22, 1999 in Madrid.
- Lampraia, Luiz Felipe. "A política Externa do Governo FHC: continuidade e renovação," *Revista brasileira de política internacional* (agosto 1999).

The Future of MERCOSUR: Argentina's Options

La Nación, February 25, 2000.

Lavagna, Roberto. "Agenda prioritaria de consolidación y profundización de la unión Aduanera." Paper presented at the Foro Sur Conference August 31, 1999 in Buenos Aires.

Magnoli, Demetrio. *O corpo da pátria, imaginação geográfica e política externa no Brasil (1808-1912)*. São Paulo: Editora da Universidade Estadual Paulista Moderna, 1997.

Mantilla, Enrique S. "El MERCOSUR en vísperas del año 2000," *Boletín Informativo Techint* 299 (July–September, 1999).

Mayoral, Alejandro E. "La política comercial intra-MERCOSUR," *Boletín Informativo Techint* 299 (July–September 1999).

Mota Sandenberg, R. "Panorama estratégico brasileiro," *Parcerias estratégicas* 5 (September 1998).

Peña, Félix. *El laudo arbitral sobre las salvaguardias textiles en el MERCOSUR*. Buenos Aires: Mimeo, 2000.

Pose, María Victoria. "La actual encrucijada del MERCOSUR. ¿Existen salidas para la crisis?" *Boletín Informativo Techint* 299 (July–September 1999).

Tussie, Diana. *Globalization and World Trade: From Multilateralism to Regionalism*. Oxford: Oxford University Press, 1999.

Relaunching or Restructuring MERCOSUR

BEATRIZ NOFAL

BACKGROUND

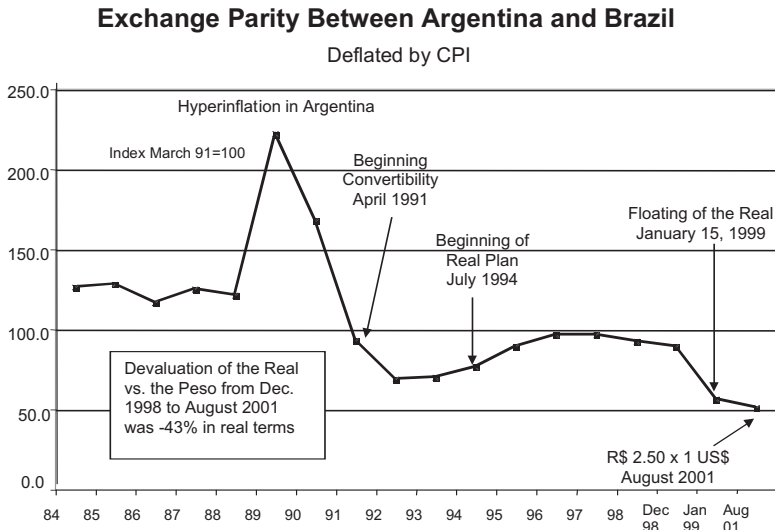
In 1999, following a decade of successful integration, MERCOSUR experienced – and overcame – its worse crisis ever. However, major challenges remain in terms of consolidating, broadening, and expanding its scope. Moreover, its future direction continues to be a subject of discussion.

On balance, MERCOSUR's results have been positive – politically, economically, and on an international level. It has contributed significantly to bolstering democracy and to increasing trade within the region and beyond, as well as to promoting direct foreign investment. At the same time, it has established itself as a major, credible, and successful player on the international scene.

MERCOSUR's performance since 1997, however, has been less than satisfactory, with no advance in consolidating the customs union and little progress in broadening integration. This culminated in the 1999 crisis, which was triggered by a combination of macroeconomic problems, devaluation and recessions in Brazil and Argentina. Brazil's devaluation of the real (R\$) in January 1999 (see Figure 1) brought about an abrupt change in relative prices, to the detriment of Brazil's MERCOSUR partners. In the case of Argentina, this exposed and magnified problems of competitiveness that had been present since 1997 – problems caused by the “superdollar,” the appreciation of the peso in the wake of the decision to link it to the dollar, and a decline in the prices of Argentina's principal export commodities. 1999 was also the first year, since the integration process began in 1986, in which MERCOSUR's two largest economies were simultaneously in recession, contributing to a decline in intra-regional trade and a proliferation of trade conflicts. In addition, MERCOSUR experienced administrative problems: the customs union process stalled in 1998 and took a step backward in 1999; there was little progress

in broadening integration; and none in achieving macroeconomic coordination. Moreover, instances of countries taking unilateral action in dealing with external affairs, without first consulting other MERCOSUR partners, created distrust within the bloc.

FIGURE 1: CPI DEFLATION



Although macroeconomic and political factors improved in 2000 – due primarily to the economic recovery and renewed growth in Brazil and the reduction of the peso-real exchange rate gap – there continue to be serious problems in negotiating and implementing the customs union. These problems have been aggravated by a new series of depreciations of the real during the current year, which led Argentina to adopt unilateral trade measures (changes in the common external tariff (CET) with a lowering of rates for capital goods and a rise in rates for consumer goods).

Consequently, there has been an increasing imbalance in the comparative benefits of integration, eroding the group’s internal cohesiveness and diminishing its credibility. Given this situation of stagnation and crisis, there are three possible options: (1) maintaining the status quo, which will mean a gradual dilution or liquidation of MERCOSUR; (2) consolidating and broadening integration in order to achieve a true common market; and (3) establishing a free trade area as an intermediate step toward creating a customs union.

The most desirable option is to move MERCOSUR in the direction originally envisioned; that of achieving trade with the rest of the world through integration and liberalization, followed by the negotiation of broader access to third party markets. Unless a comprehensive, near-term agreement is reached on broadening MERCOSUR, with the subsequent execution of the plan, it will most likely be necessary to consider the option of reshaping MERCOSUR into a free trade area, as an intermediate step toward establishing a customs union and a common market.

MERCOSUR: CUSTOMS UNION OR DE FACTO FREE TRADE AREA?

The concept of a customs union includes free trade between member states, as well as a common policy for trade with the rest of the world. The latter implies that customs unions would, in practice, function as a trade bloc vis-à-vis third parties – a fundamental difference with free trade areas such as NAFTA, in which each country adopts its own, independent external trade policy.

FIGURE 2: ELEMENTS OF REGIONAL INTEGRATION

Forms of Regional Integration	Free Movement of Goods and Services	Common Trade Policy	Free Movement of Factors of Production (Capital & Labor)	Common Currency
Free Trade Area	<i>MERCOSUR plus Chile and Bolivia</i> ■			
Customs Union	■	<i>MERCOSUR (Imperfect Customs Union)</i> ■		
Common Market	■	■	■	
Monetary Union (European Union)	■	■	■	■

Source: Prepared by the Author

Figure 2 shows a table that lays out in graphic form the major common and distinguishing elements of the main types of regional integration structures that exist in the international economy. A free trade area is a group of countries that eliminate tariffs and other trade barriers among themselves on a preferential basis, while each member country adopts its own trade policy in relation to countries outside the group. A customs union is a group of countries that preferentially eliminate trade barriers within the group, but share a common policy regarding trade with other countries, including a CET for imports from such countries. A common

market, in addition to the elements contained in a customs union, entails free movement of factors of production (capital and labor) and substantial harmonization of tax and other policies. The creation of a monetary union involves an even greater level of integration, including (in addition to elements of a common market) a common currency and a high degree of harmonization in monetary, exchange, and fiscal policies.

In this range of increasing levels of integration – from free trade area to customs union to common market to monetary union – each succeeding stage involves greater coordination and harmonization of economic policy, providing individual countries reduced freedom to set their own domestic policy.

The MERCOSUR customs union is imperfect and incomplete. Though intra-regional trade was liberalized substantially, reducing tariffs to zero, some sensitive products are still exempt from the free trade provisions (e.g., automobiles and sugar) and there are some temporary exceptions to the CET (including new unilateral tariff actions on the part of Argentina, Uruguay, and Paraguay) adopted primarily in response to the continued depreciation of the Brazilian real. Other imperfections include: non-tariff barriers; use of drawbacks and temporary admission for intra-zone sales; bureaucratic customs procedures for trade between partners that function as customs frontiers; and asymmetries in terms of indirect taxation and investment and export incentives.

In practice, for many goods, trade within MERCOSUR currently functions in the same way as in a free trade area with a CET. Thus, it operates differently from trade in even an imperfect customs union, given that imported goods do not circulate freely within MERCOSUR, with certificates of origin still required for many originating products containing imported contents, as is true in a free trade area where there is no common external tariff. This is due primarily to MERCOSUR's failure to consistently comply with the officially agreed upon CET, exemplified by extended use of temporary admission for trade within MERCOSUR (referred to in Brazil as a drawback regime) in force until 2006 pursuant to CMC Resolution N° 31/2000, and widespread use of special import regimes. Both of these factors are harmful to the CET, which is the core of the customs union. It should be noted that NAFTA, which is a free trade area, limits the use of these special customs instruments for intra-zone exports.

Moreover, the customs union option involves additional problems in the case of MERCOSUR, since there has been little progress in achieving macroeconomic coordination and in harmonizing conditions governing competition – including policies regarding investment and export incentives. Theoretically, sales and purchases made by member states in a customs union are treated as domestic trade; thus, there are no mechanisms to provide intra-regional protection against unfair competition, such as dumping or subsidies. By contrast, in free trade areas, sales and purchases between member states are treated as import/export operations; thus, the countries retain mechanisms that can be used to defend themselves against unfair competition (anti-dumping policies and countervailing duties). Similarly, a free trade area allows for autonomous export policies (including fiscal and customs measures) regarding sales to member states and third party countries, consistent with WTO standards.

Trade within MERCOSUR is treated as an import/export operation, but member states are only permitted to adopt anti-dumping mechanisms on a temporary basis, and the use of countervailing duties is prohibited. However, the increasing use of anti-dumping duties in response to problems related primarily to asymmetrical incentives and differing competitive conditions represents a highly unsatisfactory solution to the problem and creates its own difficulties and tensions. For MERCOSUR, the solution lies in the harmonization of policy, the establishment of collective disciplines regarding investment and export incentives, and a sound common policy to combat anti-competitive measures and actions.

ECONOMIC ADVANTAGES OF MERCOSUR: THEORY AND PRACTICE

In times of crisis, the validity and appropriateness of MERCOSUR's *raison d'être* are repeatedly questioned. The fundamental answer is that MERCOSUR represents the best strategic alliance, the best means of addressing existing challenges, and the best option for leveraging the opportunities created by globalization; a method of strengthening the region's growth potential within the framework of open regionalism.

The justification for MERCOSUR is based primarily on the following four factors:

1. Creating a single market offers potential productivity gains, due to economies of scale, specialization, and a market size

with the competitive ability to increase flows of trade, investment, and technology. MERCOSUR has a domestic market comparable in size to that of the four Asian Tigers and three times the size of the Eastern European market, while its size surpasses those markets in geographic area and population.

However, as Figure 3 illustrates, MERCOSUR’s export, import, and investment as a proportion of GDP – key indicators of economic growth – are less than in those markets.

FIGURE 3: COMPARISON: MERCOSUR, ASIAN TIGERS, EASTERN EUROPE

	4 Asian Tigers (1)	Eastern Europe (2)	MERCOSUR + Chile + Bolivia
Territory (in Km ²)	136,912	834,001	14,735,832
Population (in Millions of persons)	79.5	89.5	236.4
GDP (in US\$ Millions)	1,008,000	302,800	983,300
GDI/GDP	30.0%	25.9%	19.7%
Total Exports (in US\$ Millions)	550,286	91,738	92,931
Total Imports (in US\$ Millions)	509,452	92,752	97,719

(1) Hong Kong, Taiwan, Korea, and Singapore

(2) Hungary, Poland, Czech Republic, Romania, and Bulgaria

Source: Prepared by the author based on World Bank statistics

MERCOSUR is also in an excellent position to foster open capitalism, consolidate democracy, and promote structural reform (privatization, deregulation, and liberalization).

2. Negotiating as a bloc strengthens the group’s international bargaining power, and MERCOSUR, through this process, has become an important economic and political player on the international scene.
3. MERCOSUR is an attractive platform from which to develop a regional presence for both international and local businesses, with the opportunity to elevate local businesses to world-class players.
4. Macroeconomic coordination gives MERCOSUR countries an opportunity to differentiate themselves from other emerging countries. At the same time, it provides a means of dealing with the problem of international financial volatility and its consequences, while reducing the “contagion” effect in international financial crises – just as the Maastricht Treaty helped the

most vulnerable European economies neutralize or reduce the effect of external shocks from international financial crises, such as those that occurred in Russia and southeast Asia.

The first three factors above provided the economic basis for the decision by Argentina and Brazil to integrate in 1986 – a process with important political underpinnings, given the goal of stabilizing nascent democracies and putting an end to old rivalries and conflicts in the region.¹ The fourth reason for integration is sharply illuminated by the problems that resulted from the 1997 Asian crisis. Macroeconomic coordination not only gives MERCOSUR an opportunity to differentiate itself from other emerging countries, at the same time it provides a means of dealing with the problems of international financial crises, the “contagion” effect, and the volatility in international capital flows that caused serious harm to emerging economies – a situation that occurred in Brazil in the wake of the 1997 Asian crisis and in Argentina, following Russia’s foreign debt payment moratorium in 1998, as well as in other countries with strong macroeconomic fundamentals, such as Chile. Given MERCOSUR’s potential theoretical advantages, it is instructive to examine the extent to which these have been realized.

The first point, relating to the advantages of a single market, has not yet come into play, due to the flaws and incompleteness of the MERCOSUR customs union outlined above.

The second point, regarding external negotiations as a bloc, also raises questions. The beginning of MERCOSUR’s disintegration in conducting common external relations as a unified bloc can be traced to the stagnation that began in 1997. In 1998, Argentina began negotiating a preferential tariff agreement with Mexico. Brazil followed with negotiations with the Andean Pact and, more recently, Uruguay has established a similar arrangement with Mexico. Moreover, the possibility of negotiating a bilateral trade agreement with the United States has recently come under study in both Argentina and Uruguay. This would mean a virtual end to the MERCOSUR customs union. In practice, bloc negotiations have occurred only in dealings with the FTAA and the European Union, with no such negotiation taking place in the case of the WTO. Thus, MERCOSUR continues to lack a sound, credible, and predictable common external trade policy. Nevertheless, at the Asunción Summit in June 2001, there was progress in efforts to reshape the CET and redefine common

negotiating platforms with regard to the WTO, ALADI, the United States (the 4-plus-1 format established in the 1991 Rose Garden Agreement), the FTAA, and the EU. These advances helped to reestablish a sense of collective resolve in conducting negotiations as a bloc.

The third point, regarding opportunities for regionalization involving establishing businesses in partner countries, involves significant asymmetries. For instance, Brazilian firms can establish locations in Argentina without major difficulties, while Argentine firms seeking to locate in Brazil encounter significant bureaucratic obstacles. The same asymmetries exist in the case of competitive bidding, with Brazil's government procurement market being less open than that in the other member states.

In regard to the last point, macroeconomic coordination, clear progress was achieved at Florianópolis in 2000, with agreement on a macroeconomic convergence program containing quantitative targets for limiting inflation, fiscal deficits, and public debt. This agreement was incorporated in the declaration issued by the presidents of the member states. The agreement, however, is not binding. A positive next step would be to adopt the agreement as a CMC decision, which could then be sent to the parliaments of the individual countries for ratification, as was done in the case of the EU with the Maastricht Treaty. Passing national legislation in each country would give the macroeconomic agreement increased force and credibility. Consideration should also be given to establishing some coordination mechanism to provide greater predictability to the peso-real exchange rate and to prevent abrupt exchange-rate changes between partners, such as those that arose from the devaluation of the real in January 1999.

In summary, there is, at present, a significant gap between the underlying economic rationale on which MERCOSUR was formed and the implementation of corresponding policies. This gap explains, in part, the eroding confidence – particularly on the part of the bloc's smaller members – in the idea that integration provides mutual benefits.

MERCOSUR'S PERFORMANCE IN TRADE AND INVESTMENT DURING THE 1990s

During the 1990s (up until 1997-98), MERCOSUR was largely responsible for the growth in trade and investment in the region. Expansion of the regional market acted in synergy with other factors, such as democratic consolidation, increased stability, trade liberalization, deregulation, and

privatization – all of which contributed to growth and stimulated trade and investment during the decade.

Intra- and Extra-MERCOSUR Trade

Intra-regional trade grew 340%, from US\$4.2 billion in 1990 to US\$18.5 billion in 2000 – a remarkable feat that was accomplished while simultaneously increasing trade with the rest of the world.

As Figure 4 shows, imports from other countries account for 83% of MERCOSUR’s total trade growth during the decade, while intra-regional exports account for only 17%. This is clearly a case of open regionalism and indicates that MERCOSUR has not experienced significant trade diversion.

FIGURE 4: IMPORTS WITHIN/OUTSIDE OF MERCOSUR

Imports	US\$ millions			2000 / 1990		
	1990	1994	2000	% Change	Change US\$	Share Growth
Within MERCOSUR	4,241	12,036	17,601	315%	13,360	23%
Outside MERCOSUR	25,060	50,763	68,738	174%	43,678	77%
TOTAL	29,301	62,799	86,339	195%	57,038	100%

Source: Prepared based on information from the National Institutes of Statistics of Argentina, Brazil, Paraguay, and Uruguay.

FIGURE 5: INTRAZONE IMPORTS/TOTAL IMPORT

Intrazone Imports/Total Imports

	1995	1996	1997	1998	1999
	%				
European Union	56.3%	56.1%	55.0%	55.0%	59.1%
NAFTA	37.7%	39.2%	39.9%	40.3%	40.5%
MERCOSUR	18.1%	20.2%	20.6%	21.2%	19.1%

Intrazone Exports/Total Exports

	1995	1996	1997	1998	1999
	%				
European Union	56.9%	56.3%	56.0%	56.4%	61.6%
NAFTA	46.3%	47.5%	49.1%	51.7%	54.7%
MERCOSUR	20.5%	22.8%	24.7%	25.0%	20.3%

Source: Prepared based on U.N. Statistics

With regard to exports, an intra-regional concentration in growth is evident. This reflects the need to establish joint efforts to provide greater diversity in export markets and make MERCOSUR a platform for exports to third party markets – one of the basic pillars of integration.

It should be noted, however, that the intra-regional trade concentration is less marked than in the case of other trade blocs, such as the EU and NAFTA, as you can see in Figure 5.

Foreign Direct Investment in MERCOSUR

FDI in MERCOSUR increased 1,039% between 1990 and 1998, representing 61% of the total FDI flows to Latin America and 22% of total FDI received by developing countries in 1998. Figure 6 indicates a major increase in MERCOSUR’s share of FDI flows to emerging markets. Between 1990 and 1998, MERCOSUR’s share in flows to Latin America nearly doubled, and it tripled in terms of its share of flows to developing countries.

FIGURE 6: FDI IN MERCOSUR NATIONS

	<i>US\$ Millions</i>					
	1990	1995	1996	1997	1998	1990-98
Argentina	1,836	4,783	5,090	6,327	6,000	227%
Brazil	901	5,043	11,112	16,330	25,115	2798%
Paraguay	76	184	225	200	245	222%
Uruguay	42	157	169	200	155	269%
(I) MERCOSUR	2,855	10,167	16,596	23,057	32,515	1039%
(II) Latin America	8,989	31,929	43,755	56,138	53,000	490%
(III) Developing Countries	34,889	105,511	129,813	148,948	145,000	316%
(I) / (II)	31.8%	31.8%	37.9%	41.1%	61.3%	
(I) / (III)	8.2%	9.6%	12.8%	15.5%	22.4%	

Source: Prepared by the author using United Nations statistics

Strength of Trade and Investment in the First Decade of the New Millennium

Can MERCOSUR be as dynamic a force for investment in the first decade of 2000 as it was in the 1990s? Can Brazil’s growth in 2001 serve

as the engine for increasing MERCOSUR exports, as it was during the Real Plan period of 1995-97?

Unless MERCOSUR shows clear progress in consolidating and broadening the customs union; establishes clear rules to combat anti-competitive practices; initiates a binding program for macroeconomic coordination; and moderates the risks posed by devaluation, foreign and local investors will have little incentive to invest in an expanded market, and MERCOSUR will have little chance of playing the dynamic role it played during the 1990s in stimulating investment.

Moreover, because of the uncertainty of access to the Brazilian market, the existence of non-tariff barriers, the periodic devaluations of the real since January 1999, and the comparative size of the country, there has been a trend toward increased investment in Brazil – leaving smaller MERCOSUR countries a less attractive focus of investment.

In regard to expanded trade activity, it should also be noted that the pattern of growth in Brazil during 2000-2001 might not be on a par with growth during the 1994-98 period, when the Real Plan was in force. This could result in a change in Brazil's demand for imports, thus affecting exports from other, smaller countries. The Real Plan produced a rise in the exchange rate, increases in real wages, and greater demand for consumer goods (such as food), consumer durables, and automobiles. Argentina's exports to Brazil during the Real Plan period increased in those goods – categories in which Argentina is in a comparatively strong competitive position. One hypothesis is that Brazil's growth during the next few years will be based on increased investment in specific sectors (e.g., telecommunications and other private enterprise sectors), which would stimulate demand for more complex intermediate and capital goods – areas in which Argentina is a relatively weak competitor. Thus, one could conjecture that Brazil's current growth profile will have a lesser effect on exports and production in Argentina, Uruguay, and Paraguay than was true during the Real Plan period. It should be noted, however, that Brazil's economic activity, at least during 2001, can be expected to slow down due to a marked shortage of electrical energy, a rise in domestic interest rates (along with a significant depreciation of the real), and the effects of the current year's financial crisis in Argentina.

In short, the strength of investment in MERCOSUR could continue to weaken for two reasons: first, problems in the functioning of MERCO-

SUR; and second, a change in the recent growth pattern in Brazil, the bloc's largest and most influential economy.

RELAUNCHING MERCOSUR: THE BEST OPTION AVAILABLE

Though 2000 saw some progress on negotiations to broaden MERCOSUR – in the area of greater macroeconomic coordination and cooperation and definition of a common automotive policy – the continuing devaluation of the real, divergent views on the desirability of accelerating integration with the FTAA (or, possibly, with the United States), and the financial crisis in Argentina led to a reemergence of new tensions. Above all, serious problems in administering and implementing the system, the lack of adequate measures to harmonize policy and rectify asymmetries, and a weak institutional structure continue to pose major obstacles.

In order to solidify and broaden MERCOSUR, a comprehensive relaunching program is needed.² Such a program must be based on the four pillars set forth below. Efforts to strengthen these four essentials must be pursued before concluding preferential free-trade agreements with either the FTAA or the EU.

PILLAR 1: SINGLE MARKET PROGRAM WITH FAIR COMPETITION, ELIMINATING BARRIERS AND DISTORTIONS IN FREE INTRA-ZONE TRADE, AND MAINTAINING OPEN REGIONALISM.

Achieving the first pillar involves guaranteeing free intra-zone trade with no non-tariff barriers and no use of financial and fiscal incentives to intra-zone exports, combined with compliance with the CET, elimination of tariff rollback regimes and of drawbacks, and temporary admission for intra-zone sales.

Market Access

Non-tariff barriers that negatively affect free intra-zone trade must be eliminated, and the first ruling of the Dispute Resolution Tribunal (April 1999) must be implemented. This ruling mandated that all non-tariff barriers in intra-zone trade be eliminated by the year 2000, since they are inconsistent with the provisions of the Asunción Treaty. Specifically, the ruling listed the non-tariff barriers that Brazil was to

eliminate, enumerated in the 1998 resolutions DECEX 37 and SECEX 7.

Instead of compliance, a step backwards was made with resolution CMC 22/00, which once again mandates that lists of non-tariff measures and restrictions be prepared, with a subsequent schedule for their elimination and harmonization. The same mandate has been made regularly since 1995, without its ever having been implemented.

Progress in the Customs Union

Resolution CMC 31/2000, which allows drawbacks and temporary admission until January 2006 in intra-zone sales – reversing the provisions of CMC 10/1994 – represents a further setback.³ As MERCOSUR's Joint Parliamentary Commission suggested, the use of drawbacks and temporary admission in intra-zone sales until January 2006: (a) discourages the incorporation of local value added (weakening chains of production); (b) facilitates triangulation; and (c) represents unfair competition for producers focused on the domestic market, whose prices incorporate tariff costs.⁴ Thus, strict and complex controls are needed to enforce rules of origin. This in turn implies that, in practice, the CET is nonexistent, impeding further progress on the customs union.

In contrast, NAFTA, which is also a free trade agreement, limits temporary admission and drawbacks in intra-zone trade. This is primarily the result of the fact that the United States did not want Mexico to import southeast Asian products tariff-free, process them with cheap labor, and sell them in its domestic markets as Mexican products with preferential treatment.

Discipline and Harmonization on Investment Incentives

In order to achieve a higher degree of collective discipline on investment incentives in the short term, an agreement needs to be negotiated between Argentina and Brazil stipulating that subsidized investments that violate WTO provisions on subsidies and countervailing duties shall be subject to countervailing duties within MERCOSUR. In the medium term, regional development policy and incentives need to be harmonized.⁵ This multilateral agreement on subsidies and countervailing duties, signed in the framework of the WTO, provides an excellent guide for agreeing upon a collective discipline within MERCOSUR, governing

actions by member states (and by their states or provinces) regarding regional development incentives.

PILLAR 2: BINDING PROGRAM FOR MACROECONOMIC COORDINATION AND CONVERGENCE

In 1991, Article I of the Asunción Treaty defined as one of its objectives “the coordination of macroeconomic and sectoral policy among member states regarding: external trade, agriculture, industry, fiscal affairs, monetary policy, currency exchange and capital, services, customs, transportation, and communication, and other policies that may be agreed upon, in order to ensure proper competitive conditions among the member states.”

Only recently, in June 2000, through Resolution CMC 30/2000 – after suffering the abrupt devaluation of the real in January 1999 – were preliminary guidelines for macroeconomic coordination within MERCOSUR set forth. This came nine years after the Asunción Treaty and five years after the creation of the customs union. The resolution called for:

- Development of harmonized statistics based on a common methodology, to cover fiscal performance and public debt.
- Regular publication of fiscal indicators, beginning in September 2000.
- Establishment, in March 2001, of fiscal goals, public debt targets, jointly agreed prices and the corresponding process for achieving convergence.
- Formation of a high-level Macroeconomic Monitoring Group (GMM).

Subsequently, in December 2000, during the Florianópolis (Brazil) summit, progress was achieved in formulating an agreement on macroeconomic coordination with quantitative goals. This agreement was incorporated in the declaration issued by the presidents at the conclusion of the summit. The following macroeconomic convergence goals were set for MERCOSUR, Chile, and Bolivia:

1. Fiscal deficit not to exceed 3% of GDP (providing a transition period for Brazil lasting until 2002–2003, with a maximum figure of 3.5%).
2. Public debt not to exceed 40% of GDP, beginning in 2010.
3. Inflation not to exceed 5% for the 2002–2005 period, and 4% from 2006 forward.

Relaunching or Restructuring MERCOSUR

Comparing these mandates with the Maastricht convergence guidelines, it can be seen that while the inflation and fiscal deficit figures are comparable to the EU figures, MERCOSUR's criteria for public debt are more demanding (as demonstrated in Figure 7). This is due primarily to the restrictions on external borrowing and on the high interest rates within MERCOSUR countries, compared to those in EU countries.

FIGURE 7: INFLATION, PUBLIC DEFICIT, AND PUBLIC DEBT

	1999		
	Inflation	Fiscal Deficit/ GDP	Public Debt/ GDP**
Argentina	-1.8%	3.8%	43.1%
Brazil	9.1%	5.6%	68.1%
Paraguay	5.4%	2.5%	41.4%
Uruguay	4.2%	3.0%	40.1%
MERCOSUR	5% (2002/5) / 4%	3.0%	40.0%
Maastricht	+1.5 (of 3 EU*)	3.0%	60.0%

* The 3 countries with the best inflationary performance

** Indicates gross public debt (domestic + external)

Maastricht goes beyond coordinating macroeconomic variables, with common currency as its ultimate objective – a goal that, while desirable for MERCOSUR, is not feasible in the short, or perhaps even the medium term. First, MERCOSUR does not yet have the conditions needed to create an optimal unified currency area, since the markets for products and factors of production (capital and labor) are not sufficiently integrated (not surprising given that the scale of intra-MERCOSUR trade is still relatively small).⁶ In 2000 for example, Argentina and Brazil exported only 3% and 1.34% of their GDP respectively to MERCOSUR countries. Other elements, such as similarity of economic structure, fiscal federalism, and the credibility of the central bank of one of the principal economies are also lacking. Second, any accord on a common currency for MERCOSUR must be preceded by a process of debate, agreement, and decision-making regarding consolidation and broadening of the system. Both are prerequisites to establishing broad economic integration, which, in turn, is a necessary first step toward addressing the question of a common currency. Once greater economic integration has been achieved

with uniform terms of trade and free movement of factors of production (capital and labor), – the region will be in a position to create a common currency. This does not preclude efforts on exchange-rate coordination, which would restore predictability in the peso-real exchange rate, providing for a restricted range of variation in currency values.

MERCOSUR still needs to enhance its macroeconomic coordination. The agreement referred to above, incorporated in the declaration of the presidents of the member states, needs to be formalized as a Common Market Council resolution, followed by consideration by the respective parliaments of the various member states. If the bloc decides to move toward broad integration, the parliaments must play a more active role than they have thus far played. The Maastricht Treaty, for example, was considered and approved by each of the parliaments of the European member countries. One of the decisive factors in establishing the credibility of the macroeconomic coordination agreement is the participation of Chile – this despite the fact Chile had already initiated bilateral trade negotiations for a free trade area with the United States. Chile's international macroeconomic reputation will be a major force in ensuring the implementation of the agreement.

PILLAR 3: INSTITUTIONAL STRENGTHENING PROGRAM: CREATION OF A PERMANENT DISPUTE RESOLUTION TRIBUNAL

It is necessary for MERCOSUR to move from the current, ad hoc arbitration tribunal to a permanent forum. There are four reasons for this, namely:

1. To ensure compliance with agreements.
2. To provide a legal means of resolving trade disputes regarding established rules.
3. To establish a separation between trade conflicts and negotiations on policy, in order to provide greater focus on establishing a single market.
4. To discourage violations, since non-complying governments will risk damage to their reputations.

MERCOSUR's institutional structures for dispute resolution must be strengthened. Brazil has expressed reservations concerning the advisability of having a permanent dispute resolution tribunal, though it is reported to be considering granting judges permanent status. Its argument is that, due

to insufficiently clear standards and rules, judges must render their decisions based on imprecise or insufficiently broad standards. This argument is only partially valid, since clear, simple, fundamental rules (such as those regarding free trade in goods among the parties with no tariff or non-tariff barriers) are in place but are simply not being enforced. The examples of the European Union and NAFTA clearly demonstrate the importance of having dependable, permanent arbitration institutions to resolve disputes.

It would also be desirable to establish an administrative entity (e.g. an executive body) to oversee the new realities of an expanded regional market.

PILLAR 4: STRENGTHENING OF MERCOSUR'S EXTERNAL POLICY AND IMPORTANCE OF MULTILATERAL NEGOTIATIONS

One of MERCOSUR's principal challenges is to strengthen external trade relations with the world's other countries and groups of countries, particularly with Latin America, the FTAA, and the European Union. Negotiations concerning preferential trade arrangements need to complement multilateral negotiations and must be consistent with WTO (World Trade Organization) agreements.

MERCOSUR's external negotiations and actions have been in four areas:

- Renegotiation of pre-existing preferential agreements with the other ALADI countries. The initial objective was to extend a free trade agreement to all of South America within approximately 10 to 15 years.⁷ This was to take the form of negotiating free trade agreements – first with Chile (1996) and Bolivia (1997), followed by agreements with the rest of South America, including the Andean Pact. Finally, in 2000, agreement was reached on beginning negotiations between MERCOSUR and Mexico – negotiations that were initially postponed due to the fact that Mexico was a NAFTA member with trade partners outside of ALADI.
- Participation in the activities of the “Program of Action,” established at the December 1994 Miami Summit, to create a hemispheric free trade zone by 2005 (FTAA). At the most recent FTAA meeting in Quebec, a draft agreement was presented, though many points remain bracketed pending agreement.

- Enhanced relations and cooperation with the European Union, beginning with the Framework Agreement on Inter-regional Economic and Political Cooperation, signed in 1995. This agreement is designed to serve as the basis for future negotiations on a free trade area. In July 2001, there was a proposal by the EU to negotiate with MERCOSUR regarding products, to which MERCOSUR was expected to present its counter-proposal in October or November.
- Multilateral negotiations. This includes MERCOSUR's presentation to the WTO, in the framework of Article XXIV of GATT, and the setting of an agenda encompassing common positions on key issues involving the multilateral trade regime (liberalization of agricultural trade, liberalization of the service sector and government procurement, etc.). There was no clear progress, however, in MERCOSUR's negotiations for the Millennium Round in Seattle. If it is able to arrive at a unified position for the fourth ministerial conference of the WTO, to be held in Qatar in November 2001, it will provide MERCOSUR a new opportunity to act as a bloc. Such a position must be based on a common vision and strategy regarding the initiation of a new multilateral round.

In addition to these four main lines of external negotiation, MERCOSUR agreed to sign a free trade area agreement with South Africa, and it maintains ongoing contact with other world regions (Asia/Pacific) and with other countries (e.g., Japan, Australia, New Zealand, and China).

In external negotiations, the priority given to multilateral issues should be at least equal to that given to preferential trade negotiations with the FTAA or the EU. In this way – rather than, as many believe, through preferential negotiations with countries or groups of countries – balance can be achieved in advancing international negotiations, with initial efforts toward establishing effective and comprehensive solutions to restrictions on agricultural and agrifood trade and to export subsidies in these sectors – subsidies in place mostly in the European Union and the United States. One prerequisite (though not the only one) is that MERCOSUR negotiate as a bloc with the WTO, and that it establish strategic alliances with other emerging countries, such as China and India, or with economies that are similarly affected, such as Australia and New Zealand.

Relaunching or Restructuring MERCOSUR

To date, the WTO (and its predecessor, GATT) has been an arena in which the rules of the game for international trade were set primarily by the United States and Europe. The fourth ministerial conference of the WTO, to be held in Qatar, November 2001 – and the possibility of a new round of multilateral trade negotiations – offers an opportunity for more balanced international negotiation, with the possibility of finding effective solutions for liberalizing trade in agriculture, agribusiness and light industry, as has increasingly been demanded by the emerging economies. In addition to initiating a new round of negotiations, there must be a rebalancing of the multilateral trade system. This includes an emphasis on important aspects of development, such as increasing job opportunities and improving standards of living in member states, through effective liberalization of trade in goods and services and elimination of non-tariff barriers and subsidies in the agricultural, food, textile, and clothing sectors. Moreover, special and differential treatment must be provided for less developed countries that produce and export agricultural and agroindustrial goods – countries hurt by the interminable transition process of liberalizing trade in these sectors. Increased technical and financial assistance must also be provided to developing countries, in order to improve their trade-related institutional structures and enhance their export platforms, thus giving them access to the benefits of trade liberalization.

Finally, it should be noted that while Chile's decision to begin bilateral negotiations with the United States postpones its full entry in MERCOSUR, it does not preclude it. From an economic point of view, this delay gives MERCOSUR time to achieve greater productive competitiveness, lower its CET, and in time, achieve greater convergence with Chile by reducing tariffs (a result difficult to achieve in the current circumstances). By pursuing its current direction, however, the integration process should produce conditions conducive to this result.

FTAA AND MERCOSUR

The administration of President George W. Bush and the Quebec meeting in April 2001 have given the FTAA new momentum. Some within MERCOSUR continue to argue – based on a conceptual fallacy and a lack of historical knowledge – that incorporation in the FTAA is incompatible with the continued existence of MERCOSUR.

Conceptually, both MERCOSUR and FTAA are integration projects involving preferential trade liberalization. As such, they entail geographic discrimination, given that tariffs are applied against countries outside the area. Thus, MERCOSUR, on the one hand, and the preferential trade liberalization envisaged in the FTAA and with the European Union and other regions on the other, are complementary and not mutually exclusive – a characteristic that will increase over time.

In addition, despite an element of complementarity, there are significant historical differences between MERCOSUR and the FTAA, as well as differences in the respective integration models on which they are based. In respect to economy, trade, legislation, policy, and geography, MERCOSUR is already a reality, while the FTAA is at present only a plan. MERCOSUR is designed to create a single market – a design that reflects a broad integration model – while the objective of the FTAA is to create a preferential free trade area.

Even in 1950, there was concern that the effects of a preferential free trade area would be different from those resulting from non-discriminatory trade liberalization – whether adopted unilaterally (by one country) or multilaterally (as in GATT or the WTO).⁸ The theory developed by Jacob Viner at that time was limited to an examination of statistical effects, formulating criteria to evaluate (a) whether a preferential free trade area would result in creating or diverting trade and (b) whether it would increase or reduce well-being. Thus, it did not take account of the dynamic effects of preferential regional integration – effects such as the benefits of economies of scale and specialization. The resurgence of a new global wave of regionalism since the late 1980s, along with the U.S. adoption of regionalism as an operational policy (first with the Canada-U.S. agreement, then with NAFTA, and now with the FTAA), has given renewed stimulus to the academic debate begun in the 1950s.

In a partial equilibrium econometric model, I have measured the possible impact of the FTAA on the food sector.⁹ I have modeled lowered tariffs, consequent price reductions, and the resulting elasticities of import demand and export supply, in addition to creation and diversion of trade resulting from the tariff reduction process. In all cases, the analysis was conducted for individual products, as well as for the sector as a whole. Research regarding changes in trade flows within the food sector in Argentina resulting from preferential tariff reductions in the FTAA indicates that the static

benefits of generating trade would likely be modest, or even negative, for Argentina, due to a predominant diversion of trade. Moreover, the analysis of preferential tariff reduction indicates that despite Argentina's relatively strong competitive advantages in the food sector, there would be a significant increase in imports from the United States, with reduced exports (aggravated by the drop in exports to Brazil, due to the displacement or partial replacement of Argentine exports by exports from the U.S.).

Jagdish Bhagwati and Arvind Panagariya, clearly supporters of global free trade, warn, on a theoretical basis, of the possible static loss of well-being that could occur in non-hegemonic countries when liberalizing their trade, on a preferential basis, with a hegemonic and, in general, more open country that can reduce barriers far more than can non-hegemonic countries with high tariff barriers. The theory developed by Bhagwati and Panagariya suggests that the level of disadvantageous redistributive effects on the income of a non-hegemonic member country depends on the degree of preferential access it grants, compared to the preferential access it receives in return. Bhagwati and Panagariya, and Robert Mundell as well, indicate that the greater the preferential tariff reduction, the greater will be the improvement in the terms of trade for the member country benefiting from such reduction.¹⁰

The question one must consider regarding potential preferential free trade between MERCOSUR and the FTAA or the EU is: to what extent do the improvements in the terms of trade – for the country benefiting from the greatest preferential tariff reduction (i.e., the United States or the EU, since MERCOSUR has higher tariffs) – function as an absolute trade advantage, as opposed to a situation in which the relative comparative advantages would hold sway.

Nevertheless, these questions raised by scholars do not take into account potential dynamic benefits: economies of scale, specialization, increased direct investment, and technological, organizational, and managerial changes in businesses. These positive effects have not yet been evaluated in the complex econometric models developed to quantify the impact of NAFTA.

The dynamic effects cited can be seen in the EU and in the Canada-U.S. integration process – two cases of broad economic integration involving trade in goods and services and the movement of factors of production in economies that are geographically proximate. Moreover, the level of reciprocal preferential access granted is relatively low, given that these are open economies with low tariffs.

It would therefore be unrealistic to attribute to the FTAA – a preferential trade integration plan in which the less developed countries receive higher trade preferences – the same dynamic benefits as would be the case with a broad economic integration scheme involving more open economies. Moreover, geographic proximity is a key distinguishing factor in the costs and benefits of free trade agreements, due to the unique advantages of localization. Geographic proximity is fundamental in guaranteeing the dynamic benefits of broad integration – benefits associated with foreign direct investment and with productivity gains derived from economies of scale and specialization.

Thus, the FTAA or, potentially, the negotiation of a free trade area with the EU, should be more than a preferential tariff agreement, and should eliminate non-tariff barriers and subsidies (including barriers in the agricultural and agroindustrial sectors among others) and ensure liberalization of the government procurement market at both the federal and state levels. In the context of complete transparency and good faith, preferential negotiations with the U.S. in the FTAA and with the EU should ensure the elimination of subsidies and of tariff and non-tariff barriers in the agricultural and agroindustrial sectors – in order to achieve an agreement advantageous and equitable to all parties (prerequisites to a lasting agreement), thus avoiding endless trade disputes in the future.

In terms of the dynamic benefits associated with investment, economies of scale, and specialization, it will be necessary to establish a program to develop infrastructure connecting the member states. Based on the EU's experiences with regional integration, such an infrastructure development program, which is not yet part of the agenda for hemispheric integration, would be highly desirable.

Finally, the success of the FTAA will be measured by the extent to which it creates a convergence in per capita income and narrows the development gap between the different countries of the region. Only if the less developed countries are provided increased opportunity to enjoy the dynamic benefits of integration will this be possible.

CONCLUSION: THE BROADENING AND CREDIBILITY OF MERCOSUR

The region suffers from a lack of international confidence and credibility due to questions about fiscal solvency and competitiveness. In order to overcome these problems, improvements in the domestic policy environ-

ment must be achieved, and methods for enhancing confidence and credibility must be found at the regional level.

As an urgent priority, MERCOSUR needs to implement a program to create a single market open to the entire world and make the convergence and macroeconomic coordination agreement binding – including exchange coordination guidelines. In the medium and long term, MERCOSUR must take further steps to liberalize its government procurement and service markets, implement an infrastructure development program, harmonize investment incentives, design common programs for cooperation in science and technology, and strengthen the alliance in regard to international policy.

In order to become more competitive, MERCOSUR must be broadened, giving domestic and foreign investors confidence and increasing credibility, while lowering the cost of capital and improving real income and standards of living for people in the member states. This means moving forward with greater speed and replacing mere words with action. MERCOSUR faces the risk of impasse: unless it achieves greater consensus on a program – one that can be implemented in the short term – to consolidate, complete and broaden the integration process, it risks moving backward, thus weakening and diluting MERCOSUR, either informally (by maintaining the status quo) or formally (by opting to reshape it in the form of a free trade area). In order to overcome this impasse, Brazil (MERCOSUR's principal member) must take a leadership role in establishing a shared vision and a sense of unity in making policy decisions.

NOTES

1. The author, as Undersecretary of Industry and External Trade, was one of the principal negotiators for Argentine-Brazilian integration, which was negotiated from 1986 to 1988.

2. At the Buenos Aires Summit of June 2000, guidelines were set for the relaunching of MERCOSUR. These were augmented slightly at the Florianópolis Summit in December 2000.

3. CMC 10/1994 defines export incentives to be provided by member states, setting clear limits on financial, fiscal and customs incentives for intra-zone exports. It thus establishes a clear distinction for treatment of extrazone exports, with incentives permitted provided that they are compatible with WTO (for-

merly GATT) standards. Thus, intra-zone trade does not permit (1) financial incentives, other than “long-term financing for capital goods;” (2) fiscal incentives, except for “reimbursement of indirect taxes,” and only “until regional tax harmonization is achieved;” (3) customs incentives, such as “drawbacks and all forms of temporary admission,” except for “products included in the lists of exceptions to the CET.”

4. CPC Recommendation N° 20/00. This recommendation was made at the insistence of the author in her capacity as National Deputy and member of MERCOSUR’s Joint Parliamentary Commission.

5. In July 2000, the author introduced a bill in Argentina’s Chamber of Deputies, entitled “Promotion of Regional Development.” This could serve as a tool for harmonizing this type of policy within MERCOSUR. The subject of harmonization of investment incentives and regional development policy is dealt with in greater detail in Beatriz Nofal, “Las grandes asignaturas pendientes en el Mercosur,” *Boletín Informativo Technit* 292 (October/December 1997): 73-87.

6. Beatriz Nofal, “Moneda común en el Mercosur: Propuesta aconsejable, factible o distracción?,” *Mercosur Journal* 10 (March 1998).

7. Though MERCOSUR initially signed agreements with Chile and Bolivia based on the 4+1 formula, each member state took unilateral steps on various foreign fronts, beginning in 1998. Given the conflicts that this created, and the holes in the CET, the CMC, at the June 2000 summit, through resolutions CMC 32, 36 and 37, set the following guidelines: 1. Beginning June 30, 2001, MERCOSUR members will be prohibited from signing new unilateral external agreements; 2. Prior to December 31, 2000, members are to renegotiate each country’s tariff bindings with the WTO, based on the CE.; 3. MERCOSUR-CAN negotiations and negotiations with Mexico will be restarted with the goal of arriving at 4+4 and 4+1 agreements before December 31, 2001; 4. If no agreement is reached, member state 1+1 agreements may not continue in force beyond June 2003.

8. Jacob Viner, *The Customs Union Issue*. (New York: Carnegie Endowment for International Peace, 1950).

9. Beatriz Nofal, Análisis cuantitativo y cualitativo del impacto del ALCA en el sector de los alimentos, Paper presented at the 34th annual meeting of the Asociación Argentina de Economía Política in Rosario, Argentina in 1999. (<http://www.aaep.org.ar>).

10. Jagdish Bhagwati and Arvind Panagariya, “Preferential Trading Areas and Multilateralism: Strangers, Friends or Foes,” Paper presented at a conference on international trade and MERCOSUR at the Universidad Torcuato Di Tella, Buenos Aires, Argentina in 1997. Robert Mundell, “Tariff Preferences and the Terms of Trade,” *Manchester School of Economic and Social Studies*, Volume? (1964): 1-13.

REFERENCES

- Balassa, Bela. "Revealed Comparative Advantage Revisited: an Analysis of relative Export Shares of the Industrial Countries, 1953-1971," *Manchester School of Economic and Social Studies* 45 (1977): 327-34.
- _____. "Trade Liberation and Revealed Comparative Advantage," *Manchester School of Economic and Social Studies* 33 (1965): 99-124.
- Bhagwati, Jagdish and Arvind Panagariya. "Preferential Trading, Areas, and Multilateralism: Strangers, Friends or Foes?" Paper presented at the conference, Trade and Mercosur: Emerging Issues conference at the Universidad Torcuato Di Tella, Argentina in 1997.
- Erzan, Refik and Alexander Yeats. "U.S. Latin America Free Trade Areas: Some Empirical Evidence" in *The Premise and the Promise: Free Trade in the Americas*, edited by Sylvia Saborio. Washington, D.C.: Overseas Development Council, 1992.
- Krugman, Paul and Maurice Obstfeld. *Economía Internacional: Teoría y Política*, Third Edition. Madrid: Mc Graw Hill/Interamericana de España, 1995.
- Krugman, Paul. *Geografía y Comercio*. Barcelona: Antoni Bosch Ed., 1992 .
- Mundell, Robert A. "Tariff Preferences and the Terms of Trade," *Manchester School of Economic and Social Studies* 32:1 (January 1964): 1-13.
- Nofal, Beatriz. "El Mercosur se encuentra entre dos posiciones: replanteo o relanzamiento," *La Nación*, June 17 2001.
- _____. "Conflictos, dilemas y oportunidades en la política comercial," in *El futuro de MERCOSUR: entre la retórica y el realismo*, edited by Felipe de la Balze. Buenos Aires: Consejo Argentino para las Relaciones Internacionales, 2000.
- _____. "Análisis cuantitativo y cualitativo del impacto del ALCA en el sector de los alimentos." Paper presented at the 34th annual conference of the Asociación Argentina de Economía Política in Rosario, Argentina in 1999. (<http://www.aaep.org.ar>).
- _____. "Obstáculos institucionales y económicos para la consolidación y profundización del Mercosur: Propuestas," *Boletín Informativo Techint* 294 (April-June 1998): 43-44.
- _____. "Moneda común en el Mercosur: Propuesta aconsejable, factible o distracción?," *Mercosur Journal* 10 (1998).
- _____. "Las grandes asignaturas pendientes del Mercosur" *Boletín Informativo Techint* 292 (October/December 1997):73-87.
- _____. "Ventajas, desempeño y perspectivas del Mercosur," *Mercosur Journal*, II, no. 7 (February-April 1997): 20-22.
- Viner, Jacob. *The Customs Union Issue*. New York: Carnegie Endowment for International Peace, 1950.
- Yeats, Alexander J. *Does Mercosur's Trade Performance Justify Concerns About the Effects of Regional Trade Arrangements?* Washington, DC: The World Bank, 1997.

CONTRIBUTORS

JOSÉ BOTAFOGO GONÇALVES is the Brazilian ambassador to Argentina. He was previously the Special Representative to the President of Brazil on MERCOSUL affairs.

ROBERTO BOUZAS is a Senior Research Fellow at FLACSO-Argentina.

ALCIDES COSTA VAZ is a Professor of International Relations and Executive Coordinator of the MERCOSUL Research Center at the University of Brasília.

FELIPE DE LA BALZE is Director of the Argentine Council on Foreign Relations and Professor of International Economics at the Foreign Service School and at the Advanced School of the Ministry of Defense in Buenos Aires.

RALPH H. ESPACH is a doctoral student in Political Science at the University of California, Berkeley and former Program Associate at the Latin American Program of the Woodrow Wilson Center.

HEATHER A. GOLDING is a student at the University of Connecticut School of Law and former Program Associate at the Latin American Program of the Woodrow Wilson Center.

JOSÉ AUGUSTO GUILHON ALBUQUERQUE is Director of the University of São Paulo Research Center for International Relations.

MONICA HIRST is Principal Investigator, International Relations, FLACSO – Argentina.

BEATRIZ NOFAL is President of Eco-Axis S.A. She is a former member of the Argentine Congress and was Minister of Trade and Industry.

RICARDO ROZEMBERG is Director of the Centro de Estudios para la Producción in Buenos Aires.

JAVIER O. TIZADO is Director of Strat Consulting, in Argentina. He was formerly Secretary of Industry, Government of Argentina.

JOSEPH S. TULCHIN is Director of the Latin American Program of the Woodrow Wilson Center.