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MERCOSUR: IN SEARCH OF A NEW AGENDA

MERCOSUR: Dilemmas and Alternatives for the Trade Agenda

Sandra Polónia Rios

Special Initiative on Trade and Integration

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This document is part of the Initiative's first component.

This study was presented in the conference "MERCOSUR: In Search of a New Agenda", which was held in the Getulio Vargas Foundation in Rio de Janeiro in June 2003. In view of the trends in emerging policies, which point to a renewed interest in furthering the initiative after the turbulence of the 1999-2002 period, the aim of the meeting was to discuss activities in the various areas geared to deepening the integration process. The preparation of the documents and the program were supported by Inter-American Development Bank's Integration and Regional Programs Department through the Special Initiative on Trade and Integration.

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MERCOSUR: IN SEARCH OF A NEW AGENDA

- MERCOSUR: DILLEMAS AND ALTERNATIVES FOR THE TRADE AGENDA -

Sandra Polónia Rios*

I. INTRODUCTION

In the past four years MERCOSUR has faced a succession of problems that have thrown the bloc into a serious crisis. This assertion, exhaustively reiterated in all recent analyses, should be accompanied by some acknowledgement that political and economic conditions in the bigger member countries now offer a window of opportunity to rebuild the integration model on bases that are conducive to regaining credibility and sustainability.

Despite the scheme's current difficulties, MERCOSUR has made a clear contribution to its members' development. The share of the member countries' smaller firms in intra-MERCOSUR trade is higher than their share of trade with the rest of the world. Moreover, the aggregate value of production for trade is higher than that for the member countries' total exports. Foreign investors indicate that the customs union is a significant factor of direct investment-attraction for the subregion, and it has become a platform for the bloc's external negotiations. The contribution made by MERCOSUR goes beyond the purely economic and political-diplomatic realms, and has been particularly important in consolidating democracy and peace in the subregion.

The recent decline in MERCOSUR's internal and external credibility stems from the choices made by the member countries to tackle the substantially adverse domestic and international circumstances of recent years. The original initiative has been distorted by excessive flexibility to accommodate differences between the members, the lack of efforts to deepen the bloc, and the absence of a common view of the role of integration in the four member countries' development strategies. Those circumstances have prompted different macroeconomic policies in the bigger countries, and explain the lack of instruments to deal with size asymmetries among the economies and to integrate their asymmetrical productive structures.

There is little prospect that further progress can be made along the same path as that chosen to date. The challenges of MERCOSUR's external agenda, which have served as the prime source of coherence among the member countries in recent years, now call for clearer commitments and outlooks. Unless the MERCOSUR countries undergo a radical change in attitude, the bloc's coherence will dissipate or MERCOSUR will lose relative importance among the vast network of ongoing regional accords.

The external agenda exerts pressure for the revival of the project, but the core motivation should come from a review of the role of subregional integration in the member countries' development

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plans. In fact, although the bargaining power conferred by the bloc on its members can be significant at the various negotiating tables, this is not strong enough to overcome the difficulties or guarantee the necessary cohesion for MERCOSUR to keep negotiating as a group on its various external fronts. The mounting problems involved in sustaining common positions in the several external negotiating areas reveal the weakness of the external agenda as the main engine of MERCOSUR's progress.

The different initiatives undertaken and the proposals made in the past three years to "relaunch", "refund" or "revise" MERCOSUR make plain that durably surmounting the crisis demands critical and broad reflection on the impasses and difficulties of the integration process. Superficial or excessively ambitious proposals have little prospect of success.

The outcome of the MERCOSUR summit in Asunción on June 18, 2003 represents an attempt to re-address the bloc's internal agenda. The presidents discussed issues that less important in terms of their immediate impact than for the signal they send about the direction of integration in the coming years.

An economic integration project does not move forward without costs, and for those costs to be worth paying the benefits (in terms of growth and international insertion) have to be significant for all those involved. That calls for a strategic plan, one conducive to a form of economic integration that is attractive enough for all the member countries, and that can induce the degree of commitment needed to implement the project, irrespective of the model chosen.

The aims of this study are to assess the problems on MERCOSUR's trade agenda, analyze the progress made and the difficulties encountered, identify the roots of the problems within the integration process, and examine the bloc's current dilemmas. On the basis of that analysis the study presents a non-exhaustive list of issues that should comprise MERCOSUR's integration agenda in the coming years.

II. A BALANCE SHEET OF THE TRADE AGENDA'S ACHIEVEMENTS AND SETBACKS

A review of MERCOSUR's achievements and difficulties should start with an acknowledgement that the bloc's creation broke with the paradigm of trade integration in South America, which was based on a network of limited, reciprocal, bilateral preferences. Attention must also be paid, moreover, to how the model chosen is adapted to the economic characteristics of the four member countries.

Construction, Implementation and Waning of the Integration Process

The paradigm shift originated in the Argentine-Brazil Economic and Integration Cooperation Program of 1986, whose main aim was to create a common market in ten years but which gave primacy to a sectoral view of integration and industrial modernization. The sectoral agreements covered the capital goods, vehicle and foodstuffs industries, among others. The cooperation accords were in the nuclear, biotechnology and communications areas.

These developments occurred in a period when some basic aspects of the two countries' development were converging, such as a return to democracy, the worsening of the external debt crisis and the search for a new development model, one that would replace import-substitution. It should be noted that in this period Argentina was emerging from a deindustrialization process following the return to a policy of protecting local industry.

The assumption of office by Carlos Menem in Argentina and Collor de Melo in Brazil marked a reformulation of the project: bilateral integration deepened and accelerated, automatic schemes to eliminate trade barriers were adopted, and the deadlines contemplated in the 1988 Treaty on Integration, Cooperation and Development were brought forward. The reformulation was endorsed by the July 1990 Buenos Aires Act, whose consequences were not confined to changing the pace of bilateral liberalization but also affected the nature of the integration process.¹ The Treaty for the Establishment of a Statute on Binational Brazilian-Argentine Businesses was signed in this period. This was part of a series of instruments of the program, and it sought to foster long-term integration.

This project attracted the interest of Uruguay and, later, Paraguay. Six months of intense negotiations among the four countries gave rise to MERCOSUR's founding agreement, the Treaty of Asunción, which was signed in March 1991 and was based on the 1990 Buenos Aires Act. Hence MERCOSUR was created as a projection, for all four members, of what was originally a model of bilateral integration. The original model was based on intra-industrial specialization to foster greater scale and to lower production costs as a means of establishing an export base for trade with the rest of the world. The reasons for the later changes were the other partners' preferential access to the Brazilian market and their alignment with Brazilian foreign policy. To meet its goal, Brazil insisted on implementation of the common external tariff, which had not featured in the initial project.

¹ For a more detailed analysis of this process, see Almeida [2002].

The goals described in Article 1 of the Treaty of Asunción for the transition stage were the creation, by December 31, 1994, of a common market with free movement of goods, services and factors of production; the establishment of a common external tariff; the coordination of macroeconomic policies; and the member countries' commitment to harmonize their legislation in relevant areas. The ambitiousness of the Treaty's goals seems to be wholly incompatible with the superficiality of the joint thinking about how to build a common vision of shared goals in the integration process.

The undoubted difficulties that sprang from that circumstance are revealed by a review of the goals there were actually attained within the timeframe. At the end of 1994, when the Ouro Preto Protocol was signed, the free movement of goods was partially achieved, although there were several exemptions and various kinds of non-tariff restrictions persisted. The CET was also defined, notwithstanding the adjustments and temporary exemption regimes (quadripartite lists) and the convergence regimes. No progress was made on the free movement of services or productive factors, and even more remote were commitments on macroeconomic coordination and the harmonization of legislation in relevant areas.

As they made a commitment to macroeconomic coordination and the harmonization of future policies, the two bigger partners adopted macroeconomic policies and strategies for international financial insertion that were independent and divergent (García Pelufo [2002]). Argentina pursued a strategy of complete insertion into international capital markets, adopted an external monetary standard (convertibility with absolute parity between the peso and the dollar), and opened up its capital account. Brazil opted for autonomous insertion with exchange controls and restrictions on access to the domestic financial market. This lack of coordination was entirely incompatible with the model of integration enshrined in the Treaty of Asunción, as evidenced by the effects of the Brazilian devaluation on trade and its substantial impact on the economies of the other member countries.

The negotiators had anticipated the risks of not advancing with mechanisms to coordinate exchange rate policies or to absorb the effects of substantial variations in exchange rate parities. As García Pelufo notes, in 1993 the High-level Group was set up in an effort to make further progress on this issue. Nonetheless, the already significant differences in stabilization policies were reflected in the irreconcilable proposals presented by Brazil and Argentina. In this period Brazil proposed the establishment of a maximum band for exchange rate fluctuations, and thought was also given to the imposition of compensation measures if the fluctuations exceeded the maximum limits. These proposals did not prosper.

The goal of harmonizing legislation in relevant areas was not simply unmet; on the contrary, the member countries continually produced rules and regulations with no thought to their effects on the bloc. The negotiation of commitments that could limit maneuvering room in internal policy-making encountered significant resistance from those responsible for devising national policies. This is particularly true in the case of Brazil, where in general there is little awareness that, in an economic bloc with the free movement of goods and a common external tariff, measures taken by the biggest partner can have substantial effect on the economies of the other member countries. Examples are changes in domestic policies on tax, import financing, or regional incentives.

As Almeida [2002] says, the period between the beginning of 1995, when the CET was introduced, and the devaluation of the real in January 1999 can be regarded as the "second stage of the transition".

In this period several initiatives were geared to MERCOSUR's internal agenda and various issues related to deepening were tackled. The association agreements with Chile and Bolivia were signed, as was the inter-regional framework cooperation agreement between the European Union and MERCOSUR. An effort was also made to reach understandings with the Andean Community and Mexico, but various issues made it difficult to attain free trade and raised doubt about the advisability of negotiating as a group. These difficulties gave rise to flexible arrangements that enabled progress to be made on several bilateral agreements. The strategy of group negotiation was consolidated in this period as part of the effort to create the FTAA.

On the internal front an effort was made to draw up the regulatory framework: protocols were signed in the areas of intellectual property, the protection of competition, regulations on the application of safeguard measures to imports from third countries, rules on unfair trade practices, government procurement, and the MERCOSUR Framework Agreement on Services. Most of these initiatives had no practical effect because they depended on additional protocols or because they were not transposed into the domestic legislation of the member countries. This period saw intense negotiations to include the automotive sector, which was excluded from the free trade area until 2002.

A new stage began in January 1999 with the devaluation of the real and Brazil's introduction of a floating exchange rate. This period was marked by serious trade disputes and political difficulties, especially between Brazil and Argentina. The consequent problems highlighted the absence of mechanisms for macroeconomic coordination and instruments to deal with asymmetries for the purposes of integration among the four countries.

In the 1999-2001 period the other three countries adopted a range of protectionist and export-promotion measures in an effort to deal with difficult economic conditions, which were largely ascribed to the flotation of the Brazilian currency. No agreement emerged from the intense debates on the introduction of safeguard measures or other mechanisms that would allow the neighboring countries' markets to be protected against the impetus given to Brazilian exports. Brazil rejected the introduction of automatic safeguard measures and instead made plain its willingness to work on sectoral cooperation convergence programs, to initiate high-level meetings on macroeconomic policy coordination, to grant waivers for new exceptions to the CET, and to introduce other specific measures.

The pressure to introduce safeguard measures was softened by the fact that the danger of an upsurge in Brazilian exports did not materialize in most sectors. The main consequences of the countries' economic decline was a substantial fall in trade and the contraction of foreign investment. MERCOSUR's internal credibility was severely shaken. Its external credibility, which was one of its main assets, also suffered substantially.

In recent years, the divergences between the two main partners in significant areas of internal economic policy, as well as in foreign policy, have clearly revealed the difficulties of moving the integration process forward. The decision to relaunch MERCOSUR, which found expression in the Buenos Aires Agenda in June 2000, reflected the efforts made by the member countries to overcome the group's stagnation. Broad and ambitious, the agenda sought to fix deadlines for the implementation of measures in various areas. There was very little connection, however, between

intentions and outcomes. The subsequent presidential summits found it very difficult to produce outcomes that would avert the persistent decline in the bloc's credibility.

The dramatic change in Argentina's exchange rate regime, with the abandonment of convertibility and fixed parity with the dollar, caused serious economic crisis as GDP contracted by 11% in 2002. It also offered a significant opportunity to renew, on realistic bases, the dialogue about macroeconomic coordination in MERCOSUR. This prospect was also favored by changes in Uruguay's exchange rate policy.

At the same time, MERCOSUR's complex external negotiating agenda (including the FTAA and discussions with the European Union) entered a decisive stage, exerting new pressure on the bloc's cohesion in the face of various issues. The different interests at play, and diverging views of matters such as market access for industrial goods, services and investment, emerged more often. They revealed the significant voids that the MERCOSUR integration process perpetuated and that, in the final analysis, reflect the vest structural differences between the member countries' economies.

In the stage beginning in 2003, conditions are right for a serious investment in the project's recovery. The new governments in three of the four member countries, the apparent surmounting of the most severe phase of the economic crisis in Argentina, the gradual economic recovery in Brazil, and greater convergence among the member countries' macroeconomic policies suggest that it is possible to devise mechanisms to tackle the structural issues that prompt many of the difficulties that the integration process has experienced: the lack of economic coordination and appropriate instruments to deal with the obvious asymmetries among the members.

The MERCOSUR summit of June 2003 give rise to three elements that reveal the orientation that the governments hope to give to the bloc. The first concerns the essence of the integration model. There was a reaffirmation of the commitment to renew the integration project in its original form, but there was also explicit recognition of one of its main difficulties: asymmetries of development and the need to deal with that issue. The second relates to cohesion on the external negotiating agenda. The governments will allow an essential degree of flexibility and will seek not to harm productive processes in each of the member countries. The third is the prioritization of integration in South America. The meeting produced no documents with detailed proposals on how to attain these goals, but perhaps its chief importance was that it reaffirmed interest in a deep integration project.

Trends in Intra- and Extra-MERCOSUR Trade

Analysis of MERCOSUR's effects on the member countries' trade demands attention to the international environment and to the national contexts within which the project was implemented. The signing of the Treaty of Asunción, not by chance, coincided with a period of structural reform in the four member countries, the most significant components of which were unilateral trade opening and a reduction in the state's economic role. In MERCOSUR's initial phase, up to 1994, the countries were involved in the conclusion of the WTO's Uruguay Round. Therein they assumed commitments in various areas of trade policy, but their hopes were dashed that there

would be a real market opening in the developed countries for the agricultural and agro-industrial products in which most of the subregion's comparative advantages are concentrated.

National economic performance, and particularly the understandings and misunderstandings on exchange-rate policy, decisively shape intra-and extra-subregional trade flows. In the initial phase of the transition, between 1991 and the signing of the Ouro Preto Protocol in 1994, a significant effort was made to eliminate customs tariffs within the bloc. This gave rise to problems originating in structural and political asymmetries. Argentina's Convertibility Plan, which was approved in 1991, revealed the differences in economic policy management in the two biggest countries.

In those four years the economic performances of Argentina and Brazil alternated. Argentina posted an annual average growth rate of almost 8% while Brazil's average growth was about 2.4%. Intra-MERCOSUR trade grew substantially. The differences in exchange rate policies (a fixed rate in Argentina and a flexible rate in Brazil), in conjunction with the satisfactory performance of the Argentine economy, gave rise to a accumulated trade balance of more than US\$ 5 billion in favor of Brazil.

Brazil's introduction of exchange rate bands and the Real Plan lessened exchange rate volatility and gave rise to greater relative price equilibrium within the bloc. The Brazilian economy also performed well in that period. These circumstances were essential for the growth of trade, notably the increase in Brazilian imports in MERCOSUR.

MERCOSUR's common external tariff was applied at the beginning of 1995. Nonetheless, tariffs were retained on certain products in intra-subregional trade as part of a new program called the "Adaptation Regime", which was in place until 1999. In that stage, subregional trade and investment in MERCOSUR grew significantly.

The Asian crisis in the second half of 1997 marked the start of a difficult period for MERCOSUR, one exacerbated by the devaluation of the real in 1999. These circumstances had a substantial impact on intra-subregional commerce. Trade fell by half in 2001 and internal negotiations practically came to a halt.

Hopes of revitalizing subregional trade were revived in 2003. The economic growth forecasts for the two biggest countries are propitious for MERCOSUR, and trade data for the opening months of 2003 seem to confirm such expectations.

In order to assess trends in subregional trade since the implementation of the agreement, the following analysis uses Vaillant's methodology [2001]. The aim is to identify the elements of a lasting transformation and to avoid references to contextual developments. To that end, three-year averages are used as the basis of the analysis, so as to reduce the distortions caused by atypical years. The reference period is 1988-1990, immediately before the signing of the Treaty of Asunción. This is compared to the 1985-1997 period, one of an upsurge in trade, and with 1990-2001, the last period for which there are comparable data for the variables under analysis.

Table 1 shows the trade intensity indices for intra-subregional exports, with a view to measuring the regionalization of the MERCOSUR countries' exports. Conditions in the period prior to the creation of MERCOSUR are compared to the period immediately after the implementation of the customs union, as well as to the more recent stage of economic crisis.

TABLE 1
TRADE INTENSITY INDEX FOR INTRA-SUBREGIONAL EXPORTS
 (percentage share)

| | Share of intra-MERCOSUR exports in total exports | | | Share of intra-MERCOSUR imports in total imports | | | Trade intensity | | |
|-----------|--|------------------|------------------|--|------------------|------------------|----------------------|----------------------|----------------------|
| | 1998-1990 (1) | 1995-1997 (2) | 1999-2001 (3) | 1988-1990 (4) | 1995-1997 (5) | 1999-2001 (6) | 1988-1990 (1)/(4) | 1995-1997 (2)/(5) | 1999-2001 (3)/(6) |
| Argentina | 13.2 | 34.5 | 30.0 | 0.7 | 1.3 | 0.9 | 18.4 | 27.6 | 32.6 |
| Brazil | 4.2 | 14.9 | 13.3 | 0.2 | 0.6 | 0.5 | 17.4 | 24.2 | 29.0 |
| Paraguay | 37.4 | 64.2 | 85.6 | 0.8 | 1.6 | 1.3 | 44.8 | 39.2 | 67.6 |
| Uruguay | 31.2 | 49.9 | 43.5 | 0.8 | 1.6 | 1.2 | 37.5 | 30.3 | 35.0 |
| MERCOSUR | 7.8 | 22.8 | 20.1 | 0.7 | 1.3 | 1.0 | 11.9 | 17.7 | 20.7 |

Drawn up by: National Confederation of Industry (CNI).

Source: Institute for the Integration of Latin America and the Caribbean - INTAL/IDB.

The figures indicate a substantial growth in MERCOSUR's importance as a destination for the bloc's exports following integration, despite some decline in the latter period because of the economic crisis in the member countries. Brazil and Argentina posted the most significant growth rates, although all of them experienced growth. Paraguay saw growth in export concentration, even in the latter period.

For each country, the second set of data in the table shows the share of imports from MERCOSUR partners in total imports. In comparison with the former periods there was a significant growth in that share in all cases, indicating that the MERCOSUR customs union did not lead to losses on the part of extra-subregional countries when all trade is assessed. In the latter period, clearly, there was a fall in imports as a result of the decline in internal demand within MERCOSUR.

Most striking, however, is how the trade indices behaved. The MERCOSUR countries as a whole experienced a regionalization of exports. The index grew in all periods, from 12 in the first three-year period to 21 in the last. The performance is not uniform. Uruguay is the only country whose index in the last period is lower than in the first, although the decline was very small. Paraguay's index fell in the second period but grew substantially in the last period. Brazilian and Argentine exports "regionalized" the most. In the period 1999-2001, moreover, despite the crisis, all countries posted growth in trade intensity indices.

MERCOSUR and Foreign Direct Investment in the Region

In the 1990s, the MERCOSUR countries, especially Brazil and Argentina, moved significantly up the ranking of recipients of foreign direct investment. The performance of Paraguay, although it seems to have benefited in the period immediately following integration, was inconsistent.

TABLE 2
FOREIGN DIRECT INVESTMENT INFLOWS
(US\$ millions)

| | 1988-1999 * % share | 1995-1997 * % share | 1999 % share | 2000 % share | 2001 % share | | | | | |
|-----------|---------------------|---------------------|--------------|--------------|--------------|--------|-----------|--------|---------|--------|
| MERCOSUR | 3,051 | 1.64 | 18,933 | 4.75 | 53,017 | 4.87 | 44,312 | 2.97 | 26,110 | 3.55 |
| Argentina | 1,337 | 0.72 | 7,239 | 1.82 | 24,134 | 2.22 | 11,152 | 0.75 | 3,181 | 0.43 |
| Brazil | 1,641 | 0.88 | 11,397 | 2.86 | 28,578 | 2.63 | 32,779 | 2.20 | 22,457 | 3.05 |
| Paraguay | 31 | 0.02 | 157 | 0.04 | 66 | 0.01 | 96 | 0.01 | 152 | 0.02 |
| Uruguay | 42 | 0.02 | 140 | 0.04 | 239 | 0.02 | 285 | 0.02 | 320 | 0.04 |
| World | 186,366 | 100.00 | 398,246 | 100.00 | 1,088,263 | 100.00 | 1,491,934 | 100.00 | 735,146 | 100.00 |

Note: * Annual average.

Source: UNCTAD

The significant growth in the subregion's importance as a recipient of foreign capital in the period after 1995 cannot be ascribed to the creation of MERCOSUR. Factors at the national level, such as commercial opening, economic stabilization and, particularly, privatization programs undoubtedly comprised the dominant influence. It is also possible that the different incentives to attract direct investment offered by national and subnational policies in the member countries have affected trends in this area.²

But the size and growth prospects of the member countries' economies, the possibility of free access to the enlarged market, and MERCOSUR's expectations of expanding to other countries in South America must have served as factors of attraction. That the group exerts *de facto* influence on investment decisions is evidenced by the European insistence on negotiating a free trade agreement with MERCOSUR as a customs union, as embodied in the negotiating mandate given to the European Commission in 1999. This interest could be motivated by a variety of political and strategic considerations. The declarations made by European entrepreneurs during the MERCOSUR-European Union Business Forum in Madrid in May 2002 also suggest a need to complete the free trade area and to consolidate the MERCOSUR customs union. They reflect the expectations and obstacles facing European businesses in their operations within the group.³

Obstacles to Goods Trade

Establishing a free trade area that includes economies with such asymmetrical productive structures as Argentina, Brazil, Paraguay and Uruguay is in any case a difficult undertaking. If the integration process unfolds in the context of diverging macroeconomic policies (significant exchange rate variations that abruptly change the conditions of competition between the countries, and an absence of mechanisms to overcome circumstantial sectoral difficulties), the context is highly propitious for the adoption of unilateral, *ad hoc* measures as a means of dealing with the pressures of sectoral lobbies. Added to this is the modest degree of commitment among the member countries' national

² For a detailed analysis of foreign investment promotion policies and their effects in MERCOSUR see Chudnovsky and López [2001].

³ The MERCOSUR-European Union Business Forum (MEBF) was created in 1998 and has produced reports with recommendations on the biregional negotiations for the authorities of the two blocs.

bureaucracies to comply with agreed rules, and the low level of pro-integrationist thinking in the formulation of new policies. This is a recipe for the proliferation of barriers that distort the free trade area.

In 2001 Vaillant outlined the disputes among the countries by examining the consultations, complaints and controversies on the list of consultations presented to the Trade Commission, the list of complaints to the Common Market Group, and the lists of the Brasilia Protocol's dispute settlement mechanism. Table 3 presents the results of the scheme of consultations sought in the Trade Commission.

Some observations should facilitate understanding of the scale of the problem:⁴

- The pattern of consultations in the period 1995-2001 is in the form of a U. There was a high level of consultation in the initial period as a result of the accumulation of disputes inherited from the previous stage, when the mechanism did not exist. The number of cases fell until 1998 and grew again after 1999. Brazil is the only country with a stable profile in the consultations presented.
- Argentina sought the most consultations and Brazil was the target of most. Uruguay presented the least number of consultations and was ranked third as a target of them.
- Agro-industrial products were the subject of the greatest number of consultations (39% of the total), most often in the areas of technical barriers and differences in norms.
- The chief issues in consultations were technical barriers, fiscal discrimination, tariff preferences, import licenses, export and import bans, antidumping and rules of origin.

The recent history of sectoral disputes in MERCOSUR is marked by some illustrative conflicts, analysis of which facilitates identification of the issues on the free trade area's future agenda. Table 4 summarizes the agenda of disputes in some sectors. The list of products presented in the table is representative of sectoral sensitivities in intra-subregional trade, and serves as a reference for proposals to overcome the difficulties of the free trade area.

Some features of the table attract attention. First, according to Vaillant, there was a clear growth of initiatives that sought to establish protection against imports from Brazil following the devaluation of the real in 1999. Conditions in sectors such as footwear, textiles poultry and pigmeat, which were suffering problems of intra-subregional competitiveness before the investment in modernization and restructuring and Brazil, were aggravated by the sudden change in exchange rate parities. Those sectors could have been candidates for the adoption of safeguard programs, combining some temporary protection with restructuring or reconversion schemes.

The use of trade defense instruments as a way of dealing with sensitivities (particularly antidumping measures and especially in the period following the devaluation of the real) was clearly a response to the absence of an agreed safeguard system but the matter did not end there. An

⁴ For a detailed description of the non-tariff barriers, see Vaillant [2001].

example is the inclusion of Argentina and Uruguay in investigations into dumping in Brazilian milk imports, which led to uniform price agreements.

The sugar sector raises the matter of the lack of subregional treatment for national incentives policies, a question that is also among the unfinished issues of the MERCOSUR relaunch agenda of 2000. Dealing with this issue will not be enough to level out differences in competitiveness in the two countries' sugar production, but it could help solve the problem in a sector of great importance for Brazilian export interests, one whose internal difficulties within MERCOSUR have also created problems for the bloc's external negotiations (different national positions in presenting offers in the FTAA and to the European Union).

The matter of technical barriers is reflected by Argentina's complaint about obstacles to the entry of phytosanitary products to Brazil. The harmonization of technical norms and the promotion of mutual recognition systems are priorities to be flagged for a short-term agenda.

TABLE 3
CONSULTATIONS TO THE MERCOSUR TRADE COMMISSION (MTC) BY TYPE OF NON-TARIFF BARRIER AND SECTOR, 1995-2001

| Non-tariff barrier | Type | AF | MM | All | MP | Chemicals | Textiles | Services | No data | Total |
|------------------------|------|------------|-----------|-----------|-----------|-----------|-----------|----------|-----------|------------|
| Technical barriers | v | 48 | 6 | 3 | 2 | 3 | 3 | 2 | 4 | 71 |
| Fiscal discrimination | ii | 28 | 3 | 13 | 3 | 1 | | 1 | 5 | 54 |
| Customs preference | vi | 10 | 20 | 2 | 5 | 9 | 2 | | 4 | 52 |
| Import license | i | 5 | 6 | 3 | 4 | 4 | 1 | | | 23 |
| Prohibition | i | 8 | 3 | | 2 | 2 | | | | 15 |
| Antidumping | ii | | 10 | 3 | | | | | 1 | 14 |
| Rules of origin | vi | 1 | 3 | 3 | | 4 | | | 2 | 13 |
| Import financing | ii | 1 | 1 | 1 | 1 | 1 | 4 | | | 9 |
| Export taxes | ii | 4 | | | 2 | | 1 | 1 | 1 | 9 |
| Customs valuation | iv | 1 | | 4 | | | 2 | | 2 | 9 |
| Customs procedures | iv | 1 | | 1 | 1 | 1 | 3 | | 1 | 8 |
| Other | | 3 | 1 | 1 | | 2 | | | | 7 |
| Register | v | 4 | | | 1 | 2 | | | | 7 |
| Nomenclature | iv | 1 | 1 | | 2 | 2 | | | | 6 |
| Export subsidies | ii | | | 5 | 1 | | | | | 6 |
| Specific duties | ii | 1 | | 3 | 1 | | | | | 5 |
| Control prices | ii | 4 | 1 | | | | | | | 5 |
| QR exports | i | 2 | | | 1 | | | | 1 | 4 |
| Consular visa | iv | | | 3 | | | 1 | | | 4 |
| Government procurement | iii | 1 | 1 | | | | | 1 | | 3 |
| QR imports | i | 1 | 1 | | | 1 | | | | 3 |
| Safeguards | ii | | | | 1 | | | | | 1 |
| No data | | 39 | 7 | 2 | 14 | 7 | 2 | 4 | 18 | 93 |
| General total | | 163 | 64 | 47 | 41 | 39 | 19 | 9 | 39 | 421 |

Notes: AF-agro-foodstuffs; MM-metal-mechanical; QR-quantitative restrictions.

Source: prepared on the basis of the minutes of the meetings of the Common Market Group and the MERCOSUR Trade Commission.

Reproduced by Vaillant [2001].

TABLE 4
AGENDA OF SECTORAL DISPUTES IN THE FREE TRADE AREA

| Product/development question |
|--|
| <p>Sugar. Argentine allegation that Brazil was granting subsidies to this product. Sugar is the only product not included in the free trade area. Argentina alleged that Brazil was granting sugar subsidies through Proálcool. In September 2002 the Argentine government decided to retain until 2005 the additional duty on imports, from any source, of sugar cane or solid, chemically pure beet and sucrose. In March 2003 the Argentine Senate approved a 20% tariff on sugar imports from any source.</p> |
| <p>Poultry Application by Argentina of a surcharge on imports of chickens from Brazil. In 2000 Argentina set minimum FOB export values on chickens from Brazil (NCM 0207.11.00 and 0207.12.00). In May 2001 the MERCOSUR Arbitration Tribunal convened at Brazil's request and decided that Argentina could continue to apply the surcharge on imports of Brazilian poultry. In August 2002, following the signing of understandings in a bilateral meeting with Brazil, the Argentine government opened up these measures to review. The duties were still not revoked. Brazil had linked the elimination of these measures to progress on the issue in the WTO's dispute settlement system, which had begun in November 2001. After almost two years, the WTO issued a ruling in favor of Brazil.</p> |
| Product/development question |
| <p>Bicycles: Argentine allegation that Uruguayan bicycles do not meet MERCOSUR rules of origin. After several efforts to solve the dispute, in May 2001 Uruguay notified the MERCOSUR Secretariat of its decision to open an arbitration procedure against Argentina because of restrictions on access to the Argentine market for bicycles of Uruguayan origin. The MERCOSUR Arbitration Tribunal, in its ruling of September 2001, decided that the Argentine resolution on the extra-subregional tariff treatment of goods exported by the Uruguayan firm infringed MERCOSUR regulations.</p> |
| <p>Footwear. Application by Argentina of restrictions on footwear imports. To block the entry of Brazilian footwear to its market, Argentina imposed a series of restrictions on footwear imports that directly affected Brazilian sales to Argentina in 1999 and 2001. In 1999 the two countries' private sectors reached a voluntary restraint agreement on Brazilian footwear exports for a set period.</p> |
| <p>Cigarettes: Application of the specific internal tax on the marketing of Paraguayan cigarettes in Uruguay. The dispute began with a complaint made by Paraguay against Uruguay in the MERCOSUR Trade Commission in November 2000. After appealing unsuccessfully to the Common Market Group, Uruguay sought a ruling from the MERCOSUR Arbitration Tribunal, which in May 2002 ruled that Uruguay should stop discrimination against Paraguayan cigarettes since Paraguay is not a bordering country.</p> |
| <p>Promoting the industrialization of wool: Argentine allegation of an incompatibility of the Uruguayan regime to foster the industrialization of wool with the MERCOSUR regulation governing the application and use of incentives in intra-subregional trade. In 1998, Argentina asked Uruguay to remove the bonus for woolen manufactures going to the MERCOSUR countries. The direct negotiations contemplated in the Brasilia Protocol began in October 2000. Convened at Argentina's request to resolve the dispute, the MERCOSUR Arbitration Tribunal decided in April 2003 that Uruguay should eliminate the bonus.</p> |
| <p>Dairy goods: Investigation into dumping in exports of milk to Brazil from some countries of the bloc, including Argentina and Uruguay. In August 1999 the Brazilian government began an investigation to determine whether there was dumping in imports of various kinds of milk from Argentina, Australia, New Zealand, the European Union and Uruguay. The antidumping duty for powdered, whole and skimmed milk (NCM 0402.1010, 0402.10.90, 0402.21.10, 0402/29.10 and 0402.29.20) for New Zealand and the European Union was set in 2001, and a compromise on prices was agreed with the Argentine and Uruguayan companies.</p> |

TABLE 4 (cont.)

Tires: Uruguayan allegation that Brazil was prohibiting imports of retread tires from Uruguay. In 2001 Uruguay unsuccessfully appealed to the bodies contemplated in the initial phase of the MERCOSUR dispute settlement system.

In its ruling of January 9, 2002, the Arbitration Tribunal decided that the Brazilian measure banning the granting of import licenses for retread and used tires, either as a consumer product or raw material, as classified in item 4012 of the MERCOSUR Common Nomenclature, is incompatible with MERCOSUR regulations.

Phytosanitary products: Argentine allegation that Brazil was erecting barriers to the entry of phytosanitary products to the Brazilian market.

Brazil had not transposed resolutions 48/96, 87/96, 149/96, 156/96 and 71/98 into domestic legislation, and thus blocked MERCOSUR norms from entering into effect.

In November 2000, the Argentine government informed the MERCOSUR Secretariat of its decision to begin proceedings against Brazil in this matter.

The MERCOSUR Arbitration Tribunal decided on April 19, 2002 that Brazil should transpose these Common Market Group resolutions into domestic legislation.

Product/development question

Automotive regime. Inclusion of the automotive sector in the free trade area.

The agreement on the MERCOSUR Automotive Policy (MAP) was approved in December 2000 following a series of difficulties related to the administration of the limits for intra-subregional trade, the definition of super local content within regional content, determining the common external tariff for heavy trucks and vehicle parts, investment incentives, and the treatment to be offered to Uruguay and Paraguay. The agreement was to be in force as of February 2001. Paraguay was formally incorporated in June of that year.

The MAP was formally filed with ALADI in October 2001 through the Additional Protocol to Economic Complementarity Agreement 18 (ECA 18), with provisions for the detailed regulation of market access conditions between country pairs until December 31, 2006.

Immediately after this there was renewed criticism of the administration of intra-subregional trade and the means of calculating the local content index, which gave rise to new bilateral negotiations, especially between Brazil and Argentina. Understandings were reached in mid-2002.

Given these discussions and Argentina's refusal to eliminate the internal measure that led to the bilateral agreement, Brazil did not transpose the additional protocol to ECA 18, relating to the MAP, and waited to settle the matter with Argentina. Following the bilateral understanding (in the framework of ECA 14 between Brazil and Argentina), it was also judged necessary to correct ECA 18. This has not yet happened, and the prior bilateral agreements remain in force.

Pigmeat: (a) Argentine allegation that Brazil was subsidizing the production and export of pigmeat.

The dispute began with a claim presented by Argentina to Brazil in two meetings of the MERCOSUR Trade Commission in 1997.

Having failed to secure the outcome it wanted, that year Argentina sought a ruling and the Arbitration Tribunal convened.

In its final decision of September 1999, the Tribunal did not rule in favor of the Argentine claim.

(b) investigation into dumping in pigmeat exports from Brazil.

In November 2001, the Argentine government decided to open an investigation into dumping in Brazilian exports to Argentina of fresh, frozen or refrigerated pigmeat (NCM - 0203.19.00 and 0203.29.00) and of fresh, frozen or refrigerated bacon (NCM 0209.00.11).

Argentina ended the process in 2002 as the result of a bilateral understanding.

Textiles: Brazilian allegation that the Argentine measure setting quotas on Brazilian cotton products was contrary to or incompatible with free trade among the MERCOSUR countries.

Argentina established a safeguard clause against Brazilian imports of five categories of cotton and cotton-mix fabrics in July 1999. This placed a three-year restriction on exports from Brazil, China and Pakistan by means of a quotas.

Since there was no understanding in the first two stages contemplated in the Brasilia Protocol (direct negotiations and the intervention of the Common Market Group) Brazil notified the MERCOSUR Secretariat of its intention to seek arbitration in November 1999.

In March 2000 the MERCOSUR Arbitration Tribunal ruled that Argentina should revoke the measures implemented.

Wheat, wheat flour and mixes: Argentina's imposition of an export tax.

In March 2002 Argentina imposed an export tax on raw materials (10%) and industrial products (5%) in the hope of increasing its tax take. The list of raw materials (chapters 10, 11, 12, 15 and 23) subject to the export tax with an aliquot of 20% was later expanded.

Brazil has insisted that these aliquots be reduced or that the mechanism be completely eliminated.

Status of the Common External Tariff⁵

The MERCOSUR customs union suffers the natural tensions of a political decision on the model of integration among four economies with very different productive structures, one that was not implemented in tandem with complementary policies and measures to help attenuate the project's innumerable difficulties. Over the years, structural differences and economic crises have fostered unilateral measures that have expanded the exceptions to the common external tariff.

Olarreaga, Soloaga and Winters [1998] show that national political variables, weighted by each member country's importance, dominated the creation of the CET. Hence the CET's structure largely reflects Brazil's tariff structure, and to some extent Argentina's, with the exception of capital goods, and information technology and telecommunications products (Kume and Piani [2001]). In general terms, acceptance of the Brazilian tariff structure entailed a lessening of real protection in the member countries.

From the outset, the CET allowed exceptions for two groups of products: capital goods (900 tariff lines) and information technology and telecommunications products (200 lines). Moreover, national exception lists allowed for the adaptation of those products for which each country feared an abrupt change in the level of protection. National automotive regimes were preserved, entailing further exceptions to the CET. Furthermore, the retention and renegotiation of various agreements involving different tariff preferences between some MERCOSUR members and other Latin American countries (for example Brazil-Andean Community, Uruguay-Mexico, Argentina-Mexico and so on) were in practice significant exceptions to the application of the CET.

Since the customs union was introduced the member countries have unilaterally implemented various alterations to the common tariff, mostly under the pretext of tackling macroeconomic problems. This process began with Argentina's introduction of a 3% "statistical tax" on extra-MERCOSUR imports. The measure was intended much more to increase the government's fiscal revenue than to heighten protection.

In 1997, the Brazilian government also decided to increase import tariffs by 3% in order to deal with a substantial growth of imports in that period. Nonetheless, the fiscal motivations for increasing the CET in Brazil became clear when, in December 2000 (the deadline set by the CMG for the elimination of the additional rate), the Brazilian government strove to prolong it for another year, having supported a reduction of barely half a percentage point. In this period, the effects on Brazil's tax take provided a reason for the initiative. A reduction of more than a percentage point was agreed in December 2000, and there was further agreement that the remaining 1.5% would be eliminated at the end of 2003.

As regards sectoral measures, the Brazilian government took the first significant initiative in early 1995 when it raised tariffs on consumer durables and increased the number of products on its national exception list by 150, some 61 of which would be reviewed every three months and the rest of which would be reviewed annually. Throughout the following two years, the member countries took other unilateral measures that were sanctioned by their partners because they too

⁵ This section summarizes detailed information in Kume and Piani [2001] and IDB/INTAL [2003].

were interested in having greater freedom regarding the commitments entailed in the customs union. This process intensified in 2001 when, amid an economic crisis, the Argentine government cut tariffs on capital goods to zero and increased those on various consumer goods to 35%.

In June 2001 the Common Market Group decided to create a High-Level Group to review the structure of the CET, and to assess the coherence and dispersal of the tariff structure. Apart from MERCOSUR's internal pressures for a review of the tariff structure, this exercise became important in light of the bloc's external agenda, especially the negotiations for the FTAA and with the EU. The need to specify the basic tariff for the duty-reduction program to be negotiated in these fora meant that MERCOSUR had to decide which CET to present. By the start of 2003 the Group had made very little progress.

In view of the need to make offers on goods in the negotiations with the EU, in 2001 MERCOSUR advised that the basic tariff for duty-reduction, once the agreement was signed, would be the CET to be applied on January 1, 2006, with no exceptions or waivers. For the FTAA negotiations, MERCOSUR secured a deadline of April 15, 2003 to state its basic tariff. The negotiations between the member countries to determine the tariff were not minor. The smaller countries, especially Uruguay, were interested in exploiting the chance to voice their demands for changes in the CET, and hence they argued for a low common tariff. Brazil and Argentina preferred to retain a "cushion" for the purposes of greater protection. MERCOSUR met the deadline to fulfill its commitment, establishing a tariff based on the following criteria: basic CET of Resolution 65/00, without the temporary increase of 1.5% and without national exceptions; 51 vehicle codes with 35% tariffs of CMC Decision 70/00; the *ad valorem* equivalents of the specific duties applied in Argentina for textiles, footwear and toys; and to inform Technical Committee 1 of requests for undetermined increases.

In addition to exceptions to the CET, other trade policy instruments in the member countries have continued to breach the spirit of a customs union, in which goods should move freely as in internal trade operations. According to Nofal [2002], in practice MERCOSUR now operates as free trade area with a CET for much goods trade. Concrete examples of the imperfections of the customs union are the certificates of origin requirement and the retention of customs controls on trade; the CET's double taxation; the persistence of drawback and special import regimes; the imposition of intra-MERCOSUR antidumping measures; and the lack of a single system for dealing with third country imports.

Table 5, which shows developments in some of the difficult issues on the bloc's relaunch agenda, illustrates the depth of the stagnation into which MERCOSUR sank after 2000. The number of references to decisions prolonging deadlines evidences the difficulties involved in moving forward on basic matters, even though the MERCOSUR summits have changed intentions in these respects.

It should be acknowledged, however, that there was some progress in 2002. Note the signing of the Protocol of Olivos, which will govern dispute settlement in MERCOSUR when it enters into force, and the transformation of the MERCOSUR Administrative Secretariat into a Technical Secretariat. This latter measure was seen by the member countries as a significant shift in Brazil's commitment to MERCOSUR, given the Brazilian government's substantial and habitual resistance to establishing any institution that might be seen as supranational. The lack of resources to further the Secretariat's activities, however, might curb the scope of this initiative.

TABLE 5
THE CUSTOMS UNION AGENDA
FROM THE RELAUNCH OF MERCOSUR TO THE MOST RECENT DECISIONS

| Measures June and December 2000 | June 2001 | December 2001 | July 2002 | December 2002 | June 2003 |
|---|---|---|--|--|--|
| <p>Circumstances or measures of a tax-related, financial, fiscal, customs administrative or any other nature that constrain current access to the markets of the MERCOSUR member countries. Decisions 22/00 and 57/00, respectively, set deadlines of November 15, 2000 and June 30, 2001 to identify the steps to be taken. Measures not warranted by Art. 50 of the 1980 Treaty of Montevideo (TM80) related to the protection of health must be reported to the CMG by May 31, 2001.</p> | <p>Decision 07/01 makes provision for the work to continue. By November 15, 2001 the Committee on Animal and Plant Health and the Committee of Customs Directors have to propose to the CMG, the steps to be taken within their remits in order to implement the measures identified in Decision 22/00 on which agreement is pending. Decision 07/01 defers until November 30, 2001 the deadline for the CMC to complete the following tasks: (a) proposal for the regulation of measures adopted under Article 50 of TM80 (protection of health and so on) and (b) drawing up disciplines on administrative procedures for the member countries' foreign trade to be submitted to the CMC in December 2001.</p> | <p>Decision 16/01 defers until May 30, 2002 the deadline for the CMG to submit the following proposals to the CMC: (a) proposal for the regulation of measures adopted under Article 50 of TM80 (protection of health and so on) and (b) drawing up disciplines on administrative procedures adopted by the member countries for foreign trade.</p> | <p>Decision 06/02 defers until November 30, 2002 the deadline for the CMG to make the following proposals: (a) proposal for the regulation of measures adopted under Article 50 of TM80 (protection of health and so on) (Art. 2 of Decision 06) and (b) proposing disciplines on administrative procedures adopted by the member countries for foreign trade. (Art. 3 of Decision 06/02).</p> | <p>The XLVIII meeting of the CMG, held on November 27-28, 2002, recorded the impossibility of completing the proposals and decided to ask the CMC to prolong the deadline to June 15, 2003 despite Argentina's proposal to suspend consideration of the matter. The XXIII meeting of the CMC, held on December 5-6, 2002, recommended that the CMG continue its work on these two matters.</p> | <p>The issue was addressed at the LXI meeting of the CMC on May 8-9, 2003 and the LXII meeting on June 5-6, 2003. There is a document including the proposal but the work is unfinished and must continue in the next meeting.</p> |
| <p>MERCOSUR dispute settlement system. Decision 25/00 of the relaunch sets a deadline of December 10, 2000, for the submission of proposals on completion of the MERCOSUR dispute settlement system Decision 65/00 approves the creation of a High-level Group to draw up the proposal and extends the deadline to June 2001.</p> | <p>Decision 07/01 defers until November 30, 2002 the deadline for the group to present its proposal,</p> | <p>The February 2002 MERCOSUR summit approves the Protocol of Olivos. The Protocol of Olivos creates the permanent review tribunal, a body for appealing the rulings of the <i>ad hoc</i> arbitration tribunals. This new option in the MERCOSUR dispute settlement mechanism will be confined to matters of law involved in the dispute and legal interpretations expressed in the rulings of the Arbitration Tribunals. The Protocol of Olivos must be ratified by the MERCOSUR countries' congresses. This will revoke the 1991 Brasilia Protocol on Dispute Settlement and the Regulation on the Brasilia Protocol approved by Decision 17/98.</p> | | <p>Decision 18/02 regulates The Protocol of Ouro Preto " General Procedure for Claims to the MERCOSUR Trade Commission" .</p> | |

TABLE 5 (cont.)

| Measures June and December 2000 | June 2001 | December 2001 | July 2002 | December 2002 | June 2003 |
|---|--|---|---|--|---|
| <p>The CET's double taxation. Decision 27/00 tackles the CET's double taxation and the distribution of the corresponding share of the customs revenue. The CMC is entrusted with the matter and the preliminary report must be presented to the CMG by December 31, 2002.</p> | | | <p>In the LVI meeting of the CMC on June 5, 2002, Argentina presents two reports on the matter: (1) a document on the movement of extra-regional goods within the EU; (2) a document on the Argentine tax system. In the LVII meeting of the CMC on August 21, 2002 Argentina, Brazil and Uruguay reach an understanding on the report to be prepared on the issue as it relates to customs transit. It is decided that Paraguay will present its comments separately.</p> | <p>At the LIX meeting of the CMC on November 25-26, 2002, on the basis of the document presented by Argentina, Brazil pledges to present a report to inform discussions of the matter. Paraguay argues that the issue should be dealt with after priority matters related to the free movement of goods have been defined.</p> | <p>Paraguay reiterates its position in the LXI meeting of the CMC on May 5-6, 2003. The same thing happens at the LXII meeting of the CMC on June 5-6, 2003.</p> |
| <p>Consistency and dispersal of the CET. In the June 2000 decisions on relaunching MERCOSUR there is no reference to examination of the coherence and dispersal of the CET. Decision 27/00 mentions only that the members that deem it advisable to review some aspect of the CET, including capital goods produced in the region, should make their proposals by September 30, 2000.</p> | <p>Decision 05/01 creates the High-level Group to examine the coherence and dispersal of the CET. The Group must submit to the CMG proposals on an assessment of a possible reduction of the levels of tariff protection and dispersal for capital goods, and for information technology and telecommunications products, irrespective of whether they be produced in the MERCOSUR countries, by November 30, 2001.</p> | <p>Decision 16/01 defers until June 30, 2002 the deadline for the Group to make proposals to the CMG.</p> | <p>Decision 06/02 extends until June 6, 2003 the deadline for the Group to make proposals to the CMG.</p> | | <p>Article 3 of Decision 10/03 extends until November 30, 2003 the deadline for the High-level Group to make proposals to the CMG on the coherence and dispersal of the CET..</p> |
| <p>Investigation and application of antidumping measures and countervailing duties in intra-MERCOSUR trade. In June, Decision 28/00 of the MERCOSUR relaunch instructs the CMG to draw up a proposal to discipline these measures in intra-MERCOSUR trade by November 30, 2000 and to eliminate them gradually by June 30, 2001. Decision 64/00 approves a series of disciplines (Annex) to be applied to investigations into antidumping measures or countervailing duties within MERCOSUR, and extends until June 30, 2001 the deadline for additional proposals.</p> | <p>Article 1 of Decision 07/01 extends the deadline for drawing up a proposal on the gradual elimination of antidumping measures and countervailing duties in intra-MERCOSUR trade. The issue will be presented to the CMG before March 31, 2004. Article 5 of Decision 07/01 extends until March 31, 2002 the deadline for the CMG to make a proposal, to be approved by the CMC, on additional disciplines for antidumping measures and countervailing duties in intra-MERCOSUR trade.</p> | <p>According to Article 2 of Decision 16/01, the proposal on the gradual elimination of antidumping measures and countervailing duties in intra-MERCOSUR trade must be submitted for the consideration and analysis of the CMC by May 31, 2003. Article 51 of Decision 16/01 extends until May 31, 2003 the deadline for the CMG to make a proposal on additional disciplines for investigations into antidumping and countervailing measures applied to imports from other member countries.</p> | <p>Decisions 13/02 and 14/02 of July 2002 deal with the adoption within MERCOSUR of the WTO's agreements on antidumping and countervailing duties, with a view to applying antidumping and countervailing measures to intra-MERCOSUR trade. In the event of a dispute about the application of the agreements to intra-MERCOSUR trade, the member countries can determine the forum in which to resolve the matter. Absent an agreement, the claimant can decide on the forum (WTO or MERCOSUR dispute settlement system). Additional measures on the application of antidumping and countervailing measures approved by the countries will take precedence over this Decision.</p> | <p>Decision 22/02 of December 2002 on the Protection of Intra-MERCOSUR Trade replaces the annex of Decision 64/00 with a document entitled: " Disciplines for the procedures and regulations for antidumping and subsidies investigations in intra-MERCOSUR trade" . The Decision must be incorporated into ALADI ECA 18.</p> | <p>Decision 10/03 extends until November 30, 2004 the deadline for submitting to the CMG a proposal on the gradual elimination of antidumping measures and countervailing duties in intra-MERCOSUR trade.</p> |

TABLE 5 (cont.)

| Measures June and December 2000 | June 2001 | December 2001 | July 2002 | December 2002 | June 2003 |
|--|---|---|-----------|---------------|--|
| <p>Common regulation on protection against antidumping and subsidies in products from third countries. Decision 28/00 indicates that the CMG must submit to the CMC a proposal on a common regulation, mindful of MERCOSUR's regulatory frameworks. These undertakings must be completed by December 15, 2000. In December, Decision 66/00 stipulates that legal and institutional matters must be assessed before June 30, 2001 and the CMC must present the critical points of the matter and the proposals for tackling it to the CMG by December 15, 2001.</p> | <p>Decision 07/01 extends until November 30, 2001 the deadline for WSG 2 on " Institutional Matters" to complete its analysis of the legal and institutional aspects of the proposals for common regulations on protection against antidumping and subsidies in goods from third countries. The CMC must continue to analyze the critical points of the draft common regulations and submit a proposal to the CMG by June 30, 2002.</p> | <p>Decision 16/01 extends until May 31, 2003 the deadlines for analysis of the draft common regulations on protection against antidumping and subsidies in goods from third countries.</p> | | | <p>Decision 10/03 of June 2003 extends until November 30, 2004 the deadlines for analysis of the draft common regulations on protection against antidumping and subsidies in goods from third countries.</p> |
| <p>Common disciplines limiting production and investment incentives that distort resource-allocation in the region and eliminate incentives to extra-MERCOSUR exports. Decision 31/00 instructs the CMG to draw up a proposal on these matters by March 31, 2001.</p> | <p>Decision 07/01 defers until December 10, 2001 the deadline for the CMG to make a proposal on common disciplines for the use of incentives. The proposal must be submitted to the CMC in December 2001. The CMG must complete its investigation of member country incentives by September 30, 2001.</p> | <p>Decision 16/01 defers until May 31, 2003 the deadline for the CMG to make a proposal on common disciplines for the use of production, investment and intra-MERCOSUR export incentives. The CMG must update its investigation of member country incentives by October 31, 2002.</p> | | | <p>Decision 10/03 of July 2003 defers until November 30, 2004 the deadline for proposals on common disciplines for the use of production, investment and intra-MERCOSUR export incentives.</p> |
| <p>Regulations on incentives for special customs regimes for imports, including those used in the Special Customs Zones and similar regimes, used in goods to be sold in MERCOSUR. Decision 31/00 stipulates that the CMG must analyze a proposal on the matter by March 31, 2001 and must draw up guidelines for such norms. Decision 69/00 defines certain norms and sets a deadline of June 30, 2001 for establishing the conditions for sale within MERCOSUR of goods from special customs zones.</p> | <p>Decision 07/01 extends to December 10, 2001 the deadline set in Decision 69/00 for defining the conditions for sale within MERCOSUR of goods from special customs zones.</p> | <p>Decision 16/01 extends to May 31, 2003 the deadline for defining the conditions for sale within MERCOSUR of goods from special customs zones.</p> | | | |

Status of Integration in the Services Sector⁶

The Montevideo Protocol of December 1997 made provision for the member countries to liberalize services trade within 10 years of the protocol's entry into force. That requires that the protocol be transposed into domestic law in at least three of the four member countries. More than five years after the protocol was signed it has not entered into force, since only Argentina has transposed it (in the second half of 2002).

On the basis of GATS norms, the protocol aims to liberalize services trade and makes provision for annual negotiating rounds, the outcome of which will be transposed automatically. Initial lists of commitments were drawn up. These were marginally more extensive than those assumed under the GATS, and the Services Group was established to conduct the negotiations. The group has made some progress, having held four rounds of negotiations to reach specific sectoral agreements.

One of the pending issues is the MERCOSUR visa, which would facilitate the movement of services providers in the subregion. This is facing resistance from Brazil. The visa would remove the requirements imposed by Brazil on the entry and installation of service providers from the other member countries, such as the demand that providers prove economic need and that there be a certain proportionality between foreign and national workers.

Services account for only a small share of MERCOSUR member countries' exports. Only in Uruguay is the sector significant, since it accounts for almost half of goods exports. As Berlinski points out, the data underestimate the value of services negotiated in the GATS, since only those payments between resident and non-residents are recorded. Services trade undertaken through commercial presence, which is direct investment, is not accounted for.

The member countries have also made different GATS commitments. Of the four, Argentina has undertaken the most significant opening in terms of the lists of services consolidated in the GATS, while Brazil's position is much more cautious.

The absence of an internal agreement and differences between the countries in terms of their consolidated GATS commitments hamper the assumption of joint positions in external negotiations.

The External Negotiating Agenda: Agreement and Conflicts of Interest

The argument that the MERCOSUR countries' bargaining power should be strengthened so that they can deal with the packed agenda of external negotiations with developed countries, especially for the FTAA, has often been used to underline the importance of maintaining and intensifying the commitment to regional integration. The mandate conferred on the European Commission to negotiate with MERCOSUR requires that agreement be reached with the customs union.

⁶ Based on Berlinski [2001] and IDB/INTAL [2003].

Cohesion in the negotiations for the FTAA and with the EU provided perhaps the main bond between the MERCOSUR countries in the stage that began in 1999. This cohesion, however, is being tested as the negotiations move to deeper stages in which more specific issues are tackled.

These two negotiating fronts recently entered into decisive phases that call for greater coordination and convergence of positions. Significant differences are apparent in various issues that are common to the three main negotiating fronts.

Market access for goods

The first difficulty was to draw up lists of offers on market access for goods in the negotiations with the EU in the second half of 2001. Because of the huge disparities in the national lists, they were merged into a single MERCOSUR offer that covered barely 32% of imports from the EU. In light of Argentina's worsening economic situation in that period, and the lack of time to bring positions closer, this was the offer made to the EU.

It was similarly difficult to make an initial offer on goods in the FTAA talks, where the deadline to present offers was February 15. The offer was to liberalize almost 52% of MERCOSUR's tariff schedule in 10 years on the basis of consolidated national lists.

Obviously, the different criteria used by the MERCOSUR member countries to draw up their own lists largely reflects their different attitudes to the CET. Paraguay and Uruguay see this as a chance to secure a reduction in the level of protection conferred by the CET on raw materials and capital goods. Brazil's offers, on the other hand, echo the degree of sensitivity reflected in that structure.

There were also significant problems in devising an offer on agricultural goods. Brazil's agricultural sector aimed to make a more aggressive offer in an effort to secure reciprocity for products in which Brazil is competitive. Argentina classified some products important to Brazil as sensitive (sugar, coffee, poultry and so on).

The negotiations between MERCOSUR and the EU made little progress in 2002 but there was renewed impetus in March 2003 when revised offers were presented, this time covering 83.5% of imports from the EU. Such progress sprang in particular from Brazil's willingness to include products that were absent from the previous list.

In the negotiations on market access, too, another source of difficulty on the eve of presenting the offer on goods in the FTAA was the introduction of the "emerging industry clause" in the conditionalities. This Brazilian proposal stemmed from some industrial sectors' concern about the standstill attendant on the notification of a basic tariff with very low aliquots for goods without national production. These sectors feared discouraging new investment for such products if it were impossible to offer temporary protection to the industry.

Brazil suggested that this condition, which had been included in the offer made by MERCOSUR to the EU in 2001, be included in the offer for the FTAA. Uruguay reacted negatively because it feared two effects: higher protection (at Brazilian initiative) for inputs and capital goods that currently have low tariffs; and the danger that other members of the future FTAA might raise

protection against Uruguayan export products. The first concern was dissipated by the commitment that if the mechanism were approved in the FTAA it would only be used by common agreement among the MERCOSUR countries. The second concern was not relevant in the negotiations with the EU, though it is in the FTAA talks. In the negotiations with the EU, the mechanism was dealt with as a development clause that could only be used by MERCOSUR. In the FTAA it can be used by all members.

Agriculture

A key common interest among the MERCOSUR countries in their negotiations with developed countries is the liberalization and elimination of distortions to agricultural trade. One of the main sources of unity for MERCOSUR in these fora is the prospect of eliminating export subsidies, arranging internal support measures or addressing sanitary and phytosanitary measures.

Note too that each member country would have to make a different number of concessions in order to have a significant effect on their market access, because of the differences in their economic size. Each country makes a different assessment of the prospect of limiting the scope of the demands.

Antidumping

Organizing the application of antidumping measures so as to avert their abusive use is one of the main issues for Brazil in the negotiations with the United States (FTAA and WTO). This is not important for Paraguay and Uruguay.

Until recently, Argentina seemed reluctant to share Brazil's stronger positions in these fora because it lacked significant productive sectors whose exports would be affected by such barriers, although the country often used these measures. In May 2003, however, the Argentine government submitted to the WTO a document that, in broad terms, took the same position as Brazil. Apart from being an important gesture of closer alignment with Brazil, this initiative might have been motivated by the recent experiences of Argentine exporters subject to US antidumping investigations.

Services

As mentioned earlier, the lack of a common regulatory framework in the member countries, differing degrees of openness consolidated in the GATS, and differences in size and expectations of future trends in certain segments complicate the joint negotiation of commitments to liberalize services in other fora.

For Brazil, the services negotiations are a delicate issue. The country has some competitive service sectors that could benefit from the opening of third country markets. Since Brazil's experience in the concession and regulation of public services is very recent, however, and since the country wants to develop high-tech service sectors, it is reticent about making commitments that hamper the prospect of adjusting the regulation and implementation of incentives for those sectors.

Argentina and Uruguay have high levels of consolidated commitments; Paraguay has been more conservative in this regard. In preparing offers for the FTAA and the EU, therefore, the MERCOSUR countries could only devise common preambles, accompanied by different national lists of commitments. In the FTAA talks, the strategy of maintaining MERCOSUR unity is undermined in this regard: on the deadline for making offers, Argentina and Brazil decided not to do so while Paraguay and Uruguay did.

Investment

The negotiations on investment are also complex for MERCOSUR, since there is no legal framework for intra-subregional investment or for flows from outside the bloc. The two protocols governing these matters were signed in 1994 but were not transposed into domestic law.

In this area too the main difficulty is posed by Brazil, one of the few countries that has not implemented any bilateral agreement on the promotion and protection of investment. Brazil has signed such accords but none have entered into force because of parliamentary resistance to some of the agreements' provisions, such as extensive commitments to the investment pre-establishment stage and mechanisms for settling disputes involving investors and states. Negotiation of this matter is particularly difficult in the FTAA because the agreement being designed follows the NAFTA model, which includes such provisions.

Since many of these bilateral agreements are in force in the other three MERCOSUR member countries, Brazil is the chief problem in negotiating this issue. Moreover, the new Brazilian government has made plain its concern to avoid international commitments that constrain the use of industrial policy instruments.

The different national policies on investment incentives have been a prime source of controversy among the MERCOSUR countries. In their detailed analysis of the issue, Chudnovski and López [2001] propose some criteria for a common MERCOSUR policy on investment incentives.

In this area too there are no common regulations, a circumstance that hampers group negotiations. As with services, investment offers have consisted of a joint preamble and lists of national commitments.

Government procurement

MERCOSUR's government procurement regime has been under negotiation since 1997 and no agreement has yet been reached. The main issues are the coverage of the agreement (whether it should be only federal or also cover states, provinces and/or municipalities, and the kind of bodies to be subject to the agreed rules); whether to establish preferences for the MERCOSUR member countries over extra-subregional competitors; and whether to include public service concessions in the regime.

The different positions on these matters, which thus far have blocked a MERCOSUR agreement, have also hampered the coordination of positions in external negotiations. The issue of the agreement's coverage, for example, incites significant differences between Brazil and the other

members. Recently, Uruguay has found it hard to assume commitments to national treatment in this agreement because of its new program on government procurement. The new Brazilian government has also been more cautious in assuming commitments in this area, since it hopes to make greater use of government procurement as an instrument of industrial policy.

There are some difficulties in the coordination of positions for specific issues in the negotiations, and the same can be said of the larger strategies. The different views of how to relate to the United States have been a source of permanent tension. Argentina and Uruguay have explicitly and repeatedly expressed a wish for bilateral agreements with the United States. This has raised discomfort in Brazil, concerned as it is with the possible effects of such a development on MERCOSUR's unity and the weakening of its bargaining leverage.

To deal with the mounting pressure from these two countries, in a June 2001 meeting of the Common Market Group the four members agreed to propose the reactivation of the 4+1 mechanism (the 1991 Rose Garden Agreement). Each country's interpretation of the significance of the initiative, however, was different. Argentina and Uruguay were very keen to conclude a free trade accord through this mechanism, while the Brazilian government was more skeptical about its scope. Washington's reaction to this initiative was not especially encouraging, and little progress has been made on it since then.

The debate on the 4+1 mechanism (now viewed more positively in some quarters of the Brazilian government) has been revived by the obvious current difficulties in the FTAA negotiations, the lack of concrete progress in areas of interest to the MERCOSUR countries (especially in agriculture), and the discrimination in offers on goods presented by the United States - which made fewer concessions to MERCOSUR than to other regions in the hemisphere. In this case it is a question of reaching some understanding with the United States so as to guarantee access to its market and reduce the scope in areas that are sensitive for Brazil, such as investment and services - given the US unwillingness to negotiate agricultural subsidies and antidumping. The US government, however, continues to evince little enthusiasm about this idea.

Even for MERCOSUR the 4+1 negotiations - though less ambitious than the FTAA agenda - could be complicated. Given the different sizes of the MERCOSUR economies and the asymmetries in their productive structures, the US offers on liberalization tend to be assessed very differently by the member countries. Moreover, US demands for liberalization in MERCOSUR will have a much greater effect on Brazilian sensitivities in the industrial and services sectors.

Finally, the negative impact of the failed attempts to renegotiate the ALADI preferential agreements (Mexico and the Andean Community) as a group are not insignificant, especially among the business community. These experiences reveal the enormous differences between the interests of the MERCOSUR members in their trade relations with the Latin American countries, and underpin the outlook of some Brazilian sectors that the smaller MERCOSUR partners hamper the conclusion of such accords so as to avoid losing preference margins in the Brazilian market. Doubtless this was not the main barrier to such agreements (which often faced greater resistance from non-MERCOSUR countries), but this perception among Brazilian sectors has nourished a view that MERCOSUR should abandon the customs union project and concentrate solely on the free trade area, freeing the member countries to negotiate bilaterally with other countries.

III. CURRENT DILEMMAS

The MERCOSUR countries implemented trade opening programs that were not properly matched by policies to boost competitiveness. Some structural reforms were geared to that end, but other priorities (such as consolidating economic stability, and especially public finance adjustments) hampered reforms to eliminate the anti-export bias of internal policies. It is important to lower import tariffs, but it is essential to cut the bureaucracy involved in foreign trade, reduce taxes on exports, and upgrade the efficiency of infrastructure.

Against that background, the policies of the 1990s did not give rise to the expected growth of exports. Various export-promotion programs were announced throughout that period, especially in Brazil and Argentina, but they failed to help remove the main barriers to exports. It should be acknowledged that, apart from the internal and intra-MERCOSUR obstacles, the bloc faces structural difficulties in increasing its extra-subregional exports: geographic location, Latin America's low growth rate and developed country protectionism in the sectors in which the MERCOSUR countries are competitive.

Increasing exports is deemed to be a prerequisite of sustainable growth for the MERCOSUR countries. Although the resumption of external capital flows can be anticipated, the experience of the 1990s reveals the need for a satisfactory export performance to lessen the national economies' vulnerability to international financial crises. If boosting exports is a national economic priority, it should be reflected on MERCOSUR's trade agenda. If MERCOSUR is to make economic sense, it should decisively help raise the competitiveness of the subregion's products.

If export expansion is crucial to overcoming the external constraints on the member countries' resumption of economic growth, a contribution to job-creation in all the member countries should be a prime outcome of the integration process. Hence trade policy-making and the design of instruments for economic integration should pay priority attention to exports and job-creation.

The recent debate on MERCOSUR's future has been dominated by the "free trade area *versus* customs union" dilemma. If the choice between "free trade area" and "customs union" is not enough in itself to surmount the dilemmas of integration, it is a matter that has to be settled because it conditions the nature of MERCOSUR's external relations.

In a context of international volatility and a deterioration in economic conditions among the member countries, the decline in subregional trade and direct investment sharpens the image in the smaller countries, especially Uruguay, that the costs incurred by retaining high tariffs on capital goods and inputs is not offset by comparable benefits.

At the same time there is a growing perception in some countries that the commitment to the customs union and the attendant need to negotiate the whole external agenda as a group are more costly than beneficial. Supporters of bilateral agreements are becoming firmer in arguing for the deferment of the customs union project.

In theory, a deeper integration model fosters efficiency gains, boosts productivity, enhances conditions for international economic insertion and readies the countries for international trade negotiations. As an intermediate step to a deeper integration model, the customs union has the advantage of being more transparent and involving lower transaction costs than a free trade area.

For such benefits to be enjoyed, however, a common protection structure must be defined; policies and regulations that might interfere with protection strategies must be harmonized; internal trade controls must be eliminated; and mechanisms to distribute customs revenue must be devised. As Bouzas [2002] points out, these are very demanding measures and sometimes they can be beyond the countries' capacity.

While it might be difficult to implement these measures in the short term, it does not seem advisable to take a step backward and forego the progress made by the customs union. The value of group unity in MERCOSUR's external negotiations cannot be disregarded. The rest of the world is tending to place greater value on that asset than do the MERCOSUR member countries. Even with all the problems that the members have faced in devising common positions and speaking with a single voice in the FTAA negotiations, for example, MERCOSUR has been able to make its voice heard in many of the negotiating fora.

The value of the customs union, moreover, should not be underestimated in terms of the foreign investment already made in the member countries, whose common external tariff is important for their business strategies. Abandoning the project could have an appreciable effect on the members' credibility as regards their respect for regulations and contracts.

If the costs of retaining the customs union seem high at the moment, it should be kept in mind that in recent years the economic situation has been particularly inconducive to a decision on a strategy of such importance for MERCOSUR's future. In the context of renewed economic growth and the possible convergence of macroeconomic policies, the advantages of the customs union will be more apparent to all the members. This debate, nonetheless, should not halt progress on deepening because, as mentioned, maintenance of the CET does not guarantee an integration model that is deep enough to address the challenges of the external agenda.

Often, negative perceptions of the customs union really reflect problems with the free trade area. As Bouzas recalls, MERCOSUR's main problem is not that it is simply an incomplete customs union but that the free trade area is fragile. While the debate on the dilemma mentioned earlier is very important, therefore, there is a long list of crucial and urgent tasks to be carried out before the benefits of the free trade area become apparent.

The "deepening *versus* widening" dilemma is also to be tackled in devising an agenda for the coming years. There can be no doubt that "cosmetic" attempts to save MERCOSUR are unlikely to succeed. The member countries will have to deal with the challenge of making the integration process credible and sustainable, an effort that calls for a plan both ambitious and realistic. The experience of the 1998-2001 period showed that MERCOSUR could produce a large number of protocols and agreements that gave a false impression of progress because they were not transposed into the domestic law of the member countries. Hence the MERCOSUR agenda should be broad enough to reflect the member countries' strategic vision of integration initiatives, and at the same time should include a realistic program that sets priorities.

Just as MERCOSUR is not responsible for the decline in economic and political conditions in its member countries (which essentially spring from economic policy options that were carefully preserved in the face of all proposals on intra-bloc coordination or negotiation), the possible improvement of economic and political conditions in the members is a prerequisite of renewed dynamism in the integration process.

IV. SOME ISSUES FOR A FUTURE MERCOSUR AGENDA

The suggestions in this section are based on conclusions drawn from the analysis in the previous chapters. It should be noted, first, that despite the deficiencies of the integration process, the repeated difficulties in moving forward on some central issues, and the grave economic crises besetting the member countries in recent years, MERCOSUR has offered clear benefits to its members. A deliberate reverse is unthinkable in the present context, given the huge economic and political costs of such a decision.

Note, second, that although the analysis of MERCOSUR's problems has several significant dimensions, they are all rooted in two difficulties that must be tackled if the others are to be resolved: the absence of mechanisms to attenuate the effects of differences in economic policy, and the lack of instruments to smooth out asymmetries in productive structures.

Third, recall that in the present circumstances three factors make it more likely that a serious effort to deepen integration would be successful: greater convergence among the four countries' economic policies after the changes in the Argentine and Uruguayan exchange rate regimes; new governments with a fresh and pro-integration spirit in three of the four countries; and the challenges of the three most ambitious external negotiating fronts (WTO, FTAA, EU), which could facilitate progress in areas of MERCOSUR's incomplete agenda.

The suggestions herein relate to specific issues on the trade agenda, not to those concerned with macroeconomic coordination or the institutional dimension. They are grouped into main issues, and are presented in an order of assessed viability and priority.

1. Maintain cohesion in the negotiating agenda

It is essential to maintain MERCOSUR's unity in the negotiations for the FTAA and with the EU, and at the same time to enhance the systematic coordination of intra-MERCOSUR positions in the multilateral WTO negotiations. Negotiating as a group strengthens the bargaining power of each of the member countries. That cohesion is essential for MERCOSUR's future as a deep integration project.

2. Create mechanisms to attenuate the trade effects of severe fluctuations in exchange rate parities while macroeconomic coordination programs are not in place

In a new context wherein the MERCOSUR countries are experiencing a period of greater convergence in exchange rate policy, an agreement on safeguard mechanisms would be very useful. It would help foster greater stability and attenuate future disputes in the case of substantial new variations. An instrument with well-defined rules could play an important role against protectionist sectoral lobbies, reducing the discretionary use of mechanisms such as antidumping measures.

should be in place for maximum period, there should be a well-defined schedule for their elimination, and they should be accompanied by sectoral restructuring programs. This mechanism should apply for a limited time and should merely be palliative, while the bloc makes progress on macroeconomic coordination.

3. Eliminate non-tariff barriers and adopt the measures contemplated in the MERCOSUR Business Facilitation Program

As well as applying the measures included in the program, progress must be made on harmonizing technical norms and regulations, and on fostering systems for the mutual recognition of conformity. Demands for prior licenses to import products that are unrelated to matters of security or public health should be eliminated.

4. Transpose into domestic law the instruments negotiated at the MERCOSUR level that have not yet entered into force.

Among the priorities in this area is parliamentary ratification of the Montevideo Protocol on trade in services, which would give full legal force to the liberalization commitments already assumed in three rounds of negotiations. In general, the member countries should pledge to ratify and transpose into domestic law the instruments negotiated at the MERCOSUR level that cannot enter into force because the countries have not implemented the measures arising from those commitments.

5. Conclude the MERCOSUR Government Procurement Agreement

An agreement on government procurement among the countries of the bloc would help boost trade in sectors that are of particular interest to the smaller countries.

6. Deploy instruments that foster a greater integration of productive chains and that are conducive to the basic aim of expanding MERCOSUR exports⁷

In this stage the instruments to be developed for this purpose should respond to the problems attendant on asymmetry of information and deficient infrastructure, so as to facilitate exploitation of the opportunities of closer integration between companies in the member countries and their relations with the rest of the world.

7. Devise financing mechanisms to facilitate integration

A matter of vital importance for real success is to devise financial instruments for infrastructure projects that promote physical integration and industrial reconversion. Steps to include FONPLATA in the Andean Finance Corporation are important in this regard.

The availability of financing to promote intra-subregional trade is another priority, and the Brazilian initiative to set up a substantial financing mechanism for this purpose is very positive.

⁷ A series of interesting proposals in this regard are presented in IDB /INTAL [2003] p. 96.

The expansion and modernization of the instruments of the Reciprocal Credit Agreement should also be studied.

8. Discipline the use of incentives for production and investment

The obvious difficulties in making progress on this issue should not hamper efforts to tackle it. There is a need for criteria for a common MERCOSUR policy on production and investment incentives, and for mechanisms to tackle the distortions created by the existing instruments.

9. Regulate the incentives granted by special import regimes

An essential part of MERCOSUR's agenda is to determine how to deal with special import regimes and those governing intra-subregional trade in goods produced in special customs zones.

10. Review MERCOSUR's rules of origin regime

A rules of origin regime is an absolute necessity in a complete customs union. Since it will take time to do this, however, it is advisable to review the current rules of origin system and to make changes that are conducive to a greater integration of MERCOSUR's productive chains.

11. Avoid the introduction of new barriers or distortions caused by a lack of coordination in creating or changing internal regulations

One of MERCOSUR's main problems has been the national governments' lack of awareness of the effects of domestic regulations on the other partners. Hence, without advocating short-term progress on the harmonization of policies that will have to be addressed in future, the countries should be willing to discuss with their partners initiatives to change norms or introduce new regulations that could have significant effects on the customs union. An example is the tax reform currently under discussion in Brazil.

12. Rationalize the structure of the CET

In the negotiations for the FTAA and with the European Union, the countries have already reported basic tariffs on the basis of the CET's current structure. During the negotiations it is difficult to propose extensive and unilateral reforms that lessen protection levels, thereby foregoing the chance to trade them for concessions from the other members. Nonetheless, it is both possible and advisable to undertake further analysis of the incongruities and to design the ideal structure, keeping in mind that the CET (as an instrument of protection) will tend to become less important over time if the negotiations for the FTAA and with the EU are successfully completed. In any case, even in the short-term, some of the most evident distortions can be corrected.

13. Implement complementary instruments for the consolidation of the customs union

The adoption of a common customs code, the elimination of the CET's double taxation, and the definition of criteria to share out customs revenue are crucial to the consolidation of the customs union and to deepening the integration process. This set of measures should also include implementation of a common regulation against third country dumping and import subsidies.

The current crisis in the MERCOSUR countries cannot and should not serve as a pretext for a passive attitude towards the problems facing the subregion, nor as an excuse for the member states to distance themselves from the integration project. Analysis of the MERCOSUR experience shows that the project is far from reaching its goals but that it has brought undeniable benefits for its members.

At present, a series of simultaneous factors offer a singular opportunity to move the project forward. Otherwise, simply maintaining the *status quo* will cause MERCOSUR to lose relevance in the face of other trade integration initiatives. The agenda proposed above is not exhaustive but rather is intended recall some issues that command attention on the basis of the analysis in the preceding sections.

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