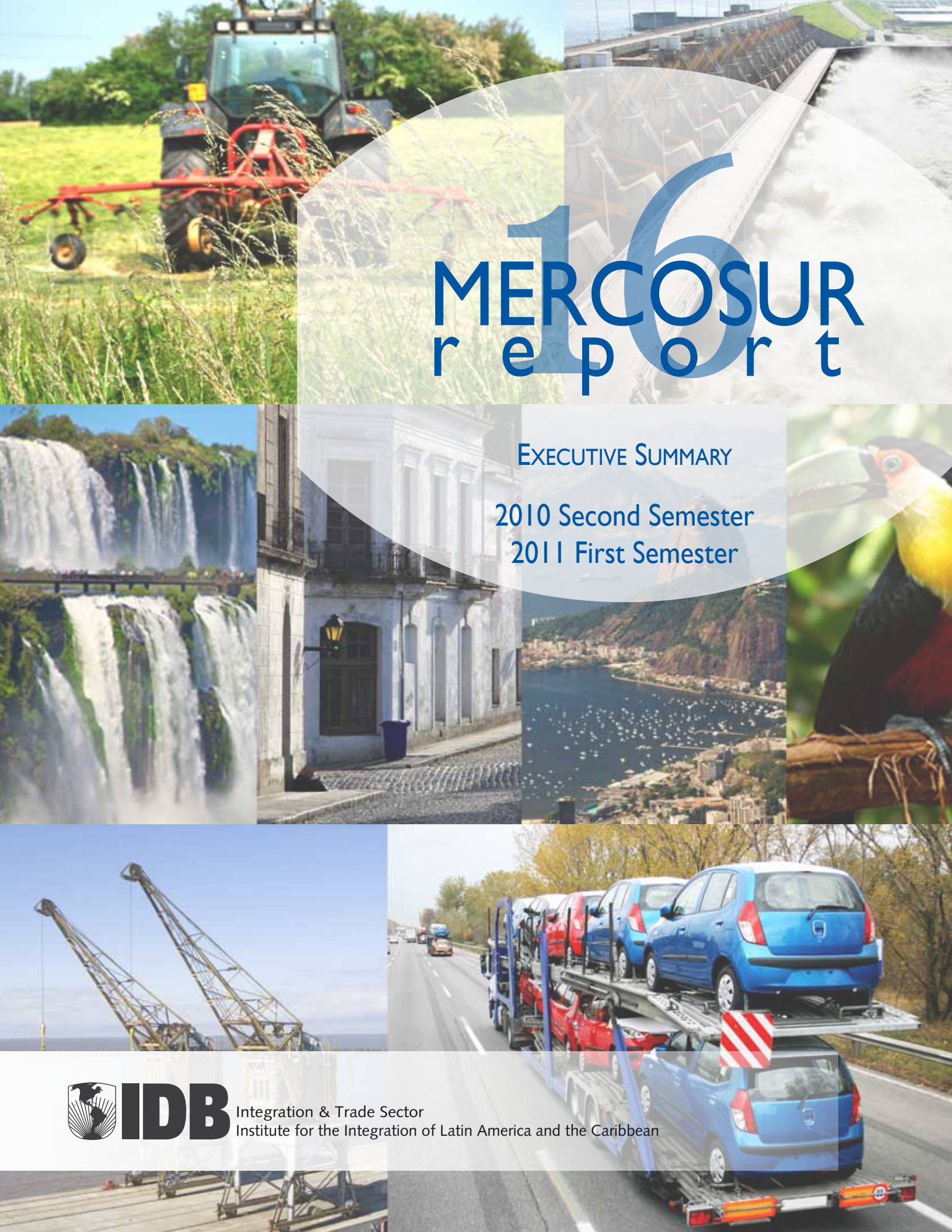




16 MERCOSUR report

EXECUTIVE SUMMARY

2010 Second Semester

2011 First Semester



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Integration & Trade Sector
Institute for the Integration of Latin America and the Caribbean

MERCOSUR Report N° 16

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Integration & Trade Sector (INT)
Institute for the Integration of Latin America and the
Caribbean (INTAL)



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EXECUTIVE SUMMARY

MERCOSUR Report No. 16 (July 2010-June 2011) analyzes the macroeconomic outlook and trade flows of the Southern Common Market (MERCOSUR) countries, as well as the main aspects of the bloc's integration process, in terms both of its internal and external agendas.

Macroeconomic Outlook and Global Scenario: According to preliminary estimates, year-on-year (YOY) global GDP will rise 4.0% in 2011, a deceleration of 1.1 percentage point on the previous year. The slowdown that began in the second semester of 2010 continued in the first semester of 2011, while the fiscal policies of core economies, such as United States and the Eurozone – veered toward restrictive positions, under pressure from growing deficits, and the sovereign debt crisis in several European countries. Similarly, there has been no resolution of the difficulties in major segments of the international financial system. According to the above projections, the GDP of the developed countries will grow just 1.6% in 2011. The emerging countries, on the other hand, should grow 6.4% in 2011, driven by Asia, which continues to be the most dynamic region. Last, by the end of 2010, world trade volumes recovered their 2008 levels, but then slowed, while prices are still below their pre-crisis highs.

The deterioration of the balance of trade in goods continues to represent a deterioration of the current account for MERCOSUR's full members. There was a surplus in the capital and financial accounts in all countries during 2010; only in Argentina was there a negative result in the first part of 2011. The GDP of MERCOSUR's full members recovered quickly in 2010 after the crisis of 2009, driven by internal demand, particularly due to private consumption and investment, while the contribution of net exports was negative. Except for Venezuela, which saw renewed growth, the forecast for the economies in 2011 is one of slowdown. The swift recovery of MERCOSUR countries' activity over 2010 made possible the gradual withdrawal of the expansionary policies that had been implemented the previous year to tackle the international crisis, while maintaining the anticyclical nature of the measures. Employment and poverty indicators improved over 2010 and the first semester of 2011, with the exception of Venezuela.

Evolution of trade and FDI: MERCOSUR's trade flows reached a record US\$537.448 billion in 2010. The higher growth rate of imports (42.4%) with respect to exports (29.5%) led to a US\$25.186 billion reduction of the trade surplus. In the first semester of 2011, exports kept up the previous year's pace of expansion (29.9% YOY), while imports slowed to 31.8% YOY.

Due to the increase in MERCOSUR's external sales being greater than that in world imports, the bloc's share of global external purchases rose to 1.82% in 2010, a trend that continued in the first semester of 2011. The level of MERCOSUR's intrazone trade at current prices (i.e. the countries' total exports to the other three partners) in relation to the bloc's total exports stood at 15.7% in 2010 and has continued to show a slow but steady increase since the low of 2002. The intrazone trade reached a US\$44.077 billion high in 2010 and was just over US\$25 billion in the first semester of 2011.

MERCOSUR's trade with all regions of the world expanded in 2010, with Asia standing out as the most dynamic market for the bloc's sales, in addition to being the main source of extrazone imports. This region, which in 2002 was behind the European Union and the North American Free Trade Agreement (NAFTA), is now MERCOSUR's main trading partner, accounting for around a third of the bloc's extrazone trade. While trade with the countries of the Latin American Integration Association (LAIA) represents a low proportion of the total, it

accounts for a good deal of the positive result of the bloc's balance of goods. External sales to NAFTA and the EU expanded less than imports from these origins, thus expanding the bloc's trade deficit with the former and reducing its surplus with the latter. While the momentum of foreign sales in Argentina and Brazil in 2010 was brought about by export prices rather than quantities, for the smaller partners the impact of the growth of quantum exported was greater than the effect of prices.

In trade with Venezuela, MERCOSUR's external sales to the destination grew faster than its total imports. In turn, the bloc's purchases from its trading partner grew faster than total Venezuelan sales in 2010. While Brazil continues to be the bloc's main exporter to Venezuela, its sales in the first semester of 2011 were up just 0.4% YOY, whereas Argentina's exports grew 27.0% YOY.

Income from FDI to MERCOSUR set a new record, of US\$58.189 billion in 2010, just above the historic high of 2008. Preliminary data to the first semester of 2011 suggest that FDI amounted to almost US\$36.077 billion, with the momentum coming from Brazil, as the bloc's biggest recipient of FDI.

This first chapter includes a section on the trade ties and productive development of the bloc's smaller economies -Paraguay and Uruguay- and analyzes their insertion in the period 1992-2008.

The Internal Agenda: The Brazilian and Paraguayan *Pro Tempore* Presidencies (PPT) did not keep up the previous period's pace of progress, although there was some progress in issues such as productive integration, the elimination of the double levying of the Common External Tariff (CET), and the distribution of customs revenue. The Customs Union Consolidation Program was approved at the end of 2010, with a series of programmatic commitments and a task schedule for the trade agenda looking ahead as far as 2019. The Macroeconomic Monitoring Group (GMM) made progress in harmonizing statistics. A Working Group was also set up to develop a Common Automotive Policy proposal, and another was set up to develop and exchange information on incentive measures. MERCOSUR's Productive Integration Group (GIP) was also instructed to examine alternatives for cooperation entailing preferential terms for technical assistance, training and/or financing to micro, small, and medium enterprises involved in productive integration between the States Party. In tariffs, an High-Level *Ad Hoc* Group was set up, with the mission to oversee work on the first phase of the elimination of the double levying of the CET and the distribution of customs revenue. The High-Level Group to Examine the Consistency and Dispersion of the Current Structure of the CET (GANAEC) was instructed to submit a proposal for a comprehensive revision of the CET to the Common Market Group (GMC) by 2014 for the entire sample, with the exception of capital goods, and information technology and telecommunications goods, which are analyzed in a specific *Ad Hoc* Group. The deadlines for the National Lists of Exceptions to the CET were also revised. Regarding the works of customs union consolidation, the partners agreed on the need to reformulate the procedures for the preparation, review, incorporation, and validity of Technical Regulations, Conformity Assessment Procedures, and Sanitary and Phytosanitary Measures (SPS) approved in MERCOSUR.

At Paraguay's request, it was stipulated that the States Party are to submit a first set of initiatives designed to overcome the bloc's asymmetries and improve the smaller economies' competitive insertion. On the one hand, a report was compiled containing a regulatory diagnosis of the States Parties' Services Sectors, defining them on the basis of their relative sensitivities for liberalization; on the other hand, the scope of the Recruitment Protocol and Regulations will be reviewed, and a document of general guidelines will be drafted for the negotiation of an

instrument in investments. The new regulations of the MERCOSUR Structural Convergence Fund (FOCEM) entered into force and four new projects were approved.

In institutional matters, the post of MERCOSUR High Representative was created, and work continued on the criterion of citizen representation for the MERCOSUR Parliament (PARLASUR), whose budget was approved. In social matters, work continued on the MERCOSUR Strategic Social Action Plan (PEAS) and the progressive development of a MERCOSUR Citizenship Statute. The MERCOSUR Social Participation Support Unit was also set up.

Sector Disputes and Trade: MERCOSUR saw a resurgence of trade disputes and tensions, partly due to the lower external sales growth in relation to purchases from the rest of the world, which led to a drop in the partners' trade surpluses. There was an increase in trade protection measures, primarily in the two largest partners. This affected both extra- and intrabloc origins. The expansion of the sample of products subject to Non-Automatic Licensing (LNA) by Argentina mainly affected Brazil and China, but also to the smaller partners. The measure resulted in a conflict with Brazil and prompted claims by Uruguay. Brazil decided to apply LNA to its automobile imports, affecting imports from all origins. After lengthy negotiations, the largest partners reached an agreement to cap trade restrictions. The sectors that saw the main trade restriction measures were the automobiles, textiles, footwear, white-line goods, dairy products, and tires.

Anyway, MERCOSUR's concern over China's growing share in its manufacturing imports continued to prompt some convergence of interests and encouraged the use of other trade defense instruments by all the bloc's partners.

The External Agenda: Based on a proposal by Paraguay, it was agreed to prioritize the external agenda, relying on analyses and feasibility studies of the potential benefits expected from various negotiations, including trade agreements, cooperation agreements, and political ties. Negotiations with the European Union continued during the period and some progress was made in the regulatory and normative texts, although there was no specific exchange of offers, and dialogue was resumed with Canada to assess the possibility of forming a free trade area (FTA).

In parallel with the negotiating fronts opened up with developed countries, MERCOSUR saw some progress in various different formats of understanding with the developing countries, even though many of these have not yet progressed beyond the very limited framework or preference agreements stage. The MERCOSUR-Egypt agreement was ratified by the partner countries, with the exception of Argentina, and the agreement with Israel came into force. The negotiating rounds with Jordan analyzed tariff reduction offers without reaching consensus over the formation of an FTA. A Memorandum for political dialogue and cooperation was signed with Turkey, as was a Framework Agreement for the creation of an FTA with the Syria, which has not yet been ratified by Uruguay and Paraguay. The Framework Agreement on Trade entered into force between MERCOSUR and Morocco, and a Framework Agreement on Trade and Economic Cooperation was signed with the Palestine Liberation Organization.

The MERCOSUR countries took an active part in UNASUR, the highlights of which included several actions by the South American Economy and Finance Council and the technical work for the 2012-2022 Strategic Plan of the South American Infrastructure and Planning Council (COSIPLAN) and its technical forum, IIRSA. The countries also took part in the formulation of the Community of Latin American and Caribbean States (CELAC) and held regular meetings with the LAIA countries.

