

Challenges and prospects of development of a Western Hemisphere connection - *the Mercosur in discussion*

Elói Martins Senhoras¹

ABSTRACT

This paper discusses theoretical concepts and practical implications involved in the current transformations of the Common Market of the Southern Cone. Mercosur as the third-largest trading bloc in the world is focused according to its development along the time and its implications in the progress of the Free Trade Area of Americas. The main goal of this discussion is to pursue a better understanding of this regional agreement as well as its future.

Keywords: Americas, FTAA, Mercosur, regional integration.

RESUMO

DESAFIOS E PERSPECTIVAS DE DESENVOLVIMENTO DE UMA CONEXÃO DO HEMISFÉRIO OCIDENTAL – O MERCOSUL EM DISCUSSÃO - Este artigo discute conceitos teóricos e implicações práticas envolvidas nas atuais transformações do Mercado Comum do Cone Sul. O Mercosul, como o terceiro maior bloco de comércio do mundo, é estudado segundo o seu desenvolvimento ao longo do tempo e sua implicação no progresso da Área de Livre Comércio das Américas. O principal objetivo desta discussão é buscar um melhor entendimento deste acordo regional e o seu futuro.

Palavras-chave: Americas, ALCA, Mercosul, integração regional.

¹ Universidade Estadual de Campinas (UNICAMP) – Instituto de Economia (IE)
Cidade Universitária Zeferino Vaz - 13.083-970 - Campinas – SP eloi@eco.unicamp.br-Economist with specialization in management and strategic business in the State University of Campinas and visiting scholar in the University of Texas at Austin and in the University of Buenos Aires. Special Acknowledgements to the CAPES foundation for the financial support.

Introduction

Mercosur is not a new concept. On the contrary, the idea of integration has been a constant factor in a shared history, even going back to the period before the discovery by the Spanish and the Portuguese, and has continued to develop over many centuries even after independence from the respective imperial powers. (PEÑA, 1997, p. 19)

One of the most significant current transformations in the Southern Cone of Latin America was the launching of Mercosur, a regional integration initiative that includes Argentina, Brazil, Paraguay, and Uruguay as full members, in association with Chile and Bolivia through a free-trade agreement.

The four countries signed a treaty in March 1991, although Brazil and Argentina had already engaged in a bilateral program of integration and cooperation since 1985. Free-trade agreements with Chile and Bolivia were signed in 1995 and 1996.

The 1991 agreement provided the establishment of a common market through the gradual harmonization of external tariffs towards a common regime and gradual trade liberalization within the region.

Mercosur is the third-largest trading bloc in the world after the European Union and the North American Free Trade Area (Nafta). Mercosur represents the coming together of two projects: one political, defined by the democratic commitment of the participating members, and the other economic, aimed at liberalization and commercial openness among regional members and within the global economy.

After several years of negotiating the Treaty of Asuncion, Brazil, Argentina, Paraguay and Uruguay inaugurated Mercosur, a regional common market group, in January 1995. Under Mercosur the trade partners agreed to reduce tariffs on imports from signatories gradually until 2006, when the 10,000 items that make up the tariff listing of all four countries must conform to a common external tariff regime.

During the negotiations over the Treaty of Asuncion between March 26, 1991, and Mercosur's inauguration, trade among the partners increased from 8 to 20 percent, making the case for a subhemispheric common market stronger.

Since its creation Mercosur has contributed to a threefold increase in trade among its members. The common market, however is in dire straits now in the wake of the Argentine financial crisis and continued economic instability in Brazil, Uruguay and Paraguay. Mercosur is also at a crossroads regarding the role it will play in the continuing FTAA process.

2 Mercosur and regional integration in the Americas

Mercosur is only the latest in a list of common market schemes in the American continent. Interestingly, Latin America's experience with economic integration is almost as long as that of Western Europe. However, until the early 1990s, the region's experience with integration was largely unsuccessful.

Macroeconomic imbalances, such as budget deficits and hyperinflation, forced many countries into a protectionist mode. Moreover, weak authoritarian regimes facing a serious socioeconomic crisis were in no position to embark upon regional integration initiatives.

Table I – List of common market schemes in Latin America

1960	Latin American Association of Free Trade (ALALC)	Initiated a process for forming a common market in 12 years. Although this goal was unfulfilled because of persistent differences among the group's members, intraregional trade increased from 7.7% in 1960 to 13.8% in 1980.
Subhemispheric common market groups unconnected to ALALC that emerged		
1960	Central American Common Market	Costa Rica, Guatemala, El Salvador, Honduras and Nicaragua. It was replaced in 1980 with the Latin American Integration Association
1969	Andean Community	Bolivia, Colombia, Ecuador and Venezuela
1980	Latin American Integration Association (ALADI)	Unlike ALALC's mission of forming a common market, ALADI's goal was to foster the formation of preferential trade agreements among subhemispheric groups
1994	North American Free Trade Area (NAFTA)	A tripartite free-trade area organized to reduce tariffs across the United States, Canada and Mexico
1995	Common Market of the Southern Cone (MERCOSUR)	Designed to be a common market among developing countries: Brazil, Argentina, Uruguay and Paraguay (original members) and Bolivia and Chile (invited members)

Source: Author's Elaboration. Based on Brandao and Pereira (1996, p. 11).

The formation of trading blocks is pointed out as one of the main trends brought about by the globalization process. The deeper integration in the European Union and the establishment of the North American Free Trade Agreement in 1992 led to a 'domino effect' of renewed interest in preferential trade areas (BALDWIN, 1995).

As a preferential trade area, the Mercosur treaty listed four instruments for forming the economic common market: trade liberalization program, common external tariff; the coordination of macroeconomic policy; and the adoption of sectoral agreements.

2.1 What motivated the countries to form and join the Mercosur?

Mercosur comprises about 250 million people and accounts for about 50 percent of Latin American industrial output and total exports. These numbers demonstrate the gains of scale brought by a regional integration.

The Mercosur agreement represents the nature of the recent Regional Integration Agreements (RIA), which is different from earlier wave of postwar RIAs, as it is more defensive than integrationist in nature, with smaller countries seeking 'safe-haven' trade agreement with larger countries. In fact, nearly all members of the WTO belong now to one or more Regional Integration Agreements.

According to Kaltenthaler & Mora (2002), there are three general types of explanations for a regional integration: geo-political, political economic and domestic politics. These 3 explanations for Mercosur are listed as follows.

Table II – Hypotheses for the Formation of Mercosur

Type of hypotheses	Motivation for integration	Mercosur Members
<i>Geo-political</i> Security alliance	Integration to meet outside security threat	None
Neo-functionalism	Integration to reduce security dilemma	Argentina and Brazil
<i>Political economic</i> Economic bloc	Integration to meet foreign economic competition	Argentina, Brazil and Chile
<i>Domestic-led</i> Institutionalism	Domestic economic actors push integration to maximize their gains from trade	Argentina, Brazil, Bolivia and Chile
<i>Regime support</i>	Integration to improve domestic economy to raise public for the regime	Argentina, Brazil, Bolivia, Chile, Paraguay and Uruguay
<i>Institutionalization of democracy</i>	Integration rules make democracy a prerequisite for participation, thus reducing the likelihood of reversion	Argentina, Brazil, Bolivia, Chile, Paraguay and Uruguay

Source: Author's Elaboration. Adapted from Kaltenthaler & Mora (2002).

2.2 Problems and advances in Mercosur

Since the Protocol of Ouro Preto in December of 1994, which marked the end of the transition period, apart from a few institutional changes, further advances have been clearly sparse. In 1995 and 1996 issues concerning consolidation of stabilization plans dominated Mercosur countries, with priority given to national solutions.

Little effort was given to widening (expanding membership) and deepening (creating institutional infrastructure and economic policy coordination) the integration process that can, for example, facilitate further trade integration and direct foreign investment and quickly resolve disputes among members and associates (PEÑA, 1999, p. 49-63).

Table III - Structural problems in the Mercosur

Asynchronous macroeconomic cycles
Absence of harmonization of macroeconomic policies
Dependence on a few countries
Lack of a permanent institutional framework

Source: Author's Elaboration. Based on Gonzalez (1997).

According to Edwards and Susmel (2001) findings, there is strong evidence of volatile co-movements among the Mercosur countries. Brazil's currency crisis of January 1999 spilled-over to its Mercosur trading bloc partners, Argentina and Chile. As well, the evidences apply for the 2001 Argentine's crisis.

However, despite these limitations, the integration process as an economic and regional phenomenon continued its progress. The integration process that culminated with Mercosur provided its partners with a venue for the discussion of common foreign and security policies such as, environmental protection, drug trafficking, nuclear cooperation and military cooperation.

The spillover effects of integration and other confidence-building measures contributed to cooperation in these non-economic areas. Moreover, the inclusion of Chile and Bolivia in 1996 as associate members was an important step in expanding Mercosur markets while moving in the direction of broadening regional integration.

3 Does Mercosur have a future?

Mercosur, by far including two of the largest economies of Latin America - Brazil and Argentina - has never been eager to create a meaningful free trade area for the entire hemisphere. It would like to protect its industries from outside competition, and has no desire to agree to the types of rules governing intellectual property, investment and government procurement that should be part of a muscular trade deal.

From a leftist point of view (conceito de "leftist"?), Mercosur is explicitly seen as a step along the road towards a Latin American Community that would extend from Tierra del Fuego to Río Bravo. One of the aims of many activists is to establish closer co-operation and eventual unification between Mercosur and the Andean Community (MÁSPERO, 1998, p. 15).

The regional integration projects in Latin America are in a state of Flux. The overlap is considerable: there are many possible new projects that would incorporate the Mercosur countries. Perhaps most importantly, there is the struggle between the US attempts to rewrite Nafta for the entire continent, and the Latin American attempts to create more autonomous and perhaps even more social-democratic integration arrangements.

The resulting South American regional bloc would in these visions then be able to resist the hegemonic advances of the FTAA or other integration schemes directed by the US, and struggle for the establishment of the Latin American Community that would not

include the US. Ideally, it would also help Latin Americans defend themselves from the negative aspects of the agreements of the World Trade Organization (MARINI, 1994).

Even in the scenario of Mercosur and the Andean Community both being subsumed under FTAA or a similar hemispheric integration process, there are some plans for a civil society participation, possibly through 'exporting' the South American model to the FTAA.

According to Jelin (2001), the negotiation of "integration" is thus a high-level process, in which state officials and business representatives play a leading role. In these negotiations there are two logics, which theoretically may appear to be mutually contradictory. On the one hand, there is a rational approach based on interests, a calculation of costs and benefits, according to which the agreements reached result in common advantages.

Agreements will only be reached in areas or on subjects where the cost-benefit calculation is not defined in zero-sum terms, that is, in situations in which the advantages for some do not imply disadvantages for others.

3.1 Mercosur and the free trade area of Americas a la carte

The FTAA has been discussed to be a free-trade bloc throughout the nations of the Western Hemisphere, with the exception of Cuba, still under a U.S. trade embargo. At about 800 million people, it would be the world's largest common market.

This initiative calls for the creation of a preferential trade arrangement with \$9 trillion in gross domestic products, encompassing the 34 democracies of the hemisphere, with negotiations scheduled to conclude by 2005.

The countries within the FTAA differ greatly in size and development, from the United States to the small island nations of the Caribbean.

Some countries have 80 percent of trade with the U.S. The countries of Mercosur have only 20 percent of their trade with the U.S. These are different realities that must be taken into account.

Can large industrialized economies, emerging markets, and small economies integrate with all parties benefiting equally?

Some would argue that the negative impact of Nafta and the disparities in the WTO structure regarding the implementation of the rules and requirements are vivid examples of how the FTAA approach is doomed to fail. What is the alternative, if any?

Regional arrangements take a variety of forms and vary radically in scope, depth, and governance mechanisms as well as in the collective political commitment to reduce regional imbalances and enhance socioeconomic integration. The FTAA future is going to be dependent on these variables that can shape by different ways the future of the area.

The discussions in Miami have moved forward the integration, but in a flexible and very low commitment way. Brazil and the United States forced upon the other nations a very general framework that calls for talks in nine areas - as such as intellectual property rights and agriculture - while giving countries flexibility and allowing them to pick and choose their levels of involvement in some of the more contentious issues within the FTAA. This can be called a Free Trade Area of Americas a la carte.

This means that a fast-track to FTAA is not opened anymore, but even though of being a la carte, the Free Trade Area of the Americas overtime has tended to move on slowly, getting shaped in one direction, as negotiators announce a series of separate trade agreements with the American nations.

The new US policy of deepening bilateral agreements makes part of the ongoing FTAA negotiations, reflecting the American leadership on what is called the Spaghetti Bowl of trade agreements.

Table IV - US separate trade agreements with Latin American nations

Trade agreement with the Andean nations since 1991
Negotiations with Chile, CACM and Uruguay in Progress
Negotiations with Colombia and Peru and later with Ecuador, Bolivia and Panama for the second quarter of 2004
Trade agreements with the "Four plus one" group (Mercosur-US) for 2004

Source: Author's Elaboration.

The negotiation with Mercosur is one of the most important for the future of the FTAA. This agreement might reinforce or cut the pace of the FTAA process. This means that Brazil's leadership within Mercosur attempts to extract concessions from Washington on the type and pacing of trade liberalization in the hemisphere.

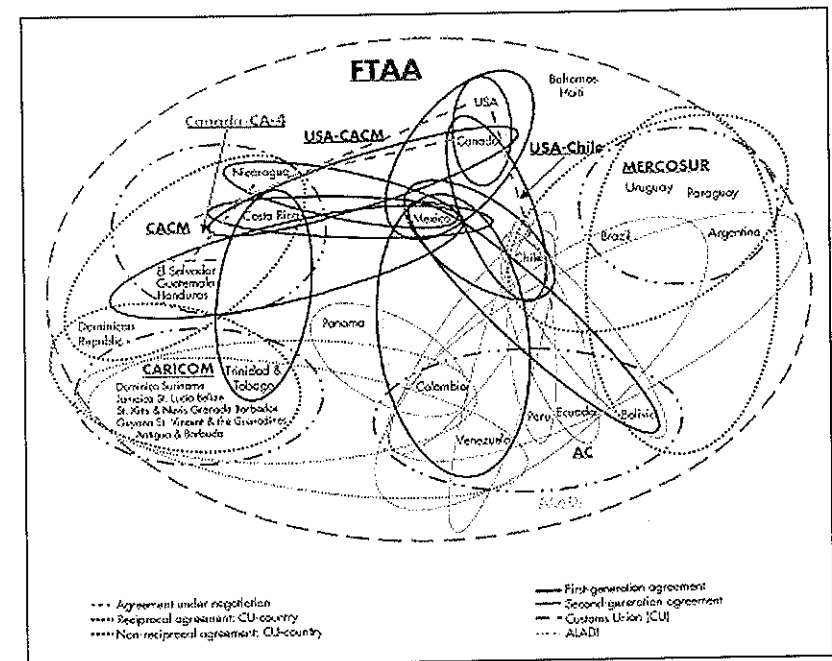


Figure 1 - Spaghetti Bowl of American Trade Agreements

Source: IADB (2002, p. 64).

4 Final remarks

Trade relations within the hemisphere have been expanding rapidly. Countries in the region are moving forward with regional trade pacts in advance or perhaps in lieu of the FTAA.

There are now five regional trade pacts, including the Mercosur common market, which encompasses South America's economic power house: Argentina and Brazil. But why Mercosur may not finish after the establishment of the FTAA in the short run?

Maybe it is not possible to sell all of the products to the United States and it may not be interesting for them in competitive terms of balance of trade. The development of alternative markets is important to the Latin American countries. And Mercosur goes a long way to strengthen and develop more trade agreements with other Latin American countries outside of Mercosur, as it has done with the Andean community, in 2005.

Table V - Priorities for Mercosur to advance growth through trade

Countries must identify and counter adverse incentives that are built into existing physical and educational infrastructural priorities and wasteful competition among sub-national governments
Countries must supplement devolution of responsibility for various public functions, including economic development, to provincial and local governments with adequate technical assistance, sufficient financial resources, and anti-corruption campaigns and create conditions for a culture of cooperation and collective governance.
Countries must selectively engage in regional development strategies for those places worst hit by emerging import competition or accept losses to new competitors elsewhere, enabling them to preserve, upgrade and transfer resources, especially human talent, into new forms of competitive economic activity.

Source: Author's elaboration.

Mercosur's trade policy reform calls for a reciprocal action between Mercosur and nonmember trading partners. Hence, if regional integration can stimulate further international cooperation and multilateral trade liberalization, then a more conducive economic environment for all countries can be anticipated.

Furthermore, as the progress toward an FTAA has slowed, countries in regional trade pacts are beginning to pursue agreements outside the hemisphere, particularly with the European Union and countries of Asia and Africa.

As the second largest trading bloc in the western hemisphere after Nafta, Mercosur not only affects its member countries' economies, but also nonmember countries that have high trade shares with it.

These factors demonstrate why Mercosur in the short term will remain as an important player as far as the three important trading partners of Mercosur are the US, the European Union and the Mercosur countries themselves.

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