FIVE
Mercosul: Beyond 2000
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INTRODUCTION

Despite a few hitches, until mid-1998, the regional integration process in the Southern Cone was generally viewed as making fairly good progress. In fact, after over three decades of frustrated attempts, the Mercosul South Cone Common Market was firming up as the first integration project in Latin America to achieve a reasonable level of success. Even within the broader context of the global economy, it was rated as an auspicious and original experiment in establishing an economic bloc linking economies that were still developing. Until recently, it was quite natural to look ahead towards a promising future for Mercosul, without this being dismissed as mere wishful thinking.

However, by year-end 2000, the circumstances are completely different. A best-case scenario—or even a fairly optimistic view—may no longer be appropriate as a working hypothesis underpinning a speculative exercise. This exercise was designed to describe the probable progress of this integration project during the first two decades of the new century. The range of options is currently far broader, and the probability of the occurrence of any specific scenario requires careful qualification.

This chapter is divided into three sections, in addition to this Introduction. The second section offers a brief analysis of the impacts of integration in the Southern Cone, highlighting the static effects, dynamic impacts and non-traditional gains arising from this process. The third section discuses the current deadlock in Mercosul, while avoiding a detailed examination of trade disputes flaring up among its members. To the contrary, stress is placed on the fact that Mercosul is not the only possible strategy for opening up the global economy to its two main members, as these clashes may be due to the existence of non-convergent alternatives running parallel to the integration drive. The fourth and final section focuses on Mercosul's external negotiations agenda, concluding with somewhat cautious forecasts for the future of this integration project.

OVERVIEW OF THE IMPACTS OF INTEGRATION

Regionalism is a phenomenon that has appeared over the past 40 years. In fact, through to early 2000 some 95 per cent of the 120 regional trade agreements notified to GATT/WTO were signed after 1960. During this period, the process of setting up free trade areas and customs unions saw two major upsurges: the first during the 1970s, when just over 60 agreements were notified to GATT, most involving the European nations; the second took place during the first half of 1990s, when some 30 initiatives were notified.

The collapse of the Soviet bloc was the main factor driving the more recent second wave of regionalism.[1] In fact, the break-up of the former Soviet Union spurred the countries of Central and Eastern Europe to seek trade agreements with the European Union (EU) and the European Free Trade Area (EFTA) as part of the process of restructuring their economies. Consequently, leadership of the integrationist process was once again taken over by Europe, which accounted for the largest number of trade agreements notified during the first half of the 1990s.

During this same period, regionalism posted significant advances in the Western Hemisphere that were few in number, but highly relevant in qualitative terms. The signing of the Treaty of Asuncion in 1991 launched the integration process in the Southern Cone, followed soon after by the introduction of the North American Free Trade Agreement. NAFTA sanctioned the establishment of a huge free trade area interlinking the three major economies in North America. Uncertainty and frustration over the outcome of the Uruguay Round (which apparently bogged down during the early 1990s) were key factors in the establishment of NAFTA, prompting the USA to explore other alternatives, moving away from multilateral negotiations. In the case of the Mercosul Southern Cone Common Market, the incentives were mainly political, particularly the almost simultaneous consolidation of the redemocratisation processes in the two main countries of this region: Argentina and Brazil.

In 1995, the importance of regionalism was unquestionable: intra-zone trade accounted for some 53 per cent of global trade, and the integration agreements actually in effect (just over 50 of the 109 notified to GATT/WTO by that date) clearly proved the dynamic nature of this process, while also revealing significant potential for expansion.[2]

Rising concern over the proliferation of regional trade agreements within WTO and elsewhere consequently caused little surprise. In fact, from the mid-1990s onward, regional initiatives began to undergo increasingly stringent assessment and analysis processes, measuring their compatibility with the multilateral trade deregulation efforts stipulated in the GATT/WTO rules.

In general, these assessments focused initially on the static effects of preferential trade schemes, particularly on the discriminatory effects of integration agreements that adversely affected non-member countries. Not by chance, this approach is preferred by those adopting a critical stance to regionalism. More recently, however, closer attention has been paid to the dynamic impacts of integration. Together with a number of the 'non-traditional' gains associated with the sweeping integration processes, these impacts are stressed mainly by those who urge and support integrationist initiatives.

Despite their importance, dynamic impacts are not easy to identify or to quantify, which is why empirical evidence in favour of preferential trade agreements is rarely in generous supply.[3] Even in cases where identification of the benefits introduced by preferential trade liberalisation seems both feasible and convincing, regional schemes are challenged under the claim that unilateral liberalisation can produce even greater benefits. Consequently, assessments of regional trade agreements are always surrounded by much controversy.

The following summary presents the proof gathered from several examinations undertaken to analyse the *pros* and *cons* of the Mercosul Southern Cone Common Market. From many aspects, the situation is still far from conclusive, but in general, it indicates a favourable outcome for the integration process in the Southern Cone.

Static effects, dynamic impacts and non-traditional gains from integration in the Southern Cone

Static effects

The formation of free trade areas or customs unions may either increase or diminish members' welfare. The benefits generated by the integration process depend on the extent of the 'trade creation' effect, while its costs are associated with the scope of the 'trade diversion' effect.[4] The net balance of these effects decides whether or not a preferential trade agreement is beneficial or harmful to its members.[5]

In Mercosul, static effects have been analysed through a number of estimates. At least two relatively important studies concluded that the integration project had promoted trade diversion to a significant extent. Based on a gravity model, one of these studies showed that intra-zone imports were appreciably higher than those forecasted by the model, which would indicate the possible existence of trade diversion.[6] In the terminology enshrined by this type of model, Mercosul does not constitute a 'natural' trade bloc, but is rather a 'super-natural' arrangement.

Based on the joint use of regional intensity indexes for exports and revealed comparative advantages indexes,[7] the second study had an even greater impact. According to this analysis, both the re-orientation of export flows favouring the regional market and fostering a rapid upsurge in trade among its members, as well as the high share held by capital-intensive manufactured products in intra-zone trade flows, revealed the existence of significant trade diversion. In the view of Yeats,[8] preferential tariffs and discriminatory sectoral policies—particularly the common automobile regime—are key factors behind the impressive upsurge in intra-bloc exports, as well as their concentration in products where Mercosul does not exhibit any obvious comparative advantages. This becomes evident from the minor share held by these products in extra-zone trade flows.

This study prompted strong reactions, even at the diplomatic level. Critics questioned the fact that Yeats grounded his conclusions on the performance of exports rather than imports. In a later work, Nagarajan[9] adopted the same methodology developed by Yeats in order to examine trade diversion, but now the analysis was based on imports. Nagarajan noted that from this standpoint the results were not conclusive. The study also spotlighted two significant facts that run counter to the concerns expressed by Yeats: (i) extra-Mercosul imports also rose at very high rates, keeping pace with the upsurge in intra-zone flows; and (ii) extra-bloc imports continued to be heavily concentrated in high-technology products, even after the establishment of the Southern Cone Common Market. Both these observations would suggest that the extent to which trade flows are diverted might well not be too significant.

An examination of intra- and extra-Mercosul trade flows over the past decade ratifies these conclusions. The growth rate for extra-zone imports (11.9 per cent p.a.) was very high during the 1990s, and the difference in terms of the increase in intra-zone flows (16.3 per cent p.a.) is not expressive. In fact, Mercosul has grown into a highly dynamic importer market for *both* its regional members and its trading partners outside the bloc (see Table 5.1).

Table 5.1:
Mercosul: Intra- and extra-zone trade flows—1990/1999 (US$ million)

	Year						*Growth (% per annum)*	
Description	*90*	*91*	*93*	*95*	*97*	*99*	*90/97*	*90/99*
Total exports	**46,433**	**45,911**	**54,046**	**70,494**	**83,473**	**74,315**	**8.7**	**5.4**
Intra-Mercosul (%)	*8.8*	*11.1*	*18.6*	*20.5*	*24.9*	*20.7*	26.0	15.7
Extra-Mercosul (%)	*91.2*	*88.9*	*81.4*	*79.5*	*75.1*	*79.3*	5.8	3.8
LAIA (%)	*7.1*	*9.1*	*10.3*	*9.7*	*9.9*	*9.4*	13.9	12.7
USA (%)	*20.7*	*17.0*	*17.6*	*15.3*	*14.2*	*18.4*	3.0	4.0
EU (%)	*31.1*	*32.2*	*26.7*	*25.5*	*23.2*	*25.6*	4.3	3.1
Others (%)	*32.3*	*30.6*	*26.8*	*29.0*	*27.8*	*25.9*	6.5	3.6

	Year						*Growth (% per annum)*	
Description	*90*	*91*	*93*	*95*	*97*	*99*	*90/97*	*90/99*
Total imports	**27,367**	**32,328**	**46,178**	**75,708**	**98,992**	**80,039**	**20.2**	**14.9**
Intra-Mercosul (%)	*15.0*	*15.8*	*19.6*	*18.5*	*20.9*	*20.0*	*26.0*	16.3
Extra-Mercosul (%)	*85.0*	*84.2*	*80.4*	*81.5*	*79.1*	*80.0*	18.9	11.9
LAIA (%)	*7.0*	*7.3*	*5.4*	*6.1*	*5.8*	*5.6*	17.1	9.8
USA (%)	*20.2*	*21.1*	*20.6*	*20.0*	*21.2*	*21.7*	21.0	13.5
EU (%)	*21.4*	*22.2*	*22.8*	*25.9*	*26.0*	*28.6*	23.6	16.4
Others (%)	*36.4*	*33.6*	*31.6*	*29.5*	*26.1*	*24.2*	11.1	4.8
Trade balance*	**19,043**	**13,577**	**6,862**	**−5,682**	**−15,584**	**−5,096**		

Source: International Economic Centre (CEI—*Centro de Economía Internacional*), Argentina.
Note: *Trade balance between extra-regional exports and imports.

More important still, both the European Union (EU) and the US (which are leading suppliers of industrialised products for this bloc) have increased their share in Mercosul's imports.[10] Consequently, concern over the possibility of trade diversion seems somewhat exaggerated.

The marked gap between the growth in intra-zone and extra-zone exports, which is stressed by Yeats, also warrants comments. Initially, it should be recalled that intra-regional exports and imports are the same thing. This means that the excellent performance of intra-regional exports (15.7 per cent p.a.) during the 1990s, merely mirrors the flip-side of the impressive expansion in Mercosul imports over the same period: a phenomenon that benefited both its members, as well as non-member nations, as mentioned above.[11] On the other hand, the poor performance of extra-regional exports (3.8 per cent p.a.) can be explained in various ways: over-valued foreign exchange rates, significant external barriers in important markets (EU and USA), and—no less important—undeniable difficulties in producing competitive goods that undermined Mercosul exports and still continue to do so.[12]

In addition to these 'Vinerian' aspects, two other static effects are also noteworthy. First, the impact of integration on transaction costs, which some studies estimate at up to 3 per cent of gross trade values. These costs include customs formalities, a lack of familiarity with the legal frameworks regulating destination markets, foreign currencies, etc. From this standpoint, there is no denying that the regional integration process in the Mercosul has made a positive contribution, pruning these costs despite frequent changes in the regulations and provisions regulating trade transactions among its members.

Finally, the impact of integration on terms of trade should also be mentioned. This may be relevant where extra-regional imports are replaced by imports from trading partners, with a significant reduction in extra-zone demands, leading to a decrease in external prices. Consequent changes in the terms of trade benefit the members of the integration scheme, but also adversely affect non-member countries.[13] In a recent study, Chang and Winters (1999) found strong evidence of changes in the terms of trade benefiting the Mercosul, concluding that '…the effects identified here are large enough to warrant serious consideration'.[14] This conclusion is surprising, as the Southern Cone integration process coincided with an increase rather than a drop in extra-zone demands, with no significant changes in its composition.

Dynamic effects

In contrast to static effects, the dynamic impacts of integration cannot be classified through an accurate taxonomy. For instance, Winters[15] adopts a broad-ranging of the concept of dynamic ('…anything that affects a country's rate of economic growth over the medium term') and basically lists three types of impacts: (i) those prompting spill-overs among the members of the integration scheme, fostering the convergence of *per capita* income growth rates among its members; (ii) those affecting the capital accumulation rate, prompting an increase in domestic investments and/or heavier inflows of direct foreign investments; and (iii) those deriving from the interaction of economies of scale with agglomeration economies and transaction costs, affecting decisions on where to locate industrial plants.

Along the same lines, Fernández and Portes[16] emphasise the impact of preferential integration on direct foreign investment flows, as well as the capacity of the extended market to heat up competition and improve efficiency in industry, boosting income. In turn, Bouzas[17] points out increases in resources aimed at R&D, because of well-known indivisibilities in this area, and the rationalisation of regulation tools as the potential dynamic impacts of integration. Finally, other authors stress economies of specialisation, as this results in an increase in intra-industry trade, as well as a learning curve that is particularly important for small and medium-size enterprises testing the water through their first experiences in internationalisation in an extended market.

There are few Mercosul studies undertaken with the specific objective of identifying or quantifying these effects. However, there is some evidence —even if indirect—illustrating the impact of integration on direct foreign investment flows, in addition to a number of analyses focused on detecting changes in the level of international integration among the Southern Cone economies.

Impacts on investment flows

The impact of the Southern Cone integration process on direct foreign investment flows is analysed by Blomström and Kokko,[18] as well as Castilho and Zignago.[19] The authors of the first study found some evidence that the sub-regional integration process encouraged an inflow of direct foreign investment, although they saw macro-economic stabilisation in the countries of this region as a far more significant factor. On the other hand, examining the relationship between the Mercosul and the OECD countries, Castilho and Zignago (2000) noted some complementarity between trade and investment flows, but failed to identify any significant association between the integration process and the inflow of direct foreign investment from the OECD nations. Macro-economic stabilisation and structural reforms are once again indicated as the main factors behind burgeoning flows of direct foreign investment during the 1990s, headed up by privatisation processes in Argentina and Brazil.

Data on the inflow of direct foreign investment tends to confirm the impression that Mercosul played a secondary role as a factor attracting these flows (Table 5.2).

From 1991 to 1995, the flow of direct foreign investment to Argentina largely outstripped flows channelled to Brazil, with the opposite noted from 1996 to 1999. This is explained by the fact that Argentina stabilised its economy and began to privatise its state-run enterprises early in the decade, while these processes began in Brazil only in the mid-1990s.

Despite these observations, there is some evidence that the creation of Mercosul had a positive effect on investment decisions in this region. Although less relevant in quantitative terms, intra-bloc investment flows and the expansion of local companies beyond their national borders constitute a trend that has been building up over the past few years. A good example of this process is the recent establishment of over 300 Brazilian

Table 5.2:
Mercosul: Net direct foreign investment—1991/1999 (US$ million)

	Year									*Accumulated 1991/1999*	
Bloc/ Count ry	*91*	*92*	*93*	*94*	*95*	*96*	*97*	*98*	*99*	*Amo unt*	*Shar e (%)*
Merc osul	*91*	*92*	*93*	*94*	*95*	*96*	*97*	*98*	*99*	145. 011	*100. 0*

	Year									*Accumulated 1991/1999*	
Bloc/ Country	*91*	*92*	*93*	*94*	*95*	*96*	*97*	*98*	*99*	*Amount*	*Share (%)*
Argentina	2,439	3,218	2,059	2,480	3,756	4,937	4,924	4,175	20,000*	47,988	*33.1*
Brazil	89	1,924	801	2,035	3,475	11,666	18,608	29,192	26,500	94,290	*65.0*
Uruguay	32	58	102	155	157	137	113	164	145	1,063	*0.7*
Paraguay	84	118	75	137	155	246	270	235	350	1,670	*1.1*

*Source: ECLA*C (2000). Note: * Includes investment in YPF by REPSOL.

companies in Argentina. Additionally, from 1995 to 1999, direct Brazilian investments in Argentina topped US$5 billion,[20] ranking Brazil fourth among the leading foreign investors in this country.[21]

On the other hand, Argentine investments in Brazil have also risen appreciably over the past few years. According to surveys carried out in Argentina, companies in this country plan to invest some US$2.4 billion in Brazil from 1998 to 2000, more than fivefold the amount of investments between 1990 and 1997.[22]

Mapping the mergers and acquisitions taking place throughout Mercosul helps highlight the impacts of integration on the asset restructuring process of companies in this sub-region.[23] From 1992 to 1998, some 650 transactions were recorded, involving mergers and acquisitions among companies in the Southern Cone Common Market. Most of them (58 per cent) took place among companies in the same country, followed by transactions involving stakes held by the subsidiaries of multinationals already established in the country (24 per cent). The volume of cross-border transactions, meaning operations where the purchasers were companies located in other Mercosul countries, was nevertheless not negligible (18 per cent). More significant still, these transactions took place largely in important industrial sectors such as auto-spares and beverages.

In general, it may be said that both Brazilian and transnational companies, particularly those already operating with production bases established in more than one country in the region, have undertaken actions designed to rationalise their activities within Mercosul. They have redefined their production schedules and thus have ensured better economies of scale and greater specialisation, while reorganising their marketing structure. In brief, there is no lack of evidence that the Mercosul is playing a reasonably important role as a magnet for investment and modernisation processes, as well as asset restructuring in the region.

Impacts on the level of integration in the international economy

One of the main expectations of the architects and formulators of the integration project was that it would pave the way for the countries in the region to move into the international economy more smoothly. In fact, they believed that the integration process would foster the use of economies of scale, resulting in intra-industrial specialisation, and encouraging the rationalisation of regional production structures. This in turn fuels the establishment of bi-national companies, joint ventures or even multinationals based in Mercosul, and makes decisive contributions to reshape trade flows between this region and the rest of the world.

The industrial structure of this region has, in fact, been swept by major changes over the past decade. However, not all of them have resulted in the desired directions or scales, due mainly to the widely varying response of industrial companies to the new macro-economic and regulatory context of the 1990s.

The industrial reorganisation process sweeping through countries in this region can be exemplified by the case of Argentina. Examining the response of its industries to the opening-up of the import substitution model, Kosacoff and Gómez[24] basically identified two types of conduct: offensive strategies and defensive or survival restructuring. Offensive strategies were adopted by corporations investing heavily in machinery and equipment, while also introducing deep-rooted organisational changes into their production models. These companies chalked up notable increases in productivity for their industrial plants, reaching levels close to international standards. However, the level of dissemination achieved by these offensive restructuring processes was somewhat limited. In fact, no more than 400 cases were found that could clearly be ranked under this type of strategy, although producing some 40 per cent of Argentina's industrial output.

Defensive restructuring was the response adopted by some 25,000 companies accounting for the remaining 60 per cent of Argentina's industrial output. This obviously includes countless firms that failed to survive, as well as a few new enterprises. On average, the companies in this group posted notable increases in productivity and, from an evolutory standpoint, their current situation compares favourably with their status some 10 or 20 years ago. However, these companies still preserve many of the characteristics of the import substitution stage: low levels of productive specialisation, widespread vertical integration, limited development of specialised suppliers, and sizes that reach only 5 per cent or 10 per cent of the optimum scale. In brief, these companies lag well behind international standards and are unable to compete in an open economy.[25]

This brief overview of the reaction of Argentine industries to the new macro-economic setting of the 1990s, can be extended to other countries in the region. Consequently, it is not surprising that no Mercosul members have recorded any more dramatic changes in their trading levels with the rest of the world. There is much evidence outlining extra-regional export flow profiles, with export listings clustered tightly around a limited number of products. This reflects the limited market share held by Mercosul in the more developed countries, low technological content of exported goods, and the incipient nature of intra-industrial trade.

Table 5.3:
Argentina and Brazil: Total exports divided into categories of goods and destination markets (%)

	Export structure				*Export destination (1997)*			
	Argentina		*Brazil*		*Argentina*		*Brazil*	
Description	*1990*	*1997*	*1990*	*1997*	*LAC**	*ROW*	*LAC**	*ROW*
Primary Goods	**28.9**	**31.3**	**19.7**	**19.7**	**29.1**	**33.5**	**4.6**	**25.3**
Agriculture	27.4	22.1	10.8	13.6	15.9	28.3	2.8	17.6
Ores	0.2	0.4	8.9	6.1	0.2	0.7	1.8	7.7
Energy	1.3	8.8	0.0	0.0	13.0	4.5	0.0	0.0
Industrialised Goods	**71.0**	**67.7**	**79.1**	**78.8**	**70.8**	**64.5**	**95.2**	**72.6**
Traditional	33.2	29.5	28.7	30.3	20.0	39.0	21.5	33.7
High economies of scale	31.3	21.4	30.8	24.4	21.0	21.9	26.6	23.5
Durables	1.7	10.5	6.8	9.8	19.7	1.2	23.5	4.7
Technical progress disseminators	4.8	6.3	12.8	14.2	10.0	2.4	23.5	10.7
Others	**0.1**	**1.0**	**1.2**	**1.5**	**0.1**	**2.0**	**0.2**	**2.1**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: ECLAC (1999). Note: * LAC=Latin America and Caribbean/ROW: Rest of the World.
Note: Traditional: Foods, beverages, tobacco, footwear, hides and leather, fabrics.
Economies of scale: petrochemicals, paper, pulp, cement, base metals.
Durables: Household appliances, consumer electronics, vehicles.
Technical progress disseminators: Machinery, instruments, fine chemicals.

From 1990 to 1997 (Table 5.3), Argentina managed to introduce some remarkable changes in the composition of its industrialised exports, reducing the share held by traditional manufactured products and intermediate goods (industrial commodities produced in sectors with high economies of scale), while boosting the share held by goods with higher added value (durable goods and disseminators of technical progress).[26]

It should be noted, however, that these changes do not affect trade flows outside Latin America, which remain heavily concentrated on primary products and traditional manufactured goods.

In contrast, Brazil's performance is somewhat more disappointing, with only limited changes in the composition of its export listings from 1990 to 1997.

Compared to Argentina, Brazil's extra-regional trade flows are certainly less tightly concentrated on traditional products. Nevertheless, the share in extra-regional Brazilian exports (15.4 per cent) held by goods with high added value remains somewhat negligible, excluding Latin America.

There is other evidence pointing in this same direction. For instance, Pereira[27] shows that the Brazilian export concentration index for Asia and the EU is six to seven times higher than exports to the Mercosul and Latin American Integration Association (LAIA) nations. More specifically, just ten products account for over 70 per cent of Brazilian exports to Asia, and 50 per cent to 70 per cent of exports to the EU. For the USA, this figure hovers between 40 per cent and 50 per cent, dropping to under 40 per cent for the Mercosul and LAIA nations. In turn, Motta Veiga[28] shows that over 47 per cent of Brazilian exports to Mercosul in 1998 consisted of medium and high technology-intensive products, shrinking to under 28 per cent for the extra-regional flows. This gap has been narrowing very slowly: in 1990, these figures stood at 44 per cent and 22 per cent respectively Finally, Markwald and Machado[29] noted that 61 per cent of the trade in industrialised products between Brazil and Argentina was intra-industrial. This share drops to 30 per cent, 25 per cent and 17 per cent respectively for trade between these two countries and the North American Free Trade Agreement (NAFTA), the EU and Asia. Overall, the assistance offered by Mercosul in paving the way to closer integration between the countries in this region and the international economy, has been almost negligible so far.

However, there are some bright spots in this somewhat gloomy picture, as Mercosul seems to be playing a relatively relevant role in the internationalisation process of companies in this region. This comment is valid for both micro-enterprises, as well as the select group of Argentine and Brazilian multinationals. In the case of Brazilian micro-enterprises, for instance, the share of Mercosul in exports rose almost sixfold during the 1990s, up from 4.3 per cent to 24.9 per cent. For Brazilian companies as a whole, the Mercosul share rose from 4.2 per cent to 14.2 per cent over the same period. The contribution of the extended market to the internationalisation process of smaller companies consequently seems quite undeniable.

At the other end of the economic spectrum are the Southern Cone multinationals. These are large Brazilian or Argentine corporations or economic groups that provide direct foreign investments. Consisting of fewer than 30 companies with annual revenues that rarely top US$4 billion,[30] their activities are concentrated in only four or five sectors: oil and petrochemicals (Petrobrás, Repsol-YPF and Pérez Companc); food and beverages (Arcor, Sancor, SOCMA, Arisco, Garantia, Brahma and Bemberg); steel (Techint, CVRD and Gerdau); engineering services (Odebrecht, Andrade Gutierrez, Techint and IMPSA); and finance (Itaú).

Most investments by Brazilian and Argentine multinationals are channelled to their respective neighbour nations (Mercosul countries and other LAIA countries), although the USA, Europe and some of the less developed countries of Asia have also occasionally benefited from flows of investment from these corporations. Well aware of this trend, Chudnovsky and López[31] noted that the specialisation levels of Argentine and Brazilian multinationals reflect dense clustering in activities that are already mature from the product cycle standpoint.[32] Internationalised corporations operate in the services sector (finance, engineering and construction); traditional manufacturing activities (food and beverages); commodities (steel, petrochemicals, paper); or natural resources (oil). There are only a few cases of internationalisation in sectors requiring heavier investments in technologies or skills: pharmaceuticals (Bagó), telecommunications (IMPSAT) and information technology (SOCMA) in Argentina; auto-spares (Iochpe-Maxion) and transportation materials (Randon) in Brazil.

The outcome of the internationalisation process for Brazilian and Argentine economic groups is still hazy Nevertheless, there is some consensus that the establishment of Southern Cone Common Market represents a clear incentive for the development of this process, as it encourages the expansion of Brazilian groups and corporations striving to consolidate their leadership on the extended market. Despite some disappointments, internationalisation has ushered in many appreciable advantages for the companies involved, as well as their countries of origin: expanding exports, higher added value for foreign sales, increased production scales, access to international sources of financing, and streamlined corporate restructuring processes, among others.[33]

Final comments

The outcome of the Southern Cone integration process is unquestionably favourable. Intra-zone total trade rose from 11 per cent in 1990 to over 20 per cent in 1999, peaking at 23.7 per cent in 1997. To a large extent, this growth is due to domestic supplies being displaced by competitive imports from regional members, rather than to the diversion of trade flows with adverse effects on more efficient producers in third-party countries. Consequently, concern over the static effects of integration lacks any solid ground. This impression is confirmed by flourishing flows of extra-Mercosul imports, added to the lack of any appreciable changes in the market share of the countries involved or the composition of imports from these same suppliers.

Nevertheless, there is no denying that the dynamic impacts of integration have not measured up to expectations. Although it is possible to pick out some examples of intra-industrial specialisation and increases in pro duction scales, as well as a number of cases of productive, organisational and asset restructuring prompted by the establishment of an extended market, these phenomena are not widespread. More serious still, there has been little change in the pattern of extra-regional trade of Mercosul economies over the past decade. This is a statement of fact, despite the impressive inflow of direct foreign investments and some far from spectacular advances in the internationalisation process of regional firms.

However, drawing up balance sheets for preferential trade agreements requires more than just assessing the static and dynamic effects of integration. Other benefits must be taken into consideration, related to various non-traditional gains ushered in by this process. By lowering transaction costs among the member countries, integration schemes may effectively increase the bargaining power of trading partners in international negotiations, for instance.[34] In the case of Mercosul, the importance of extra-zone trade—over 75 per cent of its total commerce—has proved a particularly powerful incentive for partners in the bloc to co-ordinate their foreign trade policy, as potential gains beckon promisingly. Mercosul has already made good use of this aspect, both in the process of establishing the Free Trade Agreement of the Americas (FTAA) as well as during inter-regional negotiations with the EU. During the FTAA negotiations, the Mercosul nations were able to withstand US pressures pushing for a faster-track liberalisation time schedule, in addition to guaranteeing their participation in the negotiations as an economic bloc. Additionally, it successfully urged that a specific negotiating group be set up to deal with agricultural trade liberalisation. During preliminary discussions over setting up a free trade area with the EU, Mercosul successfully blocked all attempts to exclude agriculture from the talks agenda.

Preferential trade agreements can also provide a safety net against future events. This is the case with integration systems whose members waive contingent trade protection measures, such as anti-dumping and countervailing duties. Mercosul cannot yet be slotted into this category of agreement, because some of its members—particularly Argentina—have been enthusiastically wielding trade protection instruments, with adverse effects on its regional trading partners. However, the harmonisation competition policies for the member nations and reviews of their export subsidy mechanisms are already on the talks agenda for this bloc.

More important still from the political standpoint is the commitment undertaken by the four members to sign the Democracy Clause. This provision imposes severe sanctions on any break-away from the constitutional democratic order in any of the member countries, up to and including the possible future exclusion of the offender from the Mercosul.[35] On the other hand, by supporting a deep-rooted integration project, the Southern Cone countries ratified their option for a new style of political relationship based on co-operation, definitively leaving behind the conflict-based approaches that characterised the relationships among its partners through to the mid1980s.[36]

The problem with the 'non-traditional' benefits of integration is that to a large extent they depend on the credibility and stability of the agreements negotiated. This means they may rapidly turn into shortcomings whenever relationships among the partners begin to crumple, or when undermined by crises triggering doubts about the solidity of previously undertaken commitments. Mercosul is currently suffering a crisis of this type. Its origins and consequences are discussed in the next section.

DEADLOCKS IN MERCOSUL

After four months of a steady outflow of its international reserves, Brazil gave up on its foreign exchange band policy in January 1999, opting for the free fluctuation of its currency. This resulted in a sudden, sharp devaluation of the real against the dollar. For the other members of the integration scheme, the reformulation of Brazil's foreign exchange policy represented a dramatic shift in the rules of the game and an about-turn in the intra-bloc conditions in terms of competitiveness, benefiting the country leading Mercosul. The deterioration of the international scenario helped make this crisis even more severe. In fact, the shift in Brazil's foreign exchange policy spurred on other adverse factors that undermined the performance of all members of the bloc: shrinking international credit supplies, the simultaneous decline of economic activities in other parts of Latin America, weak commodity prices on the international market, and the widespread slowdown in global trade. Additionally, the competitive stance between the two main partners in this bloc was swayed by yet another factor: less than two weeks prior to Brazil's foreign exchange crisis, Argentina and Brazil lifted the last tariff constraints on intra-zone trade, with the only remaining exceptions being automobiles and sugar.[37] Consequently, for Argentina, the Brazilian crises took place at a particularly unfortunate time, as it coincided with the removal of the remaining tariff protection for industrial sectors rated as sensitive. In brief, these were the factors that fuelled the most serious crisis in Mercosul since the start of the integration project.

Two years after the start of the crisis, the regional macro-economic scenario is still causing concern, particularly the precarious state of the Argentine economy. However, the relationship between the partners has shown some progress. The devaluation of the Brazilian currency shrank to around 18 per cent in real terms, compared to pre-crisis levels, easing the competitive disadvantage of the other members of the bloc. On the other hand, Brazil should grow 3.5 per cent to 4.0 per cent in 2000, with its imports up more than 10 per cent, making a positive contribution to the expansion of intra-regional trade. Additionally, the balance of trade between Brazil and Argentina remains favourable to the latter, due to the rising value of Argentine oil sales to the Brazilian market. Finally, the new government in Argentina has helped—even if moderately—to make political dialogue with Brazil more fluid. Thus, in turn, Argentina has taken up a more flexible stance in its relationship with Brazil.

Despite the relatively favourable development of the relationship between the partners, the process of 'relaunching' Mercosul has proven excessively sluggish and difficult. The agenda for extending the Customs Union has posted few advances, while a variety of disputes continue in the commercial area. Lacking real effective progress in settling domestic issues, diplomatic efforts are tending to focus on the external agenda of the bloc, eager to make Chile a full member and establish a free trade agreement with the countries in the Andean Community. Nevertheless, it is obvious that the crisis in the bloc has not yet been resolved, and a solution is not prompted merely by changes in the competitive conditions ushered in by the devaluation of the Brazilian currency. There are many other broader-ranging issues now threatening the future of this integration project. These issues warrant further examination.

Political and economic issues

Initially, this deadlock has a clearly political aspect that can be described very simply: Mercosul is not the only possible strategy for moving into the international economic scenario for either Brazil or Argentina. In fact, despite official rhetoric that insists on proclaiming that Mercosul is a genuine 'politique d'État', both these countries are considering alternative options and strategies that are not necessarily convergent. At times of crisis, these alternatives obviously move upstage to appear more clearly and firmly. However, it would be naive to believe that they are prompted merely by today's delicate economic situation. Much to the contrary, the existence of strategies other than the sub-regional integration project is the outcome of more permanent factors of a structural nature, such as the size of each country, the specific characteristics of each country's production structure, and their individual history.[38]

Brazil

Brazil has at least two reasonably firm options: the first is to try to move into the world in an autonomous manner, which some more sceptical observers have called the 'Lonely Runner' strategy. The second is to urge a strategic alliance with its neighbours, in order to affirm its leadership in the region and ensure a higher profile on the international scene. However, this latter alternative is subject to the following conditions: (i) its leadership should include the whole of South America and not merely Mercosul; (ii) the costs deriving from the exercise of this leadership should be low; and (iii) its foreign policy should preserve a reasonable level of autonomy.

The option for autonomous entry expresses a view of the national interest that has never ceased to be present in the paradigm of Brazil's foreign policy. In fact, Brazil has always believed that the size of both its populace and territory, together with the complexity of its industrial structure and the clout of its GDP, are sufficient credentials for it to claim a leading role on the international scene, even with 'Lonely Runner' status. This is not a completely groundless ambition for a country whose economy rates ninth world-wide, backed by a network of broadly diversified relationships that rank it as a legitimate global trader. In fact, Brazil is often lined up with India, Russia and Indonesia as a pivot country: regional powers with their own specific weight on the global scene.

On the other hand, the strategy based on promoting Brazilian leadership in South America should also be considered as an alternative to the sub-regional integration project. This certainly does not exclude Mercosul, but rather, bypasses it. Within the framework of this alternative, the preservation of Mercosul in fact constitutes a necessary, but not sufficient condition in itself. This is because, without the support of the other countries in South America, the incentives to promote a deepening of the subregional scheme are extremely weak. Consequently, this is not an incremental foreign policy that starts with a hard core (Brazil—Argentina relationship) and extends outwards in concentric circles. It is the outer circle that shapes the inner, rather than the other way around. This results in somewhat tepid enthusiasm for consolidating this core, in parallel to a clear preference for more informal leadership, with lower costs and few rules and institutions.

The conditioning factors behind this latter alternative can be easily understood in the light of a few indicators (Table 5.4).

For instance, in aggregate terms, the Mercosul members are equivalent to only 27 per cent of the area, 39 per cent of the populace and 44 per cent of the GDP of Brazil. On the other hand, the share of the three partners together in Brazil's trade flows hovers at just under 16 per cent. From the

Table 5.4
Brazil in South America

	*Population**		*Area**		*GDP**		*GDP (PPP)**		*GDP per capita (PPP)**	
Countries in South America	*(10^6 inhab.)*	*Index*	*(10^3 Km^2)*	*Index*	*(US$ 10^9)*	*Index*	*(US$ 10^9)*	*Index*	*(US$)*	*Index*
Brazil	**165.9**	**100**	**8,547**	**100**	**767.6**	**100**	**1,070.0**	**100**	**6,460**	**100**
Rest of Mercosul (A)	*44.6*	*27*	*3,364*	*39*	*319.5*	*42*	*475.0*	*44*	*10,628*	*164*
Argentina	36.1	22	2,780	32	290.3	38	424.0	40	11,728	182
Uruguay	3.3	2	177	2	20.0	3	28.0	3	8,541	132
Paraguay	5.2	3	407	5	9.2	1	23.0	2	4,312	67
Mercosul Associates (B)	*22.7*	*14*	*1,856*	*22*	*81.9*	*11*	*144.0*	*14*	*6,314*	*98*
Chile	14.8	9	757	9	73.9	10	126.0	12	8,507	132
Bolivia	7.9	5	1,099	13	8.0	1	18.0	2	2,205	34

	*Population**		*Area**		*GDP**		*GDP (PPP)**		*GDP per capita (PPP)**	
Countries in South America	*(10^6 inhab.)*	*Index*	*(10^3 Km^2)*	*Index*	*(US\$ 10^9)*	*Index*	*(US\$ 10^9)*	*Index*	*(US\$)*	*Index*
Andean Community (C)	*101.0*	*61*	*3,620*	*42*	*261.7*	*34*	*513.0*	*48*	*5,067*	*78*
Colombia	40.8	25	1.139	13	100.7	13	239.0	22	5,861	91
Venezuela	23.2	14	912	11	82.1	11	133.0	12	5,706	88
Peru	24.8	15	1,285	15	60.5	8	104.0	10	4,180	65
Ecuador	12.2	7	284	3	18.4	2	37.0	4	3,003	47
Subtotal (A+B+C)	**168.3**	**101**	**8,840**	**103**	**663.1**	**86**	**1, 132.0**	**106**	**6,709**	**104**

Source: World Development Indicators (World Bank, 2000). Note: *Data from 1998.

Brazilian standpoint, these asymmetries constitute an undeniable stumbling-block to any extension of the regional integration scheme, particularly for issues involving constraints on its national sovereignty.

The inclusion of the other countries in South America in this comparison undoubtedly changes this situation. Nevertheless, the weight of Brazil is still equivalent to that of the nine partners together. The trade between Brazil and the countries in the Andean Community and the associate members of Mercosul is still relatively modest, with the global share held by South America in Brazil's trade flows barely topping 22 per cent. On the other hand, Brazil's unwillingness to bear the costs of more formal leadership of either Mercosul or even South America, within a broader context, can be better understood through an examination and comparison of its *per capita* GDP: Brazil ranks well below Argentina, Uruguay and Chile, and only just above Colombia and Venezuela. In fact, Brazil is above only Bolivia, Ecuador, Peru and Paraguay, and even so, its income distribution profile is more jagged than most of these latter countries.

The fact that Brazil's foreign policy simultaneously includes alternative strategies for moving into the global economy, lies at the root of the lack of definition and the ambiguities permeating its economic and commercial relationships with its partners in Mercosul. First, unilaterism is particularly noteworthy, reflected in the use of economic policy tools that rarely take into account the impact of domestic policy measures on the economies of its regional partners. In fact, Brazil took over as the natural leader of this bloc and assumed that the other partners would passively implement policies tailored to Brazil's activist approach.[39] However, there is no clear perception of the limits to be respected by this leadership. They cannot be either hegemonic or the outcome of coercive dynamics, as this would run the risk of incompatibility with the intention of fostering a strategic alliance.[40]

Another element to be stressed is the lack of a community vision, understood as a genuine concern that Mercosul should make effective contributions to the industrial development of the other regional members. This concern was in the fore prior to the formal establishment of Mercosul (1985–90), but faded during the 1990s. In fact, the explicit objective guiding talks on the initial bilateral agreement between Brazil and Argentina was to usher in an intra-industrial specialisation and complementation scheme within the framework of reasonably well-balanced and symmetrical trade. This was intended to avoid the possibility of any type of intra-industrial specialisation among the countries. For Argentina, this was in fact the only acceptable basis for an integration agreement with Brazil, as both government and business reject any project that might relegate Argentina to the role of a mere supplier of agricultural raw materials or industrial commodities.[41]

The idea that the regional partners could specialise in producing primary goods with low added value and develop into markets for Brazil's industrial output, still shapes many of its attitudes. Quite correctly, Lavagna[42] stresses that the Argentine interest in this type of proposal is nil. If Argentina decided to enter the global economy solely on the basis of its static advantages, its target would not be just the Brazilian market, but rather the entire world. In turn, Motta Veiga[43] stresses that one of the driving ideas behind Brazil's foreign policy is to help build up the conditions for the development of Brazilian industry. This would be why Brazil does not support integration based on liberal policies. However, according to Motta Veiga, Brazil is also reluctant to support integration based on policies that would foster the industrial development of the region as a whole, as its industrialisation project is domestic rather than community-based. This explains its aggressively competitive stance in terms of its policy for attracting foreign investments, as well as its lack of interest in setting up a regional bank to finance development projects within Mercosul. Furthermore, it also explains its opposition to *maquilas* in Paraguay, as well as its utterly intransigent position during the crisis that swept through the first six months of 1999, when it refused to discuss any type of measure—even temporary—with Argentina in order to cushion the dramatic shift in competition conditions resulting from the devaluation of its currency.

Briefly, unilateralism and the lack of a community-based vision—as well as a certain unwillingness to incur the costs deriving from the exercise of leadership—

are the results of the Brazilian stance, which is based on a foreign policy that is still reluctant to opt definitely for an integration project through Mercosul.

Argentina

Like Brazil, Argentina is also analysing the possibility of an autonomous global economy as a strategic alternative to Mercosul. In this case, its options are not very different from the strategy already adopted by Chile, whose economy is supported on an industrial base that is far narrower, and three to four times smaller than that of Argentina. The options are: (i) lower import costs; (ii) encourage specialisation in limited groups of sectors; (iii) exploit market niches that require intensive use of skilled labour; (iv) sign free trade agreements with the largest possible number of partners; and (v) try to preserve preferential access to the Brazilian market, in order to enhance its attractions and streamline the inflow of direct foreign investments.

If Brazil's strategy for autonomous entry to the global market may be restricted by over-confidence in its true possibilities, the Argentine strategy errs the other way: it may underestimate the potential of the Argentine economy and propose a development model whose capacity to guarantee the balance of its foreign accounts and underpin full domestic employment may be uncertain.[44]

The option for a Chilean-style strategy reflects an ongoing discussion in Argentina that picks up momentum whenever conflicts flare up with Brazil. This was the case in 1993, when the bilateral trade balance was highly favourable to Brazil, and discussions over the establishment of the Common External Tariff (CET) were dragging, due mainly to protectionist demands from a variety of industrial sectors in Brazil. This reappeared in 1995, when Brazil introduced its own automotive system that, although inspired by a similar scheme in effect in Argentina since the start of the decade, ran counter to the provisions of the Treaty of Ouro Preto. Soon after, Brazil decided to offer tax incentives to foreign auto-assemblers setting up plants in Northeast Brazil, once again fuelling discussions over the flimsy trustworthiness of the major partner and the convenience of reformulating the entire integration project. Since mid-1998, when the first signs of the Brazilian crisis became apparent, open discussions have been under way in Argentina over the possibility of turning Mercosul into a simple free trade area. Downsizing this regional integration project would allow Argentina to take back the reins of its own trade policy, opening up a new round of tariff reductions and establishing trade agreements with new partners—in brief, opting for a strategy similar to that of Chile.

From the political point of view, opting for this alternative would officially firm up the triangular relationship between Argentina, the USA and Brazil, with the former as its main ally and the latter as its principal market. This strategy was clearly explained by Escudé (1998):

> The alliance with the USA has three functions: Eliminating barriers to Argentine development due to useless political clashes that have taken place for decades; discouraging the potential buccaneering spirit of certain military sectors in Chile without earmarking funds to purchase weapons, and curbing the expectations of Brazil, as the alliance between Argentina and USA shows that Argentina is not willing to face up to the USA through Third World utopias remote from the immediate interests of the Mercosul nations. In turn, the alliance with Brazil meets three main objectives; encouraging economic integration at the subregional level, which is vital for the development of Argentina; imposing limits on its alliance with the USA and clearly indicating that Argentina would not tolerate any US attempt to intervene in the domestic affairs of Brazil (for instance, claiming the need to protect the eco-systems of Amazonia), while also helping discourage the potential buccaneering spirit of some military sectors in Chile.[45]

By considering a strategy offering an alternative to Mercosul, Argentina has also heaped coals on other disputes and irritated Brazil. However, this irritation has been caused far more by the consequences of the political emergencies of the alternative Argentinean project than by its outcome at the economic level. In fact, the strategic dependence of this partner on a power outside South America is more threatening for Brazil than the weakening of its preferential status on the Argentine market. As a matter of fact, suggestions of 'shrinking' Mercosul into a free trade area have been backed by some segments of the Brazilian public opinion as well. However, the Argentine initiative of negotiating its status as an ally outside NATO was rated as far more provocative, as at the same time it refused to support Brazil's claim to a Permanent Seat on the UN Security Council.

The new government, which took office at Argentina in late 1999, boosted optimistic expectations in Brazil. In fact, it was believed that an effective shift would take place in the policy of alignment with the US. However, the new administration introduced only moderate adjustments to the guidelines shaping Argentina's foreign policy, reflecting a diplomatic style that is both undefined and defensive. Its financial fragility and heavy dependence on international capital markets have undoubtedly helped prune its negotiating power. The fact is that—despite some discomfort— Argentina seems resigned to clinging on to the US bandwagon.[46]

Legal and institutional issues

Mercosul suffers from legal and institutional shortfalls. This diagnosis is generally agreed, prompting little dispute. However, the relevance of the problem and its implications for the future of Mercosul—as well as which members benefit, which are adversely affected, and what solutions should be adopted—are all subjects where widespread disagreement prevails. Consequently, it is worthwhile attempting to offer a brief overview of these issues.

There are three main problems: (i) the rules approved by Mercosul entities do not constitute community law *strict sensu,* but are merely international law in the classic sense, consequently requiring prior inclusion in the domestic legal arrangements of the member countries through the procedures defined by constitutional rules or laws in each of them; (ii) Mercosul lacks an effective system for settling disputes, and has no juridical entity that is empowered to interpret and apply the agreements and; (iii) the organs established by Mercosul are all intergovernmental and consequently political in nature, implying mechanically analogous negotiations for political and technical matters, with obviously adverse effects for the latter.[47]

With regard to the problem of the juridical status of Mercosul in the member countries, it should be stressed that there are marked differences among its members. For instance, Argentina acknowledges the hierarchy of the international treaties as being superior to national law and even constitutional provisions.[48] Paraguay also accepts a supra-national juridical order, although in a more restricted manner, as international rules are subject to later control by its Supreme Court of Justice.[49] There is far more uncertainty over the judicial status of integration law in Brazil and Uruguay, where: 'international treaties do not prevail over the Constitution, or even over domestic infraconstitutional law, and are merely equivalent to domestic law, by which they may be modified'.[50] In realistic terms, this means that a national law sanctioned by the Legislative Authority in Brazil or Uruguay, may at any time refuse to acknowledge the matters agreed through the Treaty of Asuncion. In the case of Brazil, it is worthwhile emphasising that in 1995 there was an attempt to introduce a constitutional provision similar to that of Argentina, which was swiftly dismissed by Congress.[51] The political implications of this fact are undeniable, as it illustrates the resistance built up in Brazil to proposals that involve curbs on its sovereignty. Consequently, it is not surprising that Argentine observers feel that the current situation breaches the reciprocity of rights and obligations enshrined in the Treaty of Asuncion.[52]

On the other hand, the need to move ahead with including these rules in national juridical arrangements, makes the decisions of Mercosul entities void in juridical terms. This results in asymmetrical or muddled situations in cases where the rules are already incorporated in one country but not in another. The process of including these rules is also extremely timeconsuming, depending solely on the will of the member countries.[53] Not without good reason, the fragility of the juridical arrangements of Mercosul has been blamed on the fact that the states have deliberately sidestepped rigid legal obligations that could curtail their room for manoeuvre.[54]

With regard to the system for the settlement of disputes, Mercosul has established reasonably complex procedures stipulating that disputes should be initially dealt with by inter-governmental entities, and if no agreement is reached, they should then be subject to the decision of an *ad-hoc* Arbitration Court. This consequently avoids establishing a supra-national Court of Justice, or even a permanent Court of Arbitration.

There are many criticisms of this system. Initially, it discourages the use of formal mechanisms and encourages the political solution of disputes, as if they must be handled initially at the inter-governmental level. The settlement of trade disputes through diplomatic means has a negative effect, as every dispute seems to be vital for the continuity of the regional project.[55] Secondly, the *ad hoc* nature of the Court hampers the accumulation of jurisprudence, as changes in its composition eliminate the moral constraints imposed on a Court by its own precedents.[56] Thirdly, without a Permanent Court, there is no juridical entity empowered to interpret and apply the agreements or reply to queries.

The possibility of establishing a Permanent Court has been under discussion by the member countries for at least two years. But this step is meeting resistance, mainly from Brazil. Paradoxically, the members of Mercosul have promptly accepted the system for the settlement of disputes introduced by the World Trade Organisation (WTO). This system regulates their trade relationships with partners all over the world, while refusing to establish a similar mechanism for settling their own disputes, despite their common project.[57]

However, the most serious problem is the essentially political nature of Mercosul entities, and the lack of any technical organisation. Mercosul institutions are staffed by civil servants, not necessarily permanent and appointed by their respective governments. They act according to the instructions received from their superiors, quite naturally complying with the existing hierarchy in the government area to which they belong. Interaction among decision-taking entities occurs after each country has filtered these issues through the mesh of its domestic interests. Consequently, each government arrives at the negotiating table urging its own specific interests, which may run counter to those of the Customs Union.[58] Consequently, the strategic vision is lost, as there is no one to present the common interest (i.e. the interests of Mercosul). This spotlights an obvious need to establish independent entities staffed by civil servants working for Mercosul rather than its member states, with the sole function of urging policies that will help fine-tune the Customs Union. Although these entities will naturally be assigned only pro-positive powers, they are nevertheless of the utmost importance.

The legal and institutional shortfall outlined above is causing concern, as it fuels disputes and makes doubts worse, while delaying the resolution of problems. In keeping with the viewpoints of the smaller members, including Argentina, the current juridical and institutional framework undermines the trust inspired individually by the countries to which investors channel their resources. This results in a situation that favours the largest market—i.e. Brazil. The lack of standards and the prevalence of slap-on-the-wrist rules also tend to favour Brazil due to its greater capacity to force decisions, or delay the settlement of disputes.

However, from the Brazilian point of view, the current decision-taking system, based on consensus, deserves criticism, as it leads to a fictional equality among the partners, granting the smaller nations excessive power.[59] Nevertheless, Brazil refuses to accept any proposal that includes the settlement of certain issues by a qualified majority This is because it would result in a discussion of the 'thorny' and presumably insoluble issue of the distribution of voting power among the member countries. In fact, given the current configuration of Mercosul, with only four members (and bearing in mind differences in size among its members), it is difficult to imagine any type of voting power share-out that would be acceptable to Brazil, while at the same time preserving the political identity of the other members.

Despite these comments, it is obvious that there is ample room for introducing changes in the current institutional framework of Mercosul. Outstanding among the solutions already presented are: (i) setting up Technical Committees; (ii) introducing an Arbitration Court endowed with greater independence and endowing its officers with a certain stability, or alternatively, the introduction of a juridical entity empowered to interpret agreements, reply to queries, and guide national courts in the application of the law emanating from the Mercosul rules; (iii) establishing fast-track procedures or deadlines for the inclusion of the rules in national juridical arrangements; and (iv) the introduction of a common anti-trust bureau to protect competition and ensure fair trade practices.

The current halt in institutional discussions cannot be blamed solely on the attempts to prevent the 'issue of supra-nationality' from even being approached. The lack of an effective strategic commitment to the integration project, as outlined above, constitutes a more plausible reason explaining this real instructional phobia.

NOTES

1. Serra, J. *et al. Reflections on Regionalism. Report of the Study Group on International Trade,* Carnegie Endowment for International Peace, Washington, 1997.
2. Ibid.
3. Winters, L.A. stresses this point critically: 'Having found that the static benefits are usually rather small or possibly even negative, advocates of regional integration arrangements typically appeal to the dynamic effects. However, what these constitute and how they come about are frequently rather vague and the evidence linking dynamic benefits to particular instances of integration very difficult to pin down', 'Assessing Regional Integration Agreements' (draft), Montevideo, 1997, p. 22.
4. Trade creation occurs when imports from member countries—meaning the trading partners—displace less efficient domestic supplies as a result of a preferential tariff reduction. In this case, there will be benefits for the local economy, as domestic consumption will be met with less expenditure of real resources. Alternatively, should the imports from the member countries help to edge out lower-cost imports

from non-member countries—meaning third party countries not benefiting from the preferential tariff concession—then trade diversion will take place. In this case, there will be losses for the local economy as domestic consumption will be met through higher expenditures of real resources.

5. Fernández, R. and Portes, J. Returns to Regionalism: An Analysis of Nontraditional Gains from Regional Trade Agreements, *The World Bank Economic Review,* Vol. 12, No. 2, May, Washington, 1998.
6. Viner, J. *The Customs Union Issue,* Carnegie Endowment for International Peace, New York, 1950.
7. Frankel, J.A., Stein, E. and Wei, S.J. *Trading blocs: The Natural, the Unnatural and the Super-Natural,* WP. 034, University of California at Berkeley, 1994.
8. Yeats, A.J. Does Mercosul's Trade Performance Raise Concerns about the Effects of Regional Trade Agreements? *The World Bank Economic Review,* Vol. 12, No. 1, January, Washington, 1998.
9. Nagarajan, N. On the evidence of trade diversion in MERCOSUL. European Commission. Technical Paper, 1998.
10. Winters, L.A. Even if import's share of more efficient non-member countries increases, this does not exclude the possibility of trade diversion, because such an approach fails to take account of changes in the relative sizes of economies as they grow at different rates. He is surely right, but there is no denying that this fact offers very strong proof that trade diversion is not too relevant. Montevideo, 1997.
11. Commenting on the increased trend towards intra-Mercosul trade between 1986/1988 and 1995/1996, Soloaga and Winters reached the same conclusion: 'The positive trend in the estimated coefficients for bloc member's imports…presumably reflects the unilateral trade liberalization that swept Latin America in the late 80's and early 90's.' In *Regionalism in the Nineties: What effects on Trade?* WPS, World Bank, Washington. 2000, p. 11.
12. Soloaga and Winters ibid., do not disagree with this interpretation: 'The increases in CACM and ANDEAN members' overall export coefficients also reflect liberalization, while the opposite trend in Mercosul suggests that its members' trade performance was dominated by currency overvaluation rather than trade policy', p. 11. Or even: 'The exception was the Mercosul, for which import and export propensities displayed opposite movements. While Mercosul members have undoubtedly liberalized since the mid-1980's, these results suggest that their trade performance has been influenced more by competitiveness than by trade policy', p. 13.
13. Once again, concern is noted over the impact of discriminatory liberalisation on non-member countries.
14. Chang, W. and Winters, L.A. *How Regional Blocs Affect Excluded Countries: The Price Effects of Mercosul,* World Bank, 1999.
15. Winters, L.A., 'Assessing Regional Integration Agreements'.
16. Fernández, R. and Portes, J., 'Returns to Regionalism'.
17. Bouzas, R.Las perspectivas del Mercosul: desafios, escenarios y alternativas para la próxima década, J.Campbell (ed.) *Mercosul, entre la realidad y la utopía,* Nuevo Hacer, Buenos Aires, 1999.
18. Blömstrom, M. and Kokko, A. *Regional Integration and Foreign Direct Investment: A conceptual framework and three cases,* WPS No. 1750, World Bank, 1997.

19. Castilho, M. and Zignago, S. *Commerce et IDE dans un cadre de régionalisation: le cas du Mercosul* (Mimeo), Rio de Janeiro, 2000.
20. ECOLATINA *Mercosul Insights,* No. 349, June, Buenos Aires, 2000.
21. Instituto para la Integración de America Latina y el Caribe—INTAL, *Informe Mercosul No. 5,* Año 4, Buenos Aires, 1999.
22. Centro de Estudios para la Producción—CEP. *Mercosul-Unión Europea: Análisis del comercio en los noventa, Sintesis de la Economía Real,* March, Buenos Aires, 2000.
23. Bonelli, R. *Fusões e Aquisições no Mercosul. Texto para Discussão No. 718,* IPEA, Rio de Janeiro, 2000.
24. Kosacoff, B. and Gómez, G. 'Industrialización em um contexto de estabilización y apertura externa. El caso argentino em los noventa', B. Kosacoff (ed.) *El desempeño industrial argentino. Más allá de la substitución de importaciones,* CEPAL, Buenos Aires, 2000.
25. Ibid.
26. A rapid increase is also noted in primary energy products (oil and oil products). To a large extent, this is the result of the privatisation of the state-owned YPF oil company.
27. Pereira, 2000
28. Motta Veiga P. 'Brasil en el Mercosul: política y economía en un proyecto de integración', J. Campbell (ed.) *Mercosul, entre la realidad y la utopía,* Nuevo Hacer, Buenos Aires, 1999a.
29. Markwald, R. and Bosco Machado, J. 'Hacia una política industrial para Mercosul', R.Roett (ed.) *Mercosul: Integración regional y mercados mundiales,* Nuevo Hacer, GEL, Buenos Aires, 1999.
30. This limit is outstripped by five Brazilian companies or groups (Petrobrás, Itaú, Garantia, Companhia Vale do Rio Doce and Odebrecht) and two Argentine groups (Repsol-YPF and Techint). For the purposes of comparison, leading Korean groups post revenues of US$30 million to US$60 billion a year.
31. Chudnovsky, D. and López, A. 'Las Empresas multinacionais de America Latina. Características, Evolución y Perspectivas', Chudnovsky, D., Kosacoff, B. and López. A. (eds) *Las Multinacionales latinoamericanas: sus estrategias en un mundo globalizado,* Fondo de Cultura Económica, Buenos Aires, 1999a.
32. Ibid.
33. Ibid.
34. Fernández and Portes, 1998.
35. The strength of this device was recently tested successfully during the political crises in Paraguay.
36. Quite correctly, García Peluffo stresses the importance of this political change for increasing links among neighbouring transportation infrastructures: 'One of the most noticeable consequences of the chronic clashes among the countries in the region has been the complete lack of connection among transportation infrastructures. Quite certainly the lowest-cost protection against any neighboring country was a physical gap which avoided building up troops on the border, as well as other similar war-like steps. Once the possibilities of conflict had shrunk, it was quite logical to launch a dynamic process of physical interconnection among the neighboring countries', in 'Algunos aspectos relevantes en la profundización del

Mercosul', Celia Barabato (ed.) *Mercosul, una estrategia de desarrollo. Nuevas miradas desde la economía poítica,* Edicones Trilce, Montevideo, 2000, p. 60.

37. In 1995, when the Customs Union came into effect, the members of the Mercosul agreed on national product lists that would constitute temporary exceptions to intra-regional free trade for these products, covered by a special system *(Regime de Adequação)*. An automatic step-down tariff schedule was agreed which ended on 1 January 1999 for the Argentine and Brazilian national listings. The Argentine list consisted of 211 products, concentrated mainly in sensitive industrial sectors: textiles, footwear, steel and paper. Consequently, in early 1999, these sectors cut their tariff protection for intra-regional trade from an average of 7 per cent to zero. Two weeks later, Brazil devalued its currency by some 60 per cent.
38. Garcia Peluffo, 2000.
39. Lavanga, R. *Zona de livre comércio ou área de decisão brasileira? Fim da integração ou a insuportável leveza das propostas, RBCE- Revista Brasileira de Comércio Exterior,* No. 51, FUNCEX, Rio de Janeiro, 1999.
40. Hirst, M. *Atributos y dilemas políticos del MERCOSUL,* em *Escenarios Alternativos,* Año 4, No. 9, Winter, Buenos Aires, 2000.
41. Campbell *et al.* describe the principles that guided these agreements: '…right from the start, it was agreed that the integration process would have to move ahead on the basis of integrated selective projects, and at different speeds. Consequently, efforts were made to move towards industrial and commercial complementation in different production segments, trying to minimize the possibility of any destructive effects on either of the two economies, while encouraging each of them to specialize in certain market niches or production lines within a given sector. The idea was not only to upgrade the production performance of both economies (based on intra-regional complementation and economies of scale), but also to underpin the evenly-balanced expansion of bilateral trade within a context of tight foreign financial constraints' (pp. 82–3).
42. Lavanga, *Zona de livre*.
43. Motta Veiga, 1999a.
44. Lavanga, *Zona de livre*.
45. Escudé, C. *La Argentina y sus alianzas estratégicas, Archivos del Presente,* Año, Número, Buenos Aires, 1998.
46. Tokatlián, J.G. *De Menem a De La Rúa: La diplomacia del ajuste,* em *Escenarios Alternativos,* Año 4, No. 9, Buenos Aires, 2000.
47. Redrado, M. *Desarrollo institucional en el Mercosul: Un aporte para la consolidación del bloque regional* (Mimeo), Buenos Aires, 1999.
48. This principle was enshrined by the 1994 Constitutional Reform (Article 75 of the current Argentinian Constitution).
49. Jimenez, 1997.
50. Abreu Dallari, P.B. 'O Mercosul perante o Sistema Constitucional Brasileiro', Maristela Basso (ed.) *Mercosul: seus efeitos jurídicos, econômicos e políticos nos Estados-membros,* Livraria do Advogado Editora, Porto Alegre, 1997.
51. In fact, the draft bill submitted by a Congressman in Rio Grande do Sul State needed 293 votes to pass; however, it was rejected with 168 votes in favour, 144 votes against, and 7 abstentions. Abreu Dallari, 1997.

52. De la Balze, F.A.M. 'El destino del Mercosul: Entre la Union Aduanera y la "integración imperfecta"', F.de la Balze (ed.) *El futuro del Mercosul. Entre la retórica y el realismo,* Cari-Aba, Buenos Aires, 2000.
53. From 1995 to 1998, the Common Market Group issued 280 Resolutions, but only 88 had been effectively incorporated by the four members through to year-end 1988 Redrado, 1999.
54. Gonzalez, F.F. *Mercosul: incompatibilidad de sus instituciones con la necesidad de perfeccionar la Union Aduanera, Integración & Comercio,* Bid-Intal, No. 9, Año 3, Buenos Aires, 1999.
55. Redrado, M. 'De la institucionalidad a la convergencia', F.de la Balze (ed.) *El futuro del Mercosul. Entre la retórica y el realismo,* Cari-Aba, Buenos Aires, 2000.
56. Gonzalez, F.F. *Mercosul:,* 1999.
57. Torrent, R. *Tres ideias sobre a institucionalizacao do Mercosul, RBCE- Revista Brasileira de Comercio Exterior* No. 62, FUNCEX, Rio de Janeiro, 2000.
58. Gonzales, F.F. *Mercosul:,* 1999.
59. Baptista, L.O. *Pautas viáveis para um desenvolvimento institucional do Mercosul* (Mimeo), Buenos Aires, 1999. However, it should be noted that consensus is not synonymous with unanimity. Consensus accepts abstentions, but not votes against.

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