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THE DEVELOPMENT OF MERCOSUR

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INTRODUCTION

Mercosur, the Spanish acronym for Common Market of the Southern Cone, composed of Argentina, Brazil, Paraguay and Uruguay, is the result of a new model of development adopted by Argentina and Brazil during the 1980's, representing the change from an economic model based on import-substitution to an industrial evolution sustained by economic globalization.

The economic integration's objective is to increase economic efficiency through better economic resource allocation, economies of scale, and regional and international competition. The first part of this paper discusses these economic considerations.

The second part of this paper offers a summary of the historical conditions which led to the establishment of Mercosur. This section discusses the evolution of trade integration in Latin America.

The third part will examine the original objective of the Treaty of Asuncion and what was actually achieved in terms of elimination of tariff and non-tariff barriers, creation of a Common External Tariff, coordination of macroeconomic policies and harmonization of states member's legislation.

CHAPTER 1: ECONOMIC CONSIDERATIONS

The basic reason that impels a country into international trade is the possibility of obtaining economic advantages. Gains from trade liberalization are generated from economies of scale, comparative advantages and competition.

Economies of scale appear whenever a proportional increase in input causes a growth more than proportional in output.[1] It is one of the factors leading Brazil and Argentina into an economic integration as a attempt to achieve scales of production that would permit greater efficiency.

From a Ricardean point of view it is possible and desirable that a country trade when comparative advantages exist. A comparative advantage between two countries appears every time that the relative labor requirements differ. This implies that whenever this situation occurs, the internal opportunity cost of producing two commodities is different in both countries.[2]

The country gains by expanding production and exporting the commodity that is relatively more valuable in the foreign market.

Increase in specialization is happening in Mercosur. Although Brazil is very nearly to the most efficient wheat producer in the world, before the economic opening, the Brazilian government used to expend on average US $ 2.5 billion a year as a subsidy to internal production. In 1986, as a consequence of this subsidy program, Brazilian producers received 2.5 times more than the average price of imported product.[3]

Since currently Brazil is substituting its wheat production for a cheaper imported product, that huge volume of money can be used more efficiently in another sector or in social programs. For instance, the Brazilian wheat production in 1990 was six million tons and now it reaches only two million tons. In the same period, Argentinean wheat exportation to Brazil rose from about two million tons to four million tons.[4]

Another economic advantage from international trade is the exposure of firms to competition. Competition induces a more efficient use of national resources, and with the possibility of acquiring foreign capital and foreign technology, permits firms to reduce their and to improve quality.

Contrasted with the past, when Argentina feared becoming an exporter of agricultural products and an importer of industrial goods from Brazil,[5] presently Argentinean Authorities expect that Argentina's specialization within Mercosur will occur through the development of industrial sectors and that many industries and services flourish around these sectors.[6]

This industrialization will happen within the Free Trade Area through competition among parties's firms, which will increase the efficiency in the economic allocation of resources. Decisions about where to invest will take into consideration the most efficient place in terms of cost of production. Many Mercosur firms are placing their plants in more specialized sites, trying to reduce their cost of production. Nestle, with 40 factories, is directing its investments of US $ 380 million a year in plant modernization and construction wherever the raw materials are most efficiently available: coffee and chocolate in Brazil, and dairy products close to Argentina's well managed and high-yielding herds.[7]

CHAPTER 2:

ECONOMIC INTEGRATION: TYPOLOGY AND LATIN AMERICAN BACKGROUND.

2.1 Economic integration: typology

Economic integration means eliminating the economic significance of the political frontiers that exists between countries.[8]

Economic union is a process composed of at least four important stages, following this order: Free Trade Area (FTA), Customs Union(CU), Common Market(CM), and Economic Union (EU).

A Free Trade Area is defined as a situation in which all members of the agreement remove tariffs and non-tariff restrictions on each other's products without losing their independence in establishing trade policies in relation to third countries. Even in this initial stage, economic integration implies market enlargement and influence in economic allocation of resources between members.

The second level of economic integration is a Customs Union. At this step, a Common External Tariff is adopted , implying that regardless of the importing countries all goods from third countries will be taxed with the same tariff. In the case of Mercosur, if the external common tariff on computers is agreed at 20%, any imports of that product will pay the same tax to enter in the Customs Union, whether the importer is Argentina, Brazil, Paraguay or Uruguay.

Achieving a Customs Union implies in establishing a common trade policy. When the state members commit to this stage of economic integration, they cannot engage in preferential agreements with third countries and, as a consequence, the group usually acts a body in negotiation with non-members

In addition to the traditional forms of economic integration, a third should be mentioned. A Common Market means to aggregate to the three anterior phases a free circulation of labor and capital among members. One can see that at the same time that the level of economic integration progress, a reduction in control of individual economy occurs.

The most advanced form of economic integration is an Economic Union. As the last stage in the process it includes all features of a free trade area, of a customs union and of a common market, and also implies unification of economic institutions and coordination of economic policy throughout all member countries. Even though political entities are still present, they are subject to supranational institutions whose decisions are binding upon all members.

As stated previously, the need to coordinate or to adopt common policies becomes stronger with the evolution of economic integration, or in other words, the need for all members to cede sovereignty in order to avoid isolated actions that could cause distortions in investments or trade flow increases. This political consideration is an important factor that causes delays in the process of integration.

2.2 Latin American Background in terms of economic integration

In Latin America, agreements aiming at creating Free Trade Areas, Customs Unions or Common Markets are phenomena originated in the 60's.

The United Nations Economic Commission for Latin America and the Caribbean's ideas, concerning economic development in Latin America through commercial liberalization, provided the theoretical base upon was initiated the movement forward major integration among the countries of that region.

Due to the fact that Article I of the General Agreement on Tariffs and Trade (GATT), signed in 1948, established strong support for nondiscrimination, and required that all GATT members benefit from the Most-Favored-Nation clause, agreements that aimed to start a preferential trade area (less than 100% of preferences) were prohibited.

This obstacle was eliminated only in 1973, when the General Agreement on Tariffs and Trade was modified (Tokyo Round), permitting that preferential trade areas to be created by developing countries.

The Latin American Integration Association (LAIA), established in 1980, by the New Treaty of Montevideo, in substitution of Latin American Free Trade Association (LAFTA), incorporated the new international trade legal framework.

Although it had the same structure as of the previous association (LAFTA) the Latin American Integration Association presented new objectives. In fact, while the LAFTA intended to create a common market in Latin America in a short period (12 years), the LAIA objective was more modest, prioritizing the establishment of preferential trade systems.

Until 1991, LAIA's objectives concerning the increase of regional trade were not completely achieved. The participation of intra-LAIA trade in the total exported by the countries of the region decreased from 13.8 % in 1980 to 10.9 % in 1990,[9] increasing again after 1991, representing 17% in 1996. This growth after 1991, however, is partly due to the increase in regional trade caused by the creation of Mercosur. The four countries of Mercosur are responsible for 40% of the total exportation among the 11 countries that comprise LAIA.

On the other hand, LAIA was successful in promoting free trade among the affiliate countries. Actually, There are 55 bilateral agreements, involving 11 nations,[10] engaged with total trade the liberalization, representing 75% of total intraregional trade.

This figure will increase when the negotiation process between the Andean Group and Mercosur is finished. By that time, 92% of the total intraregional trade will be engaged in a free circulation of goods.

The integration process between Argentina and Brazil, which began in the mid-1980s, was the precursor to the Treaty of Asuncion. This momentum is the result of two great changes experienced by these countries to in the 1980s: the transition to democracy and the revision of government intervention pattern.

These changes were not simultaneous, however. The displacement of the military regimes preceded the shift towards trade liberalization. Early movements toward integration during the Alfonsin-Sarney era were made stronger by a strategic political commitment fostering amiable relations between the two countries, after many years of rivalries and potential conflict. Still in the framework of repressive import regimes, these movements rose to an integration strategy.

In July of 1986, the Integration and Economic Cooperation Program (IECP) was established, which aimed at the selective opening of both Brazilian and Argentinean markets.

The next step occurred in 1988 when both countries signed the Treaty of Integration, Cooperation and Development, which sought the establishment of a Common Market by year 2008 through elimination of tariff and non-tariff barriers on the trade of goods and services, and the coordination of macroeconomic policies.

To accomplish these objectives, several protocols were signed during the 1986-1990 period, each one related with specific sectors such as capital goods, food, wheat, industrialized products, automobile, industry, biotechnology, etc.

An important change in the design of integration between Argentina and Brazil came immediately after the presidential changes which brought Menen and Collor to power, altering the framework of trade policies in both countries. Brazil’s decision, in March 1990, to launch a trade liberalization program cleared the way for the integration agreement.

The selective opening of markets on a product by product basis was replaced by linear and automatic tariff reductions. Through the "Ata de Buenos Aires", signed in July 1990, the creation of the Customs Union was anticipated for January, 1995. In December of the same year, Argentina and Brazil formalized those changes as a bilateral agreement in LAIA under the legal framework of the Economic Complementation Agreement NR. 14.

The signing of the *Ata de Buenos Aires*, followed by the US President George Bush’s speech proposing hemispheric integration, provided the impetus for a high-level meeting between representatives of Argentina, Brazil, Paraguay and Uruguay. The goal of the meeting, which took place in Brasilia in August 1990, was to discuss the idea of expanding the geographic boundary of the Common Market encompass the Southern Cone. This meeting created the conditions for the Treaty of Asuncion forming Mercosur on March 26, 1991.

CHAPTER 3:

MERCOSUR: OBJECTIVES AND ACCOMPLISHMENTS.

3.1 The Treaty of Asuncion: Objectives

Through the Treaty of Asuncion, the four signatories decided to form a Common Market on January 1, 1995, that, according to Article I of the Treaty, dictates the free circulation of goods, services and production factors by means of elimination of duties, non-tariff restrictions and other measures with an equivalent effect on trade between Argentina and Brazil by December 31, 1994, and by December 31, 1995 for trade with Uruguay and Paraguay.

They also agreed to establish a Common External Tariff (CET) and in adopting a common trade policy in relation to third countries while coordinating their position in regional and international, commercial and economic meetings.

A third item in the Agreement is the coordination of macroeconomic and sectoral policies among member states - foreign trade, agricultural, industrial, tax, monetary, exchange rate and capital, service, customs, transport and communications- in order to ensure adequate conditions for competition among states members.

The last item of the Pact establishes a commitment by member states to make any necessary legislative adjustments to strengthen the integration process.

3.2 Mercosur: Accomplishments.

3.2.1 Elimination of duties, non-tariff barriers and measures with equivalent effect.

3.2.1.1 Duties

Duties are customs rights and tariffs on foreign trade, including fiscal, monetary and exchange charges. The Agreement determined that the duties to be paid on imports can not exceed the approximate cost of services rendered.

In the Mercosur, elimination of tariffs is the object of a progressive, direct and automatic project that will benefit all products subject to taxation in member states, according to the following schedule:

Date	*% Lifting of Import duties*
June 30, 1991	47%
Dec. 30, 1991	54%
June 30, 1992	61%
Dec. 31, 1992	68%
June 30, 1993	75%
Dec. 31, 1993	82%
Dec. 31, 1994	100%

This was the original timetable for the elimination of tariffs and other non-tariff restrictions in the member states. Nevertheless was agreed that each nation had a list of adaptation, including products considered "sensitive" to their economies. This list is composed of 950 items, in the case of Uruguay, 427 for Paraguay, 221 for Argentina, and 29 for Brazil.[11] At the end of each calendar year intrazone tariffs on these products will be gradually cut to zero per cent in 1999 for Brazil and Argentina and 2000 for Paraguay and Uruguay.

The products protected under these lists reflect the wish of Treaty of Asuncion signatories of guaranteeing to their most important production sectors a longer term by comparison with 1995 for adapting to the new free trade covered by Mercosur.

The national lists present the following composition: Argentina's iron and steel products (56 percent of the excluded items), textiles and shoes (25 percent), and paper (10 percent). Brazil's protected products are textile (50 percent) and rubber (38 percent). Paraguay's lists are composed of textiles and shoes (50 percent), food (12 percent), paper (4 percent) and iron and steel products (4 percent) . Uruguay excluded textiles (23 percent), food (10 percent) chemical products (11 percent), iron and steel (8 percent), and paper (4 percent).[12]

The intra-Mercosur trade of these products does not have a significance importance to the total commerce in the region. Imports for each country in 1993 show that Uruguay's exceptions represent 13.3 percent of its importation, Argentina's exclusions represent 6.8 percent, Paraguay's 3.1 percent, while Brazil excluded products symbolize only 0.2 percent.[13]

3.2.1.2 Non-tariff barriers and measures with equivalent effect.

This theme covers a list of procedures that causes restrictions to intraregional trade. Non-, tariff-barriers and measures with equivalent effect are the instruments used by the government as part of its commercial policy in order to control trade flow. This subject will be further analyzed in the section discussing the coordination of commercial policies.

3.3 Common External Tariff -- CET

A Common External Tariff (CET) is a list of products and their respective tariffs to be levied on member states' trade with third countries. This implies that wherever is the place the merchandise enters in the union it will pay identical taxes.

During negotiations to conform the Common External Tariff there were some divergences related to capital goods, computer and telecommunications equipment. Consequently, in addition to lists of adaptation, lists of exceptions to Common External Tariffs were created. They involve the merchandises mentioned above, whose tariffs will progressively be cut until they reach 14% in 2001 on capital goods, and 16% in 2006 on the others. These lists were formed to permit the Brazilian industries in such sectors to develop the necessary competence to face external competition.

Although Argentina, like Paraguay and Uruguay, had low tariffs on capital goods, computers and telecommunications equipment to allow its firms cheap access to imported technology, the Brazilian objective was to protect its industries. Besides Brazil, none of the three countries have a significant computer and telecommunications equipment production. The agreement reached was for Argentina and the others to raise tariffs, and Brazil to reduce them.

The CET of Mercosur includes more than 85 percent of all commodities. It is based on 11 tariff levels ranging from 0 percent to 20 percent at intervals of 2 percentage points. The arithmetic average, calculated for all products, including those merchandises present in lists of exception reached 11.4 percent with a dispersion level (standard deviation) of 6.22 percent.

Apart from the exceptions agreed to intraregional trade, the exceptions to foreign commerce have a noteworthy importance in the total trade of Mercosur.

" The relationship between the temporary exceptions to CET and the total number of items in the Mercosur nomenclature, as well as their impact on total imports of each country were also recently calculated, giving an idea of their relative importance. (...) The items exempted from the CET varies between a maximum of 16.1 percent for Argentina and a minimum of 11.2 percent for Uruguay, while the figures for Brazil and Paraguay are 12.1 percent and 14.4 percent respectively. The weighting by global imports of each country in 1993 shows that Paraguay's exceptions from the CET represent some 54.3 percent of its trade, Argentina's 28. percent, Brazil's 22. percent, and Uruguay's 19.2 percent."[14]

Due to macroeconomic instability in the member states some changes on tariffs on important sectors have been agreed to. During 1995, Brazil was allowed by other members to reduce temporally in same cases tariffs on 150 products bellow Common External Tariffs level in order to support its anti-inflation plan or to increase tariffs in such other segments, as cars, toys, electronic, and textile, to equilibrate its Trade Account.

3.4 Coordination of economic policies.

In an attempt to inject objectivity into the discussion of economics policies, the Presidents, Ministers of Foreign relations and Ministers of Finance of Argentina, Brazil, Paraguay and Uruguay, met in Las Leñ as in 1992 to establish the Las Leñ as Agenda. During the meeting they scheduled the mainly economic policies to be harmonized and the final time to conclude the evaluation or to reach a decision.

POLICIES TO CONFORM MERCOSUR

	Mainly instruments to be harmonized	Final time to conclude evaluation or to reach a decision[a]
Commercial Policy	dumping/subsidies	Jul-Dec/92
	elimination of non-tariff barriers	Jul-Sep/92
	External Common Tariff	Jul-Set/94
	special customs regimes	Apr-Dec/93
	agreements with third countries	Apr-Jun/93
Development Policy	protection of investments	Apr-Jun/93
	industrial policy	Oct-Dec/93
	competition policy	Out-Dec/93
	technology policy	Apr-Jun/94
	agricultural policy	Oct-Dec/93

Macroeconomic Policy	coordination of exchange rates	Apr-Jun/93
	coordination of fiscal policy	Jul-Sep94
	capital flow	Oct-Dec/93

Source: Veiga, Pedro da Mota & others -- A Agenda de Las Leñ as e a integraç ao no Mercosul

a: latter modified by decision Mercosur/CMC/DEC 09/9

3.4.1 Trade policy

A common trade policy is the set of actions used to influence the trade flow between a common trade area and third party nations. Trade policy includes all tools that can be utilized by countries concerning international trade such as antidumping duty or countervailing duties, establishment of quotas, prohibition of import or export, adoption of a import or export license system, and the negotiation of "voluntary" export restraint as a means to avoid the imposition of an import quota if the restriction is not adopted by the exporter.

If these tools are used by a country that is a member of a common economic area, the other partners must consent with application of the measure. The unilateral imposition of restrictions over foreign trade influences other member states' economies and may bring about complaints.

When two or more countries decide to embark upon a deeper economic integration, as occurs in a Common Market, decisions over placement of economic activities are made as if members' territories were only one. Consequently, an isolated measure of commercial policy adopted by one of the parties may affect the investments made in other member countries. The more economically important country taking the action is, the stronger are the effects.

As an example, a 1997 Brazilian decision to make difficult the financing of imports in order to reduce the volume of importation to equalize its Balance of Payments Accounts sparked an immediate response from Argentinean Diplomacy and Ministry of Finance. Argentina complained that such measures should not be applied to the trade inside Mercosur.[15]

Coordinated macroeconomic and sectoral policies are fundamental to guaranteeing the adequate competition conditions among the state members of Mercosur, as stated in Article I of the Treaty of Asuncion.

Coordinated policies differ from common policies. While the latter means adoption and application simultaneously of rules by all countries, or even by a supranational agent, the former consists of choosing goals but continually discussing and evaluating the goals and their accomplishments.

3.4.2. Dumping/subsidies

So far there have been no substantial alterations in the parties' legislations. The objective of establishing a common code in Mercosur has not been achieved yet. Each member state continuous to follow its own laws legislation concerning imports from third countries. When complains arise over dumping or subsidies in intraregional importation, the decision Mercosur GMC 63/93, extended by decision Mercosur GMC 124/94, establishes a procedure consisting of exchanges of information between the two countries in order to investigate whether the damage suffered by local industries or agriculture results from a cause-effect relation with the imports.

3.4.3. Elimination of non-tariff barriers and measures with equivalent effect.

This topic has shown the most important advances. Many decisions have been made by Common Market Council, the highest decision-making group and by the Common Market Group, the main executive body, in favor of a flowing intra-regional commerce.

Elimination of non-tariff barriers does not include any measure taken in order to control the trade of gold, silver, armaments or radioactive products, nor to protect life, health, moral principles, and the historical and artistic heritage.

The most relevant measure adopted in this area was the institution of common rules of origin. Through this legislation any product which has at least 60% of its value added within any member country is considered to have been originated in Mercosur, and thus receives duty-free treatment.

This common legislation makes it for each country to avoid establishing different rules concerning minimum requisites, which create barriers to intraregional the trade.

Up to now, the majority of the measures adopted by Mercosur has been concerned with harmonizing such technical and hygienic standards as the size, labeling, presentation, and so on, of commercialized products.

Through decision Mercosur GMC 20/93 a Common Rule of Technical Norms was created. In the area concerning sanitary control, the harmonized legislation is taking into consideration international standards such as those of the United Nations Food Agriculture Organization (FAO) and of the World Health Organization (WHO).

3.4.4. Agreements with third countries

In December 1995, Mercosur and the European Union signed the Framework Interregional Cooperation Agreement. This agreement is the legal instrument that will eventually lead to a political and economic association between the two Customs Unions. For that purpose, the agreement establishes that the parties will maintain a regular and institutional dialogue in several areas, including trade, investment and the environment.

In June 1996 Mercosur signed a free trade agreement with Chile to form a Free Trade Area in ten years. The products listed as exceptions will converge to become duty-free after 15 to 18 years.

In December 1996, Bolivia and Mercosur signed an agreement to eliminate tariffs immediately on a number of products (400 for Mercosur and 500 for Bolivia). Most of the remaining products will be duty-free in 10 years. As with the Mercosur-Chile agreement, a list of exceptions was formed with tariffs scheduled to be removed in 15 to 18 years.

Establishment of these Free Trade Areas does not mean that either Chile or Bolivia is going to join to Mercosur. It continues to consist only of Argentina, Brazil, Paraguay and Uruguay.

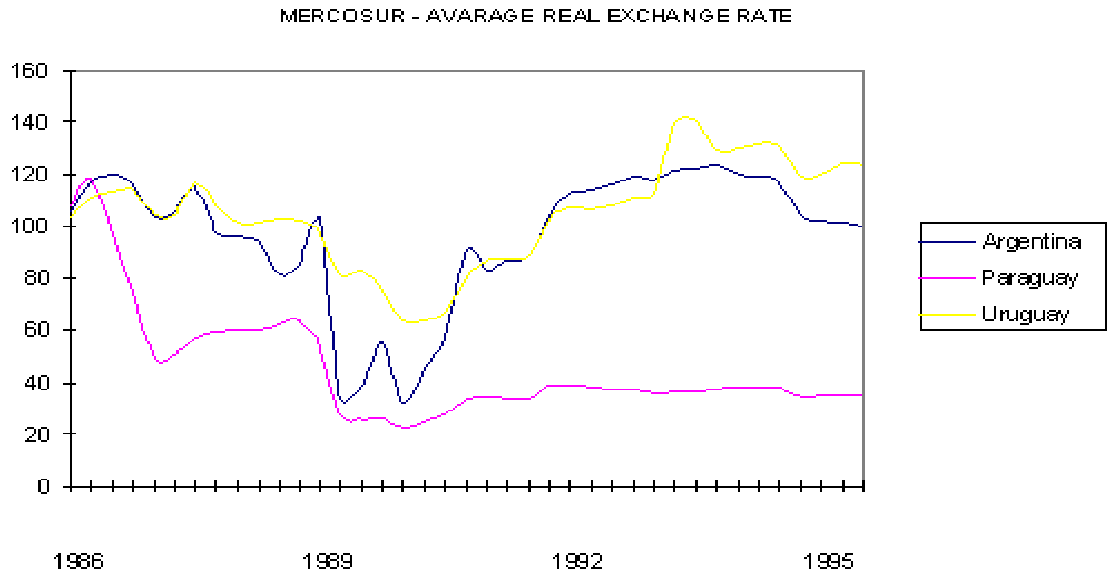
3.5 Macroeconomic policies

3.5.1 Exchange rates

One of the most important policies to ensure the stability of trade relations among the member countries of any commercial agreement is the exchange rate policy.

When trade barriers and obstacles to financial movements are removed, the importance of stable exchange rate increases. If, for any reason, the currency of a country is constantly depreciated in relation to another member state, the latter country probably will face commercial deficits. This situation may induce the damaged country to adopt compensatory mechanisms like increases on tariffs.

The strong economic instability that the Latin American countries experienced during the 80’s, accompanied by huge variations in the exchange rate, has been identified as one of the causes of the failure in projects of economic integration in the region.



Index base: Jan. 86 = 100

Source: Pereira, Lia Valls -- Mercosul: Perspectivas da Integracão, 1996

This figure shows the fluctuations of the Brazilian currency in relation to the other members of Mercosur.

Differences in the level of exchange rate have a great influence over trade flow. The low price of Brazilian currency in relation to the Argentinean currency -- verified up to 1994 -- explains, partly, the continuous Brazilian surpluses in its trade with Argentina.

In fact, the results occurred in the Balance of Trade between Brazil and Argentina follow the same pattern as the variations in the exchange rate. Between 1989-1994, Brazil evolved from a commercial deficit of US $ 528.60 million to a surplus of US $ 523.54 million with Argentina. In the same interval, the average real exchange rate(R$/P$) changed from 57.51 to 146,48.

To ensure stability to relative exchange rates and continuity in Mercosur the coordination of exchange rate policies is a necessity. In fact, differences in exchange rates can be used as a substitute for tariffs, replacing the eliminated barriers to imports.

Even though it is not necessary to utilize a system similar to the one to be implemented in the Europe Economic Union, which involves the creation of a common currency and the election of one of the Central Banks, a coordination of exchange rate policies should be adopted among the Mercosur members.

That coordination will not be an easy task. The exchange rate has been used as an instrument of macroeconomic policy to control inflation, mainly in Brazil and Argentina. Moreover, Argentina adopts a fixed parity between its currency and dollar, what makes infeasible an adequate policy that should take into consideration a wider bands mechanism in order to accommodate asymmetries verified in the macroeconomic policies.[16]

Even though coordination of exchange rate policy does not dictate that any aspect of sovereignty be renounced by each country, that decisions must be made by consensus within Mercosur brings an additional level of difficulty to reach the coordination of policies . The problem resides in the huge economic differences among the parties. It is difficult to imagine Argentina and Brazil coordinating their exchange rates according to Paraguay or Uruguay's requirements.

Until now, nothing has been done, in pragmatic terms, to coordinate exchange policies among Mercosur's members.

3.5.2 Fiscal policy

Harmonization of fiscal policies means eliminating distortions that influence capital and labor flows through the participating countries.

Depending on the importance of both the differences concerning taxation on profits and the relative prices from economic activities the tax level may cause such distortions. In other words tax levels will depend on investment return rate and the differences in cost production from one region to another.

There are significant discrepancies among tributary structures of the four countries that compose Mercosur. For example, Brazil collects 5.40 % of its Gross Domestic Product (GDP) from Income Tax, while Argentina, Paraguay and Uruguay collect 2.08%, 1.38 and 2.03, respectively.[17] This divergence is due to tax structure, different definitions concerning the base adopted to calculate the tax and aliquots.

In the case of economic integration, harmonization among member countries fiscal policy is necessary to avoid competition for international capital or to influence decisions of investments the inside region.

In fact, disputes among some Brazilian States to receive investments on car assembly lines, offering fiscal advantages to achieve that, have caused Argentinean complaints.

Harmonization of fiscal policies aims to compensate any structural disequilibrium among countries, inducing geographical allocation of resources according to regionally established priorities.[18]

Taxes on intraregional trade are being gradually removed and soon will not be an issue to economic allocation of resources. On the other hand nothing has been done to harmonize fiscal policy related to the internal taxation on services, revenue and consumption.

3.6 Development policies

3.6.1 Protection of investments

Two protocols regulate investment in Mercosur: The Protocol for Reciprocal Promotion and Protection of Investments concerning non-member countries and the Colonia Protocol normalizing investments among member states. Capital can move freely from one place to another. Investments by partners are granted treatment no more favorable than the treatment granted to investors from the receiving country or from third countries.

The decision Mercosur/CMC/DEC 08/93 enacts the Minimum Regulation for Capital Markets, eliminating all restrictions to movement of capital were the investors are persons or companies resident or domiciled in the territory of any member state.

The same issue, now concerning investments from non-member states, was regulated by Decision Mercosur CMC/11/94. Through this decision investments from third countries were guaranteed the same favorable conditions as the treatment granted to investments within Mercosur.

3.6.2 Industrial policy

Until the late 80's the majority of Latin American countries used to adopt an economic development pattern based upon import-substitution, that meant to protect the national economy against external competition.

The new economic development strategy embraced by Argentina, Brazil, Paraguay and Uruguay is based on intraregional and international competition by means of gains in economies of scale and specialization in a larger internal market.

This new model demands a definition about convergent industrial policies to assure long-running sustainability to the integration process.

Industrial policy means to ensure macroeconomic conditions to competition through exchange rate stability, technology policy, government expenditure and commercial policy.

Exchange rate stability, as affirmed above, is necessary to avoid interference in the trade flow and in the relative competitiveness among the member countries.

Technology policy is related with creation of infrastructure, education supply, energy power, telecommunication systems and investment in research and development as a means to equalize the conditions to competition among enterprises

Government expenditure as an important component of the total demand in the economy can be used to foster competition if it was permitted that firms from all member countries participate in the government bidding system.

The commercial policy, specifically the Common External Tariff, should be used to equalize the competitive conditions in the integrated area and at the same time to incentive a higher productivity, avoiding development of inefficient industrial structures under exaggerated protection. It signifies to insure adequate protection levels to regional production, permitting utilization of advantages that were created by the common market, as well as equitable distribution of these benefits.

These policies are responsible for the maintenance of a opened and competitive market that receives competitive pressures as an element that forces the adoption of microeconomic strategies aiming at structural adjustment of industry.

Up to now, Mercosur has not taken any measure of either coordinated or common industrial policy. On the contrary, the Common External Tariff has been used in the four countries to protect inefficient sectors that do not have conditions to face intraregional or international competition.

3.7 Harmonization of internal legislation

Harmonization of internal legislation is closely related to advancements in coordination of economic policies. As stated above, the majority of the measures that have been taken within the ambit of Mercosur is related to standardization of both technical issues, hygienic procedures and rules of origin.

However, there is a relevant measure taken by Mercosur. By means of decision Mercosur CMC/25/94 the member countries approved Mercosur Customs Code, based on WTO rules, that is a common administrative code giving definitions, regulating custom procedures, setting up rights and obligations to both importer and Administration and establishing hypotheses of infraction and their penalties.

It is important to note that a decision made by Mercosur does not have immediate effect on the member countries. nce Mercosur was not built with supranational institutions with power to bind their decisions, all new rules need to be approved by each Congress. This manner, many of the regulations agreed within of Mercosur may not be in force in the states parties.

CONCLUSION

Up to now, Mercosur has been a commercial and political success. It has been able to increase significantly intra-regional trade and to tight political ties among the four countries. In the period 1991-1995, the flow of goods and services between Brazil and Argentina, the two most economically important countries, surged 44% on average in the case of Brazilian exports to Argentina and 32% concerning exports from Argentina to Brazil.

The general consensus is that Mercosur has been a more a trade-creating than a trade-diverting, benefiting the world.[19]

The partly consolidated Free Trade Area is attracting investments from all over the world. The Brazilian decision to increase tariffs and to establish quotas on automobile trade has caused complaints before the World Trade Organization-WTO, showing that the Brazilian and, as a consequence, Mercosur market is very important. The Brazilians subsidiaries of foreign car assemblers are committed to investing US $ 17 billion in the next 3 years in new plants and production lines.[20] Many international car producers that did not have plants in Mercosur are announcing investments.

It also has worked to strengthen democracy in the region. When in April 1996 Paraguay’s army tried a coup d'état, Mercosur’s foreign ministers declared that since democracy is a formal condition to be a member Paraguay would face diplomatic and economic isolation.

In contrast, coordination of economic policies is progressing at a slow pace. Elimination of non-tariff barriers is not enough to guarantee the continuity of integration process in the long-run.

Without coordination of fiscal and industrial policies, industrial activities tend to concentrate in areas that present better both infrastructure and services, increasing the existing development disparities among member countries.

Although many agree that macroeconomic policies are less urgent, changes in commerce flow due partly to fluctuations in exchange rates and the war of fiscal incentives to attract foreign investments show that such coordination is indispensable to sustainable economic integration.

Footnotes

1. *Araujo Jr., Jose Tavares -- Cited in Faria, Jose Angelo Estrella - O Mercosul: Principios, Finalidade e Alcance do Tratado de Assuncao*

2 *Appleyard, Dennis .- International economics -- 1995*

3 *Araujo o Jr., Jose Tavares de - Os Fundamentos Economicos do Progama de Integracão Argentina-Brasil - quoted in Faria, Jose Angelo Estrella - O Mercosul: Principios, Finalidade e Alcance do Tratado de Assuncao, 1993*

4 *Folha de Sao Paulo 12/31/94*

5 *Cammillon, Oscar - Integracion Argentina-Brasil: realidades y proyecciones, 1987 - quoted in Faria, Jose Angelo Estrella - O Mercosul: Principios, Finalidades e Alcance do Tratado de Assuncao, 1993.*

6 *Folha de Sao Paulo 12/31/94*

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