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**MERCOSUR: Objectives and Achievements**

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Sam Laird: *WTO*

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Telephone: Geneva 739 5493  
Fax: Geneva 739 5765  
e-mail: SAM.LAIRD@WTO.ORG

## MERCOSUR: OBJECTIVES AND ACHIEVEMENTS

Sam Laird, World Trade Organization

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### Abstract

MERCOSUR is one of the most important examples of renewed world-wide interest in regional trade agreements. It may be seen as a consolidation of unilateral reforms undertaken in conjunction with major macroeconomic adjustments. The paper reviews the objectives of MERCOSUR and assesses its achievements, focusing on institutions and fulfilment of commitments. It concludes that considerable progress has been made to achieving a customs union and even beyond that towards a common (but not EU-style single) market, but there are a number of areas where progress is still to be made.

Key words: Customs union, MERCOSUR, tariffs, non-tariff measures.

JEL Category: F15

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## MERCOSUR: OBJECTIVES AND ACHIEVEMENTS

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### I. Introduction

1. The Southern Common Market (*Mercado Común del Sur*, MERCOSUR) is a notable example of renewed world-wide interest in regional trade agreements, although these have provoked some concerns because of the possibility of welfare-reducing trade diversion as well as the systemic implication for the world trading system.

2. Concern about the possible trade diverting effects of MERCOSUR (and other Latin American regional integration agreement) stems mainly from the experience of earlier attempts at regional integration. In the 1960s the regional agreements were an extension of the import-substitution industrialization policies being applied in the individual countries under the influence of Raúl Prebisch and United Nations Economic Commission for Latin America and the Caribbean (ECLAC). In reviewing the efforts in the 1960s to establish the Latin American Free Trade Association (LAFTA), the Andean Pact and Central American Common Market (CACM), de Melo and Dhar (1992) argue that there were several reasons for failure: first, reductions were not across-the-board but on a product-by-product basis that resulted in many exceptions; second, high rates of protection were maintained against third countries; and, third, there was little scope for efficiency gains through the exploitation of economies of scale. A similar conclusion was reached by Langhammer and Hiemenz (1991).

3. Today, the context is quite different. In conjunction with macro-economic (and political) reforms pursued in the aftermath of the debt crisis of the early 1980s, there has been a serious import liberalization in most Latin American countries. Edwards (1994), Laird (1995) and Rajapatirana (1994) show that throughout Latin America there has been a substantial reduction in the use of non-tariff measures, while tariffs have been substantially reduced and rationalized. As an indication of tariffs prior to these reforms Argentina had a tariff average of some 30 per cent in 1989, Brazil's rate was 51 per cent in 1988 and Uruguay's was over 100 per cent in 1978 (GATT, 1992a, b and c). These rates were reduced in unilateral reforms up to 1991 when the Treaty of Asunción was ratified, and then as part of (incomplete) process of convergence towards to MERCOSUR CET; by the time of implementation of the common external tariff (CET) in 1995, external tariffs among members averaged some 10.7 per cent. Thus, the new interest in regional agreements takes place against a backdrop of increased outward orientation, exhibited in unilateral reforms as well as increased membership and substantive participation in the work of the General Agreement on Tariffs and Trade (GATT) and now the World Trade Organization (WTO).

4. There is little question that intra-MERCOSUR trade has grown rapidly during the period from the signing of the Treaty of Asunción up to the establishment of the common external tariff at the beginning of 1995. Table I shows that exports within MERCOSUR have more than doubled as a share of total exports since 1990, while imports from within the group have also expanded sharply as a share of the total. However, the growth of intra-trade cannot be attributed uniquely to trade diversion resulting from the creation of MERCOSUR as, apart from certain years and partners, trade has also been growing strongly with other countries in the same period.<sup>1</sup> Moreover, one of the more important and fastest growing areas of trade in MERCOSUR is the automotive trade between Argentina and Brazil under arrangements which are not yet part of MERCOSUR *per se*, but among the exceptions (more later). In addition, in 1995, imports from outside the region grew somewhat faster than intra-regional trade.

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<sup>1</sup>Of course, there is trade diversion if the counterfactual is free trade.

Table I: External trade of MERCOSUR 1985-94 (US\$ million and per cent)

Exports	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
World (US\$ m.)	30,549	34,133	44,875	46,550	46,403	45,896	50,467	54,122	61,893	70,029
Intra-MERCOSUR	8.6	7.4	6.6	8.2	8.9	11.1	14.3	18.5	19.5	20.5
Total extra-MERCOSUR	91.4	92.6	93.4	91.8	91.1	88.9	85.7	81.5	80.5	79.5
Other LAIA	7.8	6.8	7.0	7.2	7.1	9.1	10.5	10.3	9.9	9.8
USA	21.7	24.3	21.8	19.7	20.8	17.1	17.1	17.6	17.5	15.2
EEC 15	27.4	27.6	29.9	29.5	31.7	32.2	30.3	26.7	27.0	25.5
Japan	6.2	5.4	5.9	5.8	6.0	6.6	5.4	5.2	4.9	5.1
Rest of World	28.3	28.4	28.8	29.6	25.6	23.9	22.4	21.8	21.2	24.0
<b>Imports</b>										
World (US\$ m.)	21,726	24,133	23,126	26,056	29,298	34,264	40,632	48,082	62,218	79,859
Intra-MERCOSUR	12.3	10.8	13.2	15.1	14.5	15.3	18.4	19.6	19.9	18.1
Total extra-MERCOSUR	87.7	89.2	86.8	84.9	85.5	84.7	81.6	80.4	80.1	81.9
Other LAIA	7.2	7.6	6.4	7.1	6.9	7.2	7.1	5.9	5.7	6.1
USA	20.3	18.4	18.5	19.9	19.2	21.2	22.1	22.0	22.0	22.1
EEC 15	25.0	25.8	24.7	22.5	22.2	23.1	23.6	23.9	27.4	27.5
Japan	6.7	6.3	6.9	7.0	7.0	6.4	5.5	5.5	4.6	4.7
Rest of World	28.5	31.1	30.3	28.4	30.2	26.8	23.2	23.1	20.4	21.5

Source: UNSTAT Comtrade Database.

## II. The objectives and achievements of MERCOSUR

### (a) Establishment of MERCOSUR

5. Under the Treaty of Asunción, signed on 26 March 1991 by the Presidents of Argentina, Brazil, Paraguay and Uruguay, the Mercado Común del Sur (MERCOSUR) was established.<sup>2</sup> The treaty was subsequently ratified by all members and entered into force on 29 November 1991. The Treaty of Asunción has been formally amended once, in the Additional Protocol of the Treaty of Asunción, known as the "Protocol of Ouro Preto", signed on 17 December 1994. This protocol, which concerns mainly institutional issues as well as dispute settlement, is also considered to confer on MERCOSUR a distinct international legal personality.

<sup>2</sup>MERCOSUR stems from the earlier Integration, Co-operation and Development Treaty of August 1989 between Argentina and Brazil, which in turn was based on the Iguazú Declaration of November 1985. See World Bank (1993) for details.

6. The Treaty of Asunción foreshadowed the establishment of a common market among the four countries with free circulation of goods, services, capital and workers from 1 January 1995 (but not all of this ambitious programme was achieved, as discussed later). The treaty has 25 Articles in six main chapters covering the purposes, principles and instruments of MERCOSUR, the organizational structure, the period of application, accession, denunciation (withdrawal) and general provisions. In addition, there are annexes covering the trade liberalization programme, rules of origin, dispute settlement, safeguards (including against other members of MERCOSUR), and the establishment of technical and policy working groups. Safeguards follow the guidelines of Article XIX of the GATT, but these have not been allowed on intra-regional trade since the beginning of 1995. The broad principles for dispute settlement were set out in the Treaty of Asunción. Various stages and procedures were elaborated in the Brasilia Protocol for the Settlement of Disputes, signed on 17 December 1991, and this is maintained in accordance with Article 43 of the Protocol of Ouro Preto.

7. Brazil notified the Treaty of Asunción to the GATT on 18 February 1992, on behalf of the Secretariat of the Latin American Integration Association (LAIA).<sup>3</sup> The notification was made under the provisions of the Enabling Clause, rather than Article XXIV, which contains the main provisions concerning Territorial Application, Frontier Traffic, Customs Unions and Free Trade Areas. The Enabling Clause, formally known as the Tokyo Round Decision on "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries", includes a legal cover for preferential trade agreements between developing countries, subject to certain conditions, including transparency. The essential provisions include that: any such arrangement should not raise barriers or create undue difficulties for other Contracting Parties (i.e., countries or trading entities signatories to the GATT); no criteria are specified for judging the acceptable degree of mutual reduction or elimination of tariffs;<sup>4</sup> and the reduction of non-tariff measures (NTMs) are to be governed by "criteria which may be prescribed by the Contracting Parties" (Paragraph 2(c)). On the other hand, unlike Article XXIV, there is no specification that substantially all trade is to be covered (but already some 95 per cent of intra-regional trade was duty-free by the end of 1994).<sup>5</sup>

8. The only significant change in procedures for examining a regional trade agreement resulting from the creation of the WTO stems from the requirement of the Agreement on Rules of Origin that a detailed work programme for the future be established. However, within the WTO, the relevant working party of the Committee on Trade and Development, which was established to examine the GATT/WTO consistency of the Treaty, did not complete its work, and the agreement is now being examined under the Committee on Regional Trade Agreements, established in February 1996, in the light of the provisions of GATT 1994, including Article XXIV.<sup>6</sup>

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<sup>3</sup>MERCOSUR is formally a sub-regional agreement within the LAIA framework.

<sup>4</sup>However, Article XXIV requires that a customs union or FTA cover substantially all trade, for those items which are included, "duties and other restrictive regulations are [to be] eliminated", i.e. that there is to be a 100 per cent reduction in tariffs and other barriers, a preferential rate other than zero is not contemplated.

<sup>5</sup>WTO (1996b), p.25.

<sup>6</sup>Disagreement about GATT consistency is the norm; conformity with GATT Article XXIV has been explicitly acknowledged in only six out of 69 cases where reports of working parties were submitted to the GATT Council - see WTO (1995b) for further details.

(b) Institutional structure

9. Under the Protocol of Ouro Preto, the institutional structure of MERCOSUR was established as follows (Article 1):

- (i) The Council of the Common Market (consisting of Ministers of Foreign Affairs and Ministers of Economy) ;
- (ii) The Common Market Group;
- (iii) The MERCOSUR Trade Commission;
- (iv) The Joint Parliamentary Commission;
- (v) The Economic and Social Consultative Forum; and
- (vi) The MERCOSUR Administrative Secretariat.

10. The role and composition of these bodies, of which the first three (the decision-making bodies) are given in hierarchical order, are laid out in the Protocol. The Ministerial-level Council embodies the legal *persona* of MERCOSUR, and is empowered to negotiate and sign agreements on behalf of MERCOSUR with third countries and international organizations. Oversight of the management of MERCOSUR is assured by trimestrial meetings of the Common Market Group, the main executive body. It consists of senior officials (four representatives and four alternates from each country) who must include representatives of the Ministries of Foreign Affairs, the Ministries of Economy (or equivalent) and the Central Banks. Meetings of Ministers of Economy and Central Bank Governors constitute the institutional framework for the exchange and analysis of macroeconomic policies.

11. The Trade Commission, which has a number of technical working committees, is responsible for co-ordinating common trade policy and implementing the common external tariff. The Joint Parliamentary Commission and the Economic and Social Consultative Forum are both Consultative bodies. The Administrative Secretariat, which is quite small and based in Montevideo, is to provide operational support for MERCOSUR, but is not intended to be a strong, policy- or rule-making supra-national authority along the lines of the European Commission.<sup>7</sup>

12. Essentially, MERCOSUR is an international treaty subscribed by the member states and the bodies established under the treaty are inter-governmental, rather than supra-national. Below the level of the treaty, implementing Decisions, Resolutions and Directives (in order of importance) are determined, respectively, at the level of the Council, the Common Market Group and the Trade Commission, but have no force by themselves and need to be implemented by corresponding national measures.<sup>8</sup> Unlike the Council of Ministers or the Commission of the European Communities, the MERCOSUR common bodies do not have powers to oblige a member state to comply with common market rules.

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<sup>7</sup>A headquarters agreement (*Acordo de Sede*) with the Uruguay Government was agreed under Decision 4/96 of the Common Market Council at its meeting of 16-17 December 1996 in Fortaleza. Financing of the Secretariat is on the basis of equal cost sharing among members; there is no independent source of finance.

<sup>8</sup>Legislative ratification and national implementation sometimes lags behind the commonly agreed measures. For example, in early 1997, the author was informed that, out of the total of 97 Decisions, 501 Resolutions and 43 Directives approved in the period 1991-96, Argentina and Brazil had ratified somewhat more than 50 per cent. This is less serious than it appears as some of these legal measures merely concern the undertaking of studies, rather than mandatory behaviour.

13. There is no supra-national court through which either a member state or the Secretariat can enforce treaty obligations on another member or a private party. There is provision for arbitration under the Brasilia Protocol (1991), but trade disputes are typically solved by negotiation. By the beginning of 1997 only one dispute had been sent to a specially constituted tribunal or expert panel under the Brasilia Protocol, and this was settled bilaterally (i.e., "out of court") in early April 1997.<sup>9</sup> It is clear that the authorities are still moving forward cautiously in this area.

14. The Common Market Group has two committees (on rules - *normalización* - and sanitary and phytosanitary measures). It is also advised by a number of working groups or "sub-groups", which examine certain issues relating to the integration process. Up to 1995, sub-groups worked under the broad headings of: trade issues; customs issues; technical standards; fiscal and monetary matters related to trade, inland transport; maritime transport; industrial and technological policy; agricultural policy; energy; co-ordination of macro-economic policies; and labour policy. These sub-groups carry out programmed examination of issues on which they make recommendations to the Common Market Group for consideration and implementation.<sup>10</sup> In 1995, under Resolution No. 20/95, a new structure was established, consisting of:

- Sub-Group 1: Communications;
- Sub-Group 2: Mining;
- Sub-Group 3: Technical rules;
- Sub-Group 4: Financial matters;
- Sub-Group 5: Transport and infrastructure;
- Sub-Group 6: Environment;
- Sub-Group 7: Industry;
- Sub-Group 8: Agriculture;
- Sub-Group 9: Energy; and
- Sub-Group 10: Labour and social security.

A new sub-group 11: Health, was created by a meeting of the Common Market Council in Fortaleza in December 1966. There are also specialized meetings on science and technology and tourism, as well as ad hoc groups on services, institutional matters, MERCOSUR-LAIA, MERCOSUR-WTO and sugar.

15. The MERCOSUR Trade Commission is advised by a Committee on the Defence of Competition as well as 10 Technical Committees on: (i) Tariffs, Nomenclature and the Classification of Goods; (ii) Customs Matters; (iii) Rules and Trade Disciplines; (iv) Public Policies which distort Competitiveness; (v) Defence of Competition; (vi) Unfair Practices and Safeguards; (vii) Consumer Protection; (viii) Non-tariff Restrictions and Measures; (ix) the Automotive Sector; and (x) the Textile Sector.

16. Overall, an impressive amount of work has been carried out by the various commissions and committees, but the weakness in the central institutional structure appears to constitute a particular disadvantage for the smaller members, leaving them vulnerable to political pressures. Moreover, it has been observed by Bouzas (1996) that, while scepticism towards supranational agencies is comprehensible in the light of earlier experience in Latin

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<sup>9</sup>The case involved a Uruguayan paper firm which complained that Argentinean levies were not in the exception lists established at Ouro Preto.

<sup>10</sup>Details of their work are provided in GATT (1994).

America, several issues, such as investment and services (discussed further below), need to be handled at a supranational level if the union is to advance and be deepened.

(c) Border measures and procedures

17. Article 5 of the Treaty set out the agreed liberalization programme, which was to consist of "progressive, linear and automatic tariff reductions accompanied across the board by the elimination of non-tariff restrictions or equivalent measures..... with a view to arriving at a zero tariff and no non-tariff restrictions for the entire tariff area by 31 December 1994." Following an initial tariff reduction of 47 per cent in applied rates after the ratification of the Treaty of Asunción in 1991, tariffs in individual member States were generally re-aligned on schedule, every six months in equal stages up to the implementation of the CET at the beginning of 1995 (except where increases were implied).

18. The Common External Tariff (CET) is applied to imports from partners subject to most favoured nation (m.f.n.) rates. Whereas only the broadest structure was set in 1991 (in order to determine the extent of the scheduled cuts), finalization was the subject of intense internal negotiations which were concluded in late 1994. It was then implemented, with exception lists for each MERCOSUR member, on 1 January 1995. The CET, based on the Harmonized Commodity Classification and Coding System (HS), consists entirely of ad valorem rates, charged on the c.i.f. value of the imports. An overview of the structure in 1995, by main sections of the International Standard Industrial Classification is shown in Table II, together with the rates to be applied when the exceptions are eliminated by the end of the transition periods (up to 2001 for Argentina and Brazil and up to 2006 for Paraguay and Uruguay).

19. The scheduled m.f.n. rates, which individual members apply as exceptions to the CET in the transition period, include sensitive items and are intended to facilitate structural adjustment, helping to place the sectors involved in a competitive position within the region at the end of the period in question; negotiations are also being conducted "with a view to harmonizing public policy in various areas and establishing a trade regime that will ensure fair competition" (WTO, 1995a). Thus, while the CET for capital goods has been set at 14 per cent, it has been agreed that Argentine and Brazilian tariffs for these products are to be allowed to converge to that rate in a linear and automatic manner over the period to January 2001, while Uruguay and Paraguay have until January 2006 to achieve convergence. For telecommunications and information technology equipment the CET is fixed at 16 per cent with convergence by all members by 2006. Some 1140 8-digit tariff items are covered by the capital goods exemptions and some 435 in telecommunications and informatics.

20. Initially, it was agreed that Argentina, Brazil and Uruguay would also have the right to have 300 national exceptions to the CET while Paraguay would have the right to 399 (WTO, 1995a). Items could be eliminated from these lists, but no new items could be placed on the lists, a ratcheting down effect. These exceptions could be higher or lower than the CET, so that for convergence to the CET, upwards and downwards modifications to national tariffs of the four members are required. For example, in 1995 the MERCOSUR countries reported to the WTO that Argentina, Brazil, Paraguay and Uruguay would increase the rates on 84,123, 214 and 212 items in the MERCOSUR common tariff schedule, respectively, while decreasing the rates on 147, 52, 0 and 6, respectively.<sup>11</sup>

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<sup>11</sup>WTO (1995a). The numbers of items are computed on the basis of the MERCOSUR tariff classification. The numbers of tariff items would be somewhat higher if measured in terms of the pre-existing national tariff classifications.



21. Apart from these items where the national scheduled rates diverge from the CET, each member has its own list of special concessionary régimes where rates may be reduced below scheduled rates, e.g., on investment items, to assure basic supplies of primary products and inputs for other industries, temporary admission of goods to be re-exported, to allow duty-free entry of goods from the free zones of Manaus and Tierra del Fuego,<sup>12</sup> and so on. These régimes are to be consolidated into a common set of MERCOSUR régimes to replace the national concessions, but a timetable has yet to be determined.

22. MERCOSUR countries maintain that the CET has been fixed in conformity with Paragraph 5 of Article XXIV of the GATT, which requires that "the duties... in respect of trade with [non members]...shall not on the whole be higher than... the duties...prior to the formation of [the] union". Elaborating on this, the Understanding on the Interpretation of Article XXIV of the GATT 1994 states that "the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected".<sup>13</sup> *Prima facie*, the CET would seem to meet the test of the GATT: thus, although Paraguay's average tariff was lower than under MERCOSUR, its weight in trade was quite small, while the large members previously had higher average rates. Thus, when the Treaty of Asunción was signed at the end of 1991, Argentina's average rate was 12.2 per cent and Uruguay had a 21.5 per cent global rate, while Brazil's rate was 21.2 per cent in January 1992 (GATT, 1992a, b and c). However, these are simple average m.f.n. rates, and they do not take account of concessional entry.<sup>14</sup>

23. It is important to note that the applied tariff levels, shown in Table II, are considerably lower than the levels which are legally bound in the WTO. Thus, the tariff bindings, made by the individual MERCOSUR countries (not the CET on behalf of the customs union, unlike the EU's CET), are mostly at a ceiling level of 35 per cent, with the main exceptions being tariffed agricultural import barriers. These are allowed to be implemented over 10 years, although Argentina implemented these rates fully in 1995. The gap between the applied and bound rates provides a wide margin for tariff increases without having to renegotiate of concessions under Article XXVIII of the GATT, and must inevitably lead to some uncertainty in the tariff regime. Brazil's June 1995 tariff increases to 70 per cent for a number of products (as well as the provision for the introduction of quotas on automotive imports) will confirm this sense of uncertainty, albeit within the binding commitment for 1995 (to be reduced progressively over 10 years to 35 per cent). However, security of access to MERCOSUR was improved by the substantial extension of the coverage of the tariff bindings to all trade, compared with a situation prior to the Round where binding coverage was only 4 per cent of items in the case of Argentina and Uruguay and 6 per cent for Brazil.<sup>15</sup>

24. MERCOSUR's CET is characterised by tariff escalation: tariff protection for raw materials (1st stage of processing) was on average 6.3 per cent in 1995, 9.1 per cent for semi-

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<sup>12</sup>Imports from export-processing zones are normally treated as imports subject to the CET.

<sup>13</sup>Unusually, in the GATT/WTO context, this requirement refers to applied tariffs, rather than to tariff bindings.

<sup>14</sup>Nogués (1983) notes that, in Argentina, the average nominal tariff was reduced from 98 per cent to 49 per cent in the Martínez de Hoz period (1976-81), and stood at over 30 per cent in 1988, but the ratio of duty collected to total imports was close to 2 per cent for all the years between 1970 and 1988. This was a result of concessional rates as well as preferences.

<sup>15</sup>Paraguay acceded to the GATT during the Uruguay Round with a comprehensive binding coverage.

manufactures and goods used as inputs for other production chains and 12.5 per cent for fully processed goods (see Table III). Escalation was most marked in Brazil and least pronounced in Paraguay in 1995 (the first three lines of Table III). For the CET as it will be applied following full implementation, escalation will be on average slightly more pronounced than in 1995. Tariff escalation exists in practically all sectors, with petroleum refineries being the sole exception.

25. The presence of tariff escalation means that processing industries benefit from higher levels of protection on their value added than is evident from the nominal tariffs alone. An indication of the levels of effective tariff protection may be obtained from a special study (Kume, 1996) carried out in Brazil, showing the current level of tariff protection, as well as the level that is expected to prevail following full implementation of the CET in 2001/2006 (see Table IV). This latter rate is therefore representative of the effective protection that will be available throughout MERCOSUR.

26. The highest effective protection is accorded to passenger cars, trucks and buses, reflecting higher nominal tariffs on motor vehicles and the relatively low value added in the industry.<sup>16</sup> Other activities benefiting from higher than average levels of effective protection include electrical materials, electronic equipment, the dairy industry, beverages and food products, textiles and plastic products. In contrast, activities with effective rates considerably below the average, notably non-fuel mining, agriculture and chemicals, tend to be relatively disadvantaged by the tariff structure; the negative effective protection estimated for petroleum and coal mining indicates that these activities are even more disadvantaged by the existing tariff structure.

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<sup>16</sup>Estimated protection would be even higher if the tariff reductions on inputs announced in late 1995 were included. The industry is further assisted by non-tariff measures, e.g., export subsidies and investment incentives.

27. The CET rates may not be modified without the consent of all MERCOSUR participants, other than to bring rates on items in the exceptions lists more rapidly into alignment with the CET than scheduled. However, in the transition period modifications are being allowed. Thus, in 1995 Brazil was permitted to exempt from the CET a further list of up to 150 additional items as part of its stabilization programme, for price control and domestic supply considerations. The products mainly covered food items such as meat, cheese, rice and barley, but also covered steel products and consumer durables, including cars, on which rates were increased to 70 per cent. In early 1996, the list was reduced and amended, with butter, oil and wine being added to preclude "undesirable" imports (WTO, 1996b). Tariffs on textiles were retained at 70 per cent and increased on wine from 20 to 35 per cent. When the additional list expired in 1996 safeguard measures were introduced on textiles (under the provisions of the WTO Agreement on Textiles and Clothing) and tariffs were increased from 20 per cent to 70 per cent on toys (under the main WTO safeguards provisions). The same procedure for modifications of the national rate would have provided legal cover for the periodic re-introduction and modification of the Argentine statistical tax (now bound at 3 per cent under the WTO in respect of "other duties and charges"); this was used in the past like an import surcharge for fiscal reasons, while preserving the psychologically important nominal anchor of the national currency to the U.S. dollar.<sup>17</sup> The increases in tariffs and charges by Brazil and Argentina were within the overall binding commitments at the time.

28. It is important to note that there remain a number of exceptions to duty-free treatment on trade within MERCOSUR. Thus, when the CET was introduced in January 1995, the members also agreed on a Régimen of Final Adjustment (*Régimen de adecuación*) to the Customs Union, which allows exceptions to internal duty-free trade. For items covered by this régime, there are to be tariff reductions on intra-group trade in a linear and automatic manner until a zero rate is reached. For Argentina and Brazil, the reductions began on 1 January 1995 and are to be completed by 31 December 1998; for Paraguay and Uruguay, the reductions began on 1 January 1996 and are to be completed by 31 December 1999. The main list of goods covered is not extensive, mainly being sensitive agricultural and industrial products, and is estimated by MERCOSUR countries as covering some 5 per cent of intra-trade. However, this does not take account of the exceptions made for sugar or automobiles, of which the latter is of particular importance in trade between Argentina and Brazil.

29. Turning to non-tariff restrictions on external trade, a distinction is made between those which have to be eliminated and those which have to be harmonized, such as measures relating to plant and animal health, technical standards environmental protection and safety. This will also allow for a common MERCOSUR policy, consistent with WTO provisions, Annex II of the Treaty of Asunción reproduces the Resolution of the Common Market Group establishing the regulatory framework for the elimination of non-tariff restrictions and harmonization of measures of a non-tariff nature. Under the trade liberalization programme of the Treaty of Asunción (Annex I), non-tariff measures were to be eliminated on internal trade under the LAIA framework (Economic Complementarity Agreement No. 18). However, while a number of non-tariff measures have been eliminated, the elimination of others still requires legislative approval at the national level. (See also discussion of sectoral policies below).

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<sup>17</sup>The level of the Argentine statistical tax has varied between zero and 6 per cent in recent years.

Table II: MERCOSUR tariff structure, 1995 and final CET (2001/2006) (per cent)

ISIC Code	Description	Argentina	Brazil	Paraguay	Uruguay	Average	Final
	<b>Total</b>	<b>10.5</b>	<b>11.9</b>	<b>9.4</b>	<b>10.8</b>	<b>10.7</b>	<b>11.2</b>
<b>1</b>	<b>Agriculture, hunting, forestry &amp; fishing</b>	<b>7.0</b>	<b>7.0</b>	<b>6.9</b>	<b>6.9</b>	<b>7.0</b>	<b>7.0</b>
111	Agricultural and livestock production	7.0	6.9	6.8	6.8	6.9	7.0
12	Forestry and logging	4.6	4.7	4.4	4.6	4.6	4.6
121	Forestry	5.8	6.0	5.5	5.8	5.8	5.8
122	Logging	2.0	2.0	2.0	2.0	2.0	2.0
130	Fishing	8.7	8.7	8.7	8.7	8.7	8.7
<b>2</b>	<b>Mining &amp; quarrying</b>	<b>3.4</b>	<b>3.6</b>	<b>3.4</b>	<b>3.4</b>	<b>3.5</b>	<b>3.4</b>
210	Coal mining	0.0	0.0	0.0	0.0	0.0	0.0
220	Crude petroleum and natural gas	0.0	6.8	0.0	0.0	1.7	0.0
230	Metal ore mining	2.2	2.2	2.2	2.2	2.2	2.2
290	Other mining	4.1	4.1	4.1	4.1	4.1	4.1
<b>3</b>	<b>Manufacturing</b>	<b>10.8</b>	<b>12.3</b>	<b>9.6</b>	<b>11.1</b>	<b>11.0</b>	<b>11.5</b>
31	Food, beverages and tobacco	11.6	11.7	11.5	11.7	11.6	11.6
311	Food products	11.0	11.2	10.9	11.2	11.1	11.0
312	Other food products and animal feeds	11.8	11.8	11.3	11.8	11.7	11.8
313	Beverages	18.1	17.3	18.6	17.6	17.9	18.6
314	Tobacco manufacturing	18.6	18.6	18.6	18.6	18.6	18.6
32	Textile, wearing apparel and leather	17.2	16.9	16.9	16.9	17.0	17.1
321	Textiles	16.8	16.7	16.6	16.7	16.7	16.9
322	Manufacture of wearing apparel	19.9	19.9	19.9	19.9	19.9	19.9
323	Leather products	13.2	12.4	13.2	12.8	12.9	13.2
324	Manufacture of footwear	24.6	19.4	18.8	19.4	20.6	19.4
33	Wood and wood products, inc. furniture	10.8	10.2	10.5	10.5	10.5	10.5
331	Wood and wood products, exc. furniture	8.1	7.7	8.1	8.1	8.0	8.1
332	Manuf. of furniture & fixtures exc. metal	18.9	18.0	18.0	18.0	18.2	18.0
34	Paper, paper prods, printing & publishing	11.7	10.7	10.7	10.4	10.9	10.9
341	Paper products	12.1	11.0	11.1	10.7	11.2	11.3
342	Printing, publishing & allied industries	10.1	9.4	9.4	9.0	9.5	9.4
35	Chemicals, petrol, coal, rubber, plastics	7.9	8.2	7.7	7.2	7.8	8.1
351	Industrial chemicals	7.2	7.5	7.1	6.4	7.1	7.5
352	Other chemicals, incl. pharm.	8.6	8.7	8.1	8.3	8.4	8.8
353	Petroleum refineries	0.9	12.7	0.9	0.9	3.9	0.9
354	Manuf. of misc. petrol. & coal prods.	2.0	3.2	2.0	2.0	2.3	2.0
355	Rubber products	16.1	15.4	15.4	15.4	15.6	15.4
356	Manufacture of plastic products n.e.s.	17.4	17.4	17.4	16.8	17.3	17.4
36	Non-metal minrl prods exc. petrol & coal	10.9	10.5	10.6	10.9	10.7	10.9
361	Pottery and china	15.4	14.8	14.3	15.4	15.0	15.4
362	Manufacture of glass and glass products	12.6	12.6	12.4	12.6	12.6	12.6
369	Other non-metallic mineral products	9.2	8.6	9.0	9.2	9.0	9.2
37	Basic metal industries	10.9	9.9	9.6	9.3	9.9	9.9
371	Iron and steel basic industries	12.6	11.4	11.0	10.5	11.4	11.4
372	Non-ferrous metal basic industries	8.7	7.9	7.8	7.7	8.0	8.0
38	Fabricated metal prods, mach.& equip.	10.9	15.8	8.0	13.2	12.0	13.3
381	Fabricated metal products	16.0	16.4	14.7	16.0	15.8	16.1
382	Non-electrical machinery incl. computers	7.7	16.8	4.5	12.4	10.4	12.5
383	Electrical machinery	12.1	14.8	9.2	12.6	12.2	12.7
384	Transport equipment	13.5	15.2	11.5	14.6	13.7	14.6
385	Professional and scientific equipment	12.2	14.8	8.8	13.3	12.3	13.4

390	Other manufacturing industries	16.8	16.6	15.8	16.6	16.5	16.6
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Note: CET to be completed by Argentina and Brazil by 2001 and by Paraguay and Uruguay by 2006.

Source: WTO Secretariat calculations, based on data supplied by MERCOSUR.

Table III: Tariff escalation and tariff ranges, 1995 and final (2001 or 2006) (Per cent)

ISIC	Product and processing	Argentina	Brazil	Paraguay	Uruguay	Average	Final
	Total						
	- 1st stage of processing	6.3	6.4	6.2	6.1	6.3	6.3
	- semi-processed	9.3	9.3	9.0	8.6	9.1	9.4
	- fully processed	12.0	14.7	10.2	13.1	12.5	13.3
1	Agriculture						
	- raw materials	7.0	7.0	6.9	6.9	7.0	7.0
2	Mining and quarrying						
	- raw materials	3.4	3.6	3.4	3.4	3.5	3.4
311	Food products						
	- 1st stage of processing	7.0	7.0	7.0	7.0	7.0	7.0
	- semi-processed	10.3	10.3	10.1	10.3	10.3	10.3
	- fully processed	12.4	12.7	12.3	12.7	12.5	12.3
312	Food manufacturing						
	- 1st stage of processing	7.0	7.0	7.0	8.2	7.3	7.0
	- semi-processed	16.0	16.0	14.4	16.0	15.6	16.0
	- fully processed	13.6	13.6	13.1	13.0	13.3	13.6
313	Beverages						
	- fully processed	18.1	17.3	18.6	17.6	17.9	18.6
314	Tobacco manufactures						
	- fully processed	18.6	18.6	18.6	18.6	18.6	18.6
321	Textiles						
	- 1st stage of processing	8.3	6.7	8.3	8.3	7.9	8.3
	- semi-processed	16.5	16.5	16.2	16.3	16.4	16.6
	- fully processed	18.7	18.7	18.6	18.6	18.7	18.7
322	Clothing						
	- fully processed	19.9	19.9	19.9	19.9	19.9	19.9
323	Leather products						
	- 1st stage of processing	10.0	10.0	10.0	10.0	10.0	10.0
	- semi-processed	9.7	8.6	9.7	9.2	9.3	9.7
	- fully processed	20.0	20.0	20.0	20.0	20.0	20.0
324	Footwear						
	- fully processed	24.6	19.4	18.8	19.4	20.6	19.4
331	Wood products						
	- 1st stage of processing	2.0	2.0	2.0	2.0	2.0	2.0
	- semi-processed	6.6	5.8	6.6	6.6	6.4	6.6
	- fully processed	11.7	11.7	11.7	11.7	11.7	11.7
332	Furniture except metal						
	- fully processed	18.9	18.0	18.0	18.0	18.2	18.0
341	Paper products						
	- 1st stage of processing	3.6	3.6	3.6	3.6	3.6	3.6
	- semi-processed	12.6	11.6	11.4	10.8	11.6	11.6
	- fully processed	15.5	13.5	14.2	14.2	14.4	14.5
342	Printing						
	- fully processed	10.1	9.4	9.4	9.0	9.5	9.4
351	Industrial chemicals						
	- 1st stage of processing	8.6	9.2	8.6	6.0	8.1	8.6
	- semi-processed	7.1	7.3	7.0	6.4	7.0	7.4
	- fully processed	11.3	11.1	9.3	7.5	9.8	11.3
352	Other chemicals						
	- 1st stage of processing	11.0	8.7	8.7	8.7	9.3	8.7

Table III: Tariff escalation and tariff ranges, 1995 and final (2001 or 2006) (Per cent)

ISIC	Product and processing	Argentina	Brazil	Paraguay	Uruguay	Average	Final
	- semi-processed	7.8	8.2	7.6	7.4	7.8	8.2
	- fully processed	8.9	8.9	8.3	8.6	8.7	9.1

353	Petroleum refineries						
	- 1st stage of processing	0.0	12.1	0.0	0.0	3.0	0.0
	- semi-processed	3.2	13.4	3.2	3.2	5.8	3.2
	- fully processed	0.6	12.7	0.6	0.6	3.6	0.6
354	Petroleum and coal products						
	- 1st stage of processing	0.0	0.0	0.0	0.0	0.0	0.0
	- semi-processed	2.0	4.8	2.0	2.0	2.7	2.0
	- fully processed	8.0	8.0	8.0	8.0	8.0	8.0
355	Rubber products						
	- 1st stage of processing	12.0	12.0	12.0	12.0	12.0	12.0
	- semi-processed	14.0	14.0	14.0	14.0	14.0	14.0
	- fully processed	17.1	16.1	16.1	16.1	16.4	16.1
356	Plastic products						
	- fully processed	17.4	17.4	17.4	16.8	17.3	17.4
361	Pottery and china						
	- fully processed	15.4	14.8	14.3	15.4	15.0	15.4
362	Glass and products						
	- semi-processed	8.1	7.9	8.1	8.1	8.1	8.1
	- fully processed	14.0	14.0	13.8	14.0	14.0	14.0
369	Non-metallic mineral products						
	- 1st stage of processing	6.0	6.0	6.0	6.0	6.0	6.0
	- semi-processed	6.9	6.6	6.9	6.9	6.8	6.9
	- fully processed	9.8	9.1	9.5	9.8	9.6	9.8
371	Iron and steel products						
	- 1st stage of processing	0.9	0.9	0.9	0.9	0.9	0.9
	- semi-processed	13.0	11.8	11.4	10.9	11.8	11.8
372	Non-ferrous metal						
	- 1st stage of processing	3.8	3.8	3.8	3.8	3.8	3.8
	- semi-processed	8.9	8.1	7.9	7.8	8.2	8.2
	- fully processed	16.0	16.0	16.0	16.0	16.0	16.0
381	Metal products						
	- semi-processed	14.0	14.0	14.0	14.0	14.0	14.0
	- fully processed	16.0	16.4	14.7	16.1	15.8	16.1
382	Non-electrical machinery						
	- semi-processed	12.0	12.0	12.0	12.0	12.0	12.0
	- fully processed	7.7	16.8	4.5	12.4	10.4	12.5
383	Electrical machinery						
	- fully processed	12.1	14.8	9.2	12.6	12.2	12.7
384	Transport equipment						
	- fully processed	13.5	15.2	11.5	14.6	13.7	14.6
385	Professional and scientific equipment						
	- fully processed	12.2	14.8	8.8	13.3	12.3	13.4
390	Other manufactured products						
	- 1st stage of processing	8.6	8.6	8.0	8.6	8.5	8.6
	- semi-processed	13.5	13.5	10.0	13.5	12.6	13.5
	- fully processed	17.5	17.3	16.5	17.3	17.2	17.3

Source: WTO Secretariat calculations based on data supplied by MERCOSUR.



**Table IV: Effective rates of protection by activity in Brazil 1993-2006 (per cent)**

	July 1993	December 1994	December 1995	CET 2006
Agriculture	3.9	3.8	4.4	4.4
Non-fuel mining	0.7	0.9	2.5	2.7
Petroleum & coal mining	-2.0	-1.9	-1.9	-1.7
Metallic mineral products	13.0	11.3	14.3	14.5
Iron and steel	10.7	10.2	12.9	13.8
Non-ferrous metallurgy	6.2	7.6	10.4	10.4
Other metal products	22.7	19.4	21.3	21.2
Machinery and tractors	22.6	23.2	20.8	14.3
Electrical material	26.1	26.3	31.3	20.4
Electronic equipment	23.1	21.3	24.9	13.0
Cars, trucks, buses	129.8	44.6	270.9	53.1
Other vehicles and parts	21.3	21.6	21.0	14.4
Wood and furniture	9.7	9.4	12.3	12.4
Cellulose, paper, etc.	8.5	8.0	10.5	12.6
Rubber products	17.3	15.3	14.6	14.7
Chemicals	12.8	9.0	5.2	16.1
Petroleum refining	10.5	5.2	8.0	8.8
Various chemical prods.	9.0	5.0	5.8	6.0
Pharmaceuticals & perf.	13.9	2.3	9.8	9.9
Plastic products	21.5	24.4	23.3	22.3
Textiles	20.6	20.2	23.6	21.5
Clothing	23.9	24.5	21.0	22.6
Footwear and leather	15.1	15.6	21.3	15.8
Coffee industry	12.7	10.1	11.8	11.8
Vegetable products	18.0	17.1	23.2	20.7
Animal slaughter	10.0	7.1	9.7	9.8
Dairy industry	21.6	25.7	24.2	16.5
Sugar	21.2	9.5	16.5	16.8
Vegetable oils	7.6	8.0	8.8	9.3
Beverages & food prods	29.7	22.2	23.9	25.1
Other products	23.6	21.0	20.6	19.9
Prod. weighted average	14.5	12.3	12.9	15.4
Median	15.1	11.3	14.6	14.4
Minimum	-2.0	-1.9	-1.9	-1.7
Maximum	129.8	44.6	270.9	53.1
Standard deviation	21.7	9.7	45.9	9.2

Source: Kume (1996).

30. Annex IV of the Treaty for the application of safeguards follows the guidelines laid down in Article XIX of the GATT (Emergency Action on Imports of Particular Products), adapting them to the institutional framework of MERCOSUR and the "need to protect the situation of certain sectors of domestic industry in some of the States Parties to MERCOSUR" (GATT, 1995a). Common Rules on Unfair Trade Practices by third countries and Common Rules and Safeguard Measures against third countries were agreed under Decision No. 17/96 of the Common Market Council in December 1996. Under the decision, a Trade Defence and Safeguards Committee was also created, taking over the relevant functions of the Trade Committee, and is responsible for safeguards investigations. A safeguard measure may be taken by MERCOSUR as a group or on behalf of a simple member. National action is no

longer envisaged in terms of GATT Article XIX, but this may still be possible under the special safeguards provisions of the WTO Agreement on Textiles and Clothing as well as the Agreement on Agriculture.

31. Under Article 1 of Annex IV, safeguard actions by one member state against another have not been allowed since the beginning of January 1995. However, anti-dumping actions are still allowed under Resolution No. 129/94 of the Common Market Group until such time as there is agreement on a set of Common Rules on the Defence of Internal Competition.<sup>18</sup> At the meeting of the Council of the Common Market in Fortaleza (16-17 December 1996), it was decided under Decision No. 18/96 to continue this situation until 31 December 2000.

32. Concerning customs (procedural) issues, the meeting of the Council and the Common Market Group at Ouro Preto on 16-17 December 1994 adopted a series of decisions and resolutions, which, as well as bringing the common external tariff (with the noted exceptions) into effect, included a number of common trade policy measures necessary for its implementation, for example, a common system of rules of origin, regulations against unfair trade practices by third countries, a MERCOSUR customs code and a series of harmonized customs regulations. However, the customs code was only ratified by Paraguay and is currently being renegotiated. The possibility of integrated customs controls at the internal frontiers has been discussed, but there is no question of their elimination, even after duties and other restrictions on internal trade are eliminated. This is because duties and domestic indirect taxes will be collected by the member state which is the final destination of imports from third countries, while indirect taxes will also be collected in imports from other MERCOSUR countries.

33. Administrative difficulties have so far limited the implementation of free circulation of goods. Free circulation would mean that, once imports from third countries enter one MERCOSUR country, they should be able to cross internal frontiers into other MERCOSUR countries simply by showing that the duty under the CET has been paid at the first port of entry.<sup>19</sup> Duties collected in the first country would then be transferred to the authorities in the country of final destination on the basis of the paperwork provided by the importer at the port of entry. At present, while free circulation is intended, in practice most goods from third countries for transit through one MERCOSUR country to another travel under international transit arrangements (i.e., under customs seal), and pay duty only in the final country of destination. (This mainly concerns Paraguay which is landlocked). Arrangements for the transfer of receipts of customs duties to the final country of destination still need to be worked out. Thus, shipments which do not enter MERCOSUR under international transit provisions and which pay the duty at the first port of entry could well encounter problems at the internal frontier if the shipper expects not to have to pay duty at that point.

34. Apart from the tax and duty arrangements, and despite ongoing efforts to simplify the transit of goods and persons, there are periodic reports of delays at the frontiers.

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<sup>18</sup>It may be noted that, since 1992, no anti-dumping actions have been allowed on intra-trade in the EU and the European Economic Area, with reliance being placed solely on common competition policy enforcement. The same is the case in the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA).

<sup>19</sup>During the period of implementation when national exceptions to the CET are allowed the difference between the CET and the national level would be paid (or, in principle, rebated where the national rate is lower) on entering the market of final destination.

35. The work on rules of origin is intended to lead to harmonized rules, since there is no intention of abolishing internal frontiers along the lines of the EU's single market. Customs will determine the origin of goods and, hence, the appropriate level duty to be paid to the fiscal authorities in the country of final destination. Duties on goods from third countries which are processed in one MERCOSUR country before being re-exported to another will essentially be assessed on the basis of general rules of change of tariff classification and/or 60 per cent local content, as well as special rules for the capital goods, chemical, telecommunications and information technology sectors. Thus, to a large degree the problems that Krueger (1995) identifies in respect of FTAs will not be avoided in MERCOSUR.

(d) Common trade policy

36. The adoption of a common trade policy towards third countries is considered by the MERCOSUR countries to be "an inseparable complement to the implementation of a common external tariff" (WTO, 1995a), and MERCOSUR has defined the main elements of such a policy. While the Ouro Preto meeting took a number of decision on trade policy these relate mainly to customs matters, as discussed above, and some sectoral questions, discussed later. They do not refer specifically to trade policy to third countries, although this is now becoming much clearer.

37. In terms of relations with third countries, MERCOSUR is also intended to be an open regional agreement: Paraguay, on behalf of the MERCOSUR countries, has stated that it is "a flexible and open process, the opposite of the idea of a 'fortress' reformulating, at the quadripartite level, old isolationist concepts" (WTO, 1995a). This can mean several things: on the one hand, MERCOSUR may take the form of open regionalism in which liberalization is also applied to third countries and, on the other, the agreement may also be open to membership or to the exchange of concessions with other countries or regional blocks. To evaluate these possibilities, we look at common external trade policy first in the multilateral context of the WTO, second in the context of the LAIA, and third in respect of bilateral relations with other countries and groups of countries.

38. First, in the WTO, despite the goal of establishing a common trade policy, the member states of MERCOSUR continue to be represented individually, compared with the European Union, where the European Commission speaks on behalf of its members. The exception to this is the new Committee on Regional Trade Agreements, where MERCOSUR is represented by the Presidency *pro tempore* (which changes every six months). As noted earlier, in the Uruguay Round tariff bindings were made individually, not as a MERCOSUR commitment. To the extent that national bound tariffs are currently lower than the CET, members are to engage in a process of renegotiation of tariff bindings to align these rates with the CET. Similarly the processes of eliminating internal exceptions to duty free trade and convergence to the applied CET will be important steps towards establishing a common external trade policy.

39. Currently, common trade rules on anti-dumping have been drafted and are being revised to bring them into alignment with WTO rules. In the meantime, members are applying their domestic legislation, keeping the MERCOSUR Trade Commission informed of any actions. Although no decision has been taken to this effect, when harmonized rules are agreed, it would seem logical that these be implemented through the Trade Defence and Safeguards Committee, as has been agreed for safeguards. Following that practice, measures could then be imposed in respect of any single member or MERCOSUR as a whole.

40. Article 50 of the Treaty of Montevideo, in accordance with Article XX (General Exceptions) and Article XXI (Security Exceptions) of the GATT, permits LAIA members, including within the framework of MERCOSUR, to apply trade measures for protection of

public morality, human, animal and plant life and health, and national security. This also covers regulation of imports and exports of arms, munitions, etc., imports and exports of gold and silver in bullion form, protection of national treasures of artistic, historical or archaeological value, and the exportation, use and consumption of nuclear materials, radioactive products or any other material used for the development and exploitation of nuclear energy. Details are provided in Annex I to GATT (1994).

41. In many areas of trade policy, convergence to WTO criteria, while leaving scope for national variations, will facilitate the establishment of a common policy, as well as improving integration within MERCOSUR. The wide sweep of WTO commitments, compared to the GATT, results from the obligation under the Single Undertaking of the Round all members of the World Trade Organization to implement all but the four plurilateral accords (the Agreement on Trade in Civil Aircraft, the Agreement on Government Procurement, the International Dairy Agreement and the International Bovine Meat Agreement). Thus, unlike the Tokyo Round codes in which adherence was voluntary, members are bound by and cannot opt out of agreements in the areas of anti-dumping, subsidies and countervailing duties, customs valuation, etc. Under these agreements MERCOSUR countries have, in effect, made commitments to bring their individual practices into line with the new WTO rules and hence to accept a degree of harmonization not apparently yet covered by decisions under the Treaty of Asunción, although, the WTO rules on sanitary and phytosanitary measures have been adopted as MERCOSUR rules at the Fortaleza meeting of the Council of the Common Market.

42. Second, the Latin American Integration Association (LAIA) provides the umbrella framework for MERCOSUR, even within the WTO, as noted earlier. Indeed, the first priority for MERCOSUR in relations with third countries is within the LAIA, where other members have also been undertaking unilateral reforms. In this context, MERCOSUR countries are renegotiating the Economic Complementarity Agreements which individual members have with other LAIA members to create a single MERCOSUR agreement with each partner. In this regard, negotiations are under way to establish an FTA with Mexico (as an LAIA partial-scope agreement) and Panama.

43. Following five years of operation, i.e., in principle from 29 November 1996, the possibility of admission to MERCOSUR is open to other members of the LAIA.<sup>20</sup> Bolivia has indicated that it would like to become a member and already participates in some technical groups; in December 1995, it signed an agreement with MERCOSUR intended to lead to a free trade agreement. In June 1996, Chile also signed an agreement which envisages the comprehensive removal of duties on MERCOSUR-Chilean trade over a 10-year period, except for a small group of agricultural products on which tariffs are to be phased out over 15-18 years.<sup>21</sup> This agreement also covers rules of origin (many of which are product specific), transport investment, services, intellectual property and investment. There is also an interest in developing a link between the Andean Community and MERCOSUR, fostered primarily by Brazil and Venezuela.

44. Third, bilateral relations with non-LAIA countries are presently dominated by work on the proposed Free Trade Area of the Americas (FTAA), announced at the Summit of the

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<sup>20</sup>Member countries of LAIA are Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

<sup>21</sup>Since Chile now has an FTA with MERCOSUR, it is not obliged to change its uniform 11 per cent tariff to the MERCOSUR CET. This also will allow Chile to maintain its FTAs with Canada and Mexico as well as pursuing its possible NAFTA accession.

Americas held in Miami on December 9-11, 1994. Work on the FTAA was consolidated by the work of Ministers at their Denver meeting in June 1995 and at Cartagena in March 1996, although inevitably the interest of the U.S. Administration was diverted in 1996, an election year. The FTAA would extend and consolidate recent autonomous trade reforms in the region, while the inclusion of the United States would also lend considerable credibility to the accord, providing an important guarantee of the outward orientation of MERCOSUR.

45. Among MERCOSUR countries, enthusiasm for the FTAA is not uniform. For example, in a similar context Brazil has argued that joining NAFTA would mean that Latin American countries "would lose their capacity for adopting autonomous policies in sensitive areas such as investment, services and intellectual property".<sup>22</sup> Certainly, such an FTA would also extend liberalization of external barriers beyond that currently agreed for MERCOSUR. In the area of trade, this includes striving for comprehensive agreements across the hemisphere on tariff and non-tariff barriers to trade, agriculture, subsidies, investment, intellectual property, rules of origin, anti-dumping duties, sanitary standards, dispute settlement and competition policy. It also seems likely that the United States would wish to request improved investment opportunities in those countries where investment is subject to restrictions. Similarly, if NAFTA is seen as a model, there would be a need to apply the principles of m.f.n. and national treatment commitments across all sectors (with limited exceptions or reservations), unlike the laxer GATS commitments made by MERCOSUR countries. Again, even if discriminatory internal taxes have not been raised as an issue in GATT, it is unlikely that they would pass unnoticed in the FTAA negotiation.<sup>23</sup> Overall, import-competing sectors in MERCOSUR countries (capital goods, automobiles and even some agricultural goods) would come under much greater adjustment pressures in such an FTAA.

46. Prior to the discussion on the FTAA, MERCOSUR signed a framework treaty with the United States in June 1991 to encourage trade and investment in the region. This treaty established a consultative council on trade and investment. It set out an initial action programme which encompassed Uruguay Round co-operation, means to reduce trade and investment barriers in the Americas, access to technology, intellectual property rights, access to markets for goods and services, sanitary and phytosanitary regulations in agriculture and the need for a transparent safeguard régime in conformity with the GATT.

47. Under an inter-regional co-operation agreement, signed in December 1995 with the European Union a joint sub-committee on trade began work in 1996. In the longer term, the agreement envisages the opening of negotiations on tariffs and technical standards in the year 2002 with the possibility of establishing free trade between the two blocks by the year 2010. To some extent this agreement is seen as counter-balancing the influence of the United States in the FTAA. There have also been indications of interest in establishing closer trade relations with APEC.

(e) Sectoral policies

48. The co-ordination of sectoral policies, which is a feature of a deeper level of integration than the WTO requirements for a customs union, has been the subject of discussions at the technical level in the areas of agriculture, industry, energy, transport and labour. The results of these activities are being incorporated in Decisions or Resolutions of the higher level bodies of

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<sup>22</sup>Mr Rubens Barbosa, Brazilian Ambassador in London, *Financial Times* December 8, 1994.

<sup>23</sup>Article III of the GATT prohibits discrimination against imports in the application of domestic taxes.

MERCOSUR, with the intention that these will lead to greater harmonization of domestic sectoral policies and further the integration process.

49. Negotiations are taking place in MERCOSUR's Technical Sub-Group No. 8 to harmonize and co-ordinate agricultural policies. These discussions are intended to lead to a scheme based on the WTO Agreement on Agriculture. National Governments would continue to have complete autonomy on measures falling within the Green Box and Blue Box measures (permitted subsidies, which are general or are de-linked in different degrees to the amount of production), while there would be some limitations on national autonomy in respect of measures are subject to WTO reduction commitments on the Aggregate Measure of Support (AMS). Decision 19/94 of the Council of the Common Market allows up to 2001 for the adaptation of the sugar sector to the operation of the customs union. Discussions are taking place on the export taxes which are applied independently by Argentina, Brazil and Uruguay on exports of raw hides and skins. The implementation of an umbrella mechanism for agriculture, including a price band (variable levy) system was under consideration in 1995 (Henz, 1995), but MERCOSUR members decided instead to strengthen and harmonize their trade defence (anti-dumping/countervailing) mechanism (WTO, 1996). These discussion are strongly linked to Brazilian concerns about the vulnerability of its farm sector and food security under a harmonization which would see the elimination of Brazilian farm support policies (Lopes, 1996).

50. Details of the Argentina-Brazil arrangements in the automotive sector are shown in Box I. Effectively, this is a managed trade arrangement, in which the sector benefits from local content plans, allowing concessional entry on vehicles and parts, as well as export balancing requirements. The arrangements, which have been particularly advantageous for the parts industry, are to remain in force until a common sectoral policy is established in 1999. The present arrangements are covered by a waiver from the provisions of MERCOSUR under Council Decision No. 29/94. To be compatible with the WTO Agreement on Trade Related Investment Measures (TRIMs), it will be necessary to eliminate the local content and export-balancing requirements by the year 2000. This results from the provision of the TRIMs Agreement which stipulates that all such measures were to be eliminated immediately in 1995 unless notified to the WTO, while those measures which were notified must be eliminated within five years (i.e., by the year 2000) by developing countries). Argentina made such a notification for its automotive arrangements. The status of the Brazilian measures was still *sub judice* at the time of writing.

51. In this respect, it may be noted that MERCOSUR provides a framework for production-sharing arrangements, under provisions which are redolent of the various sectoral arrangements that preceded MERCOSUR. These are intended to foster the rationalization of investment and increase the competitiveness of companies in the region (GATT, 1992c). A production-sharing arrangement for the steel industry was in place between 1992 and 1994 between Argentine and Brazilian firms, but since January 1995, Brazil has applied duty-free quotas for steel imports from other MERCOSUR members, under the adjustment régime. It is feasible, but apparently has not been discussed that arrangements in the automotive sector could come under those provisions, but they could not remain as they are because of the TRIMS agreement.

52. The extended periods of convergence to the CET for the capital goods and electronics sectors, may be seen as part of the coordinated action on sectoral policies in the area of manufacturing. They are also linked to the asymmetries that exist in the economies of MERCOSUR and, to a degree, a lack of international competitiveness in those sectors. In electronics, Brazil was by far the major producer, but has essentially renounced its earlier programmes to develop the electronics sector which imposed major costs on other parts of its

economy (WTO, 1996b).<sup>24</sup> The convergence periods effectively provide a prolonged adjustment period to a more open régime, especially in Brazil.

53. In the national economies of the MERCOSUR countries, services now constitute the larger part of national production. To derive greater benefits from international exchange, the Treaty of Asunción provides for free movement of services, capital and workers as well as goods among MERCOSUR countries. However, while trade in goods has been substantially liberalized, much remains to be done in these other areas where negotiations for a framework were ongoing in an ad hoc group at the time of writing.

**Box I: Argentina-Brazil arrangements on motor vehicles**

In January 1996 Brazil and Argentina signed a bilateral agreement for the automotive sector, revising the text signed between the two countries in Ouro Preto in December 1994. Under the Ouro Preto Agreement motor vehicles were granted special treatment, while establishment of a common policy on intra-trade in this sector was postponed until 1999. In the meantime, Argentina was granted freer access to the Brazilian market than it was required to grant Brazilian exports.

Under the agreement signed in January 1996, both vehicles and parts may be imported duty free as long as the importer balances its foreign purchases with exports to any destination (except for replacement parts). The situation of firms established in only one country had not been defined in early 1996. The agreement provides for an average local content of at least 50 per cent computed over a three-year period (MERCOSUR local content-level is generally 60 per cent).

Each partner engages to recognize the validity of the automotive regime of the other country until 31 December 1999. In effect, this formalizes Argentina's acceptance of the changes made to Brazil's domestic regulations in 1995. Under the agreement of January 1996, Brazil and Argentina will meet twice a year to evaluate developments under the agreement and to decide on any necessary adjustments. From 1 January 2000, bilateral trade will be duty-free.

The Agreement contains a "side letter" allowing Argentina to compensate the sectoral deficit of US\$850 million accumulated with Brazil between 1992 and 1994. Such compensation is to take place through the duty-free importation by Brazil of close to 85,000 Argentinean cars between 1996 and 1998. Under the side letter, the two Governments were to negotiate the quantities and the use of motor vehicles made by companies installed in other one of the two countries. Negotiations were still in progress in 1996.

Under the Agreement imports from third-countries are treated less favourably than intra-regional trade. Moreover, the provisions of the Agreement make it advantageous for foreign vehicle makers to set up local plants to satisfy the local market. The Agreement also seems to favour location of assembly operations in Brazil, as manufacturers are less likely to consider producing vehicles in Argentina for export to Brazil unless they can export the same quantity of Brazilian-made vehicles.

Brazil and Uruguay granted each other an increase of 15 per cent in the import quotas for cars, under which assemblers installed in Uruguay (Peugeot and Citroën) were to be allowed to export 11,500 units in 1996. Brazilian exports to Uruguay were to increase from 3,000 to 4,500 cars. In 1995 Uruguay did not fill its quota of 10,000 units, which was extended until March 1996.

Source: WTO (1996b)

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<sup>24</sup>In developed economies, these sectors are often supported under R&D programmes as well as defence contracting.

54. The work on services is being carried out by the Ad Hoc Group on Services and its various sub-committees. A framework agreement was scheduled to be submitted to the Common Market Council before the end of September 1997.

55. In MERCOSUR there is relatively little integration in financial services, although it is more advanced in banking than in other areas (Machado, 1996).<sup>25</sup> However, there are considerable asymmetries in MERCOSUR financial services markets, and this is reflected in the rather different offers of the members in the WTO sectoral negotiations, with Brazil's offers being somewhat more restrictive than those of other MERCOSUR countries, reflecting the earlier stage of sectoral liberalization (Abreu, 1996). Within the region, it has been agreed through the Protocol of Colonia to apply national treatment to intra-regional investment, with some exceptions, with guarantees for investors. A network of national banks (*Red BANOSUR*) is intended to find new operational mechanisms to promote intra-regional trade. Sub-Group 4 (Financial Matters) of the Common Market Group has been examining inconsistencies in the capital market regimes and financial systems, and drawn up some priorities for co-operation, focusing on supervision, exchange of information, privatization, money laundering and external relations. The work programme extends through to the year 2000.

56. In the area of prudential supervision, the Common Market Council in its Decision No. 10/93 adopted standards covered by the Basel Agreement of 1988, but much hinges on surveillance and enforcement. Coordination in financial services could usefully be extended to certain basic management principles for financial intermediaries, including standards of accounting and auditing, compatibility of systems, network linkages, user rules and/or rates of commission, but little work has been done by MERCOSUR in this area.

57. Transport policy issues have been discussed in Sub-Group 5 on Transport and Infrastructure (previously Sub-Group 5 on Inland Transport and Sub-Group 6 on Maritime Transport). Proposals include the total elimination of standing and flexible quotas for road transport, direct transport between rail terminals, a joint shipping register, labour regimes (stemming from the original Sub-Group 11, now Sub-Group 10), etc. At present, transport of goods and persons across the frontiers is allowed, as well as returning with cargo or passengers. However, internal cabotage is not allowed. At the Ouro Preto meeting the members adopted a Multi-modal Transportation Agreement, governing trade operations under a single contract involving more than one transport mode, as well as a Hazardous Merchandise Transportation Agreement, covering the harmonization of regulations on the transport of dangerous goods. Technical discussions are continuing in the area of safety standards, etc.

58. Discussion has been taking place on the possibilities for harmonization, co-ordination and regulation in the areas of audiovisual information and data processing and computerized marketing and distribution.

(f) Technical barriers

59. MERCOSUR's Standards Committee, comprising the national standards bodies of member states, has already carried out extensive work on the harmonization of a national standards. Resulting from that work, the Council has agreed (Decision 6/96) on the

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<sup>25</sup>There has been a substantial re-structuring of Latin American banks, linked in some instances to inefficient and corrupt management (see "Banks in Latin America An Urgent Case for Repair" and "Miami or Bust" in The Economist, July 1st, 1995, pp.79-80). The situation deteriorated in the wake of the Mexican financial crisis, but this was not the prime source of the problems.



application of the WTO rules on sanitary and phytosanitary measures as the set of rules for MERCOSUR. To the extent necessary, national measures will be adjusted to bring them into conformity with that agreement. Where further work is desirable in this area it might be possible to draw on international standards, such as International Standards Organization (ISO), the Codex Alimentarius of the Food and Agriculture Organization (FAO) and World Health Organization (WHO) on food products, or the Office Internationale des Epizooties (OIE) on animal health; failing this, it could be advantageous to adopt standards from major external markets or suppliers such as the United States or the European Union. This could facilitate exports, making it easier to gain access to foreign markets and expand sales outside MERCOSUR. On the import side, it would also help to ensure the openness of the customs union.

60. On the basis of experience in the European Union, sectors where technical standards may constitute serious barriers to trade and, accordingly, where priority needs to be given to work on standardization include: information technology, telecommunications, transport, construction, pharmaceuticals and foodstuffs. As far as can be readily ascertained, these are areas where there has already been extensive work in MERCOSUR. A sub-group also appears to be working on an agreement on testing and certification procedures, common conditions and codes of practice for laboratories and certification bodies.

61. In the short term, full and immediate mutual recognition of national standards on quality, food composition, etc., should be the goal. Since the main objectives of legislation for the protection of human health and the environment are generally similar, having identical intentions although often taking different forms, then there is no reason in theory why a product legally manufactured in one country should not be sold anywhere in the customs union.<sup>26</sup> This would obviate the need to meet national standards, with tests and certification in the importing member states, allowing any purchaser - wholesaler, retailer or individual - to choose freely his supplier from anywhere within the customs union.

62. In the longer term, MERCOSUR countries could move from mutual recognition towards greater harmonization which allows for even greater rationalization of production to capture economies of scale and specialization. While harmonization implies greater regulation, taking longer to implement and perhaps introducing inflexibility and stifling innovation, it is sometimes argued that harmonization is more likely to promote cost reductions and the achievement of competitiveness at the international level, particularly in high technology goods and areas where economies of scale and specialization matter. In the EU, harmonization, rather than mutual recognition, was considered particularly important in the areas of information technology, telecommunications and transport to ensure compatibility between users and operators throughout the customs union. However, these are also areas where MERCOSUR does not have any evident comparative advantage and it would be undesirable to establish harmonized standards which effectively operated to restrict access to least-cost sources or world markets (particularly since these are also important inputs into other sectors of the MERCOSUR economies).

(g) Intellectual property

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<sup>26</sup>This was also a matter of extensive debate and legal action in the European Union - see, for example, the Cassis de Dijon case (*Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein*, (ECJ case 120/78), which determined, *inter alia*, that differences in national marketing laws should only be allowed as a restriction on free movement of goods to the extent necessary for the enforcement of fiscal supervision, protection of public health, fairness in commercial transactions and defence of the consumer.

63. In the past, the issue of protection of intellectual property was an area where there were significant divergences from overseas practices in the MERCOSUR area, where intellectual property protection was often based on process rather than product protection and unexploited patents fell into the public domain relatively rapidly. While this has helped some development of domestic industry, it has also been a source of tension in international relations, and no doubt has also had certain adverse consequences in the developing countries, for example by higher royalties to offset risks. Rowat (1993) argues that the increased interest in strengthening laws for the protection of intellectual property is strongly linked to the revisions of the trade and investment régimes, designed to make developing countries more attractive to foreign investors, describing this linkage as a "marriage of convenience".

64. Most international agreements to protect intellectual property are administered by the World Intellectual Property Organization (WIPO), which is responsible, *inter alia*, for the Paris Convention for the Protection of Industrial Property, first established in 1883, the Berne Convention for the Protection of Literary and Artistic Works, first adopted in 1886, and the Madrid Agreement concerning the International Registration of Marks, adopted in 1891. The most important new development of the international framework is the adoption by the WTO of compromise rules on Trade Related Intellectual Property (TRIPs) issues, which were developed largely at the instance of the United States because of perceived weaknesses of the WIPO framework. Member states are now bound by the WTO rules, which should oblige a minimum degree of harmonization, including within MERCOSUR.

65. The original Sub-Group 7 (Industrial and Technological Policy) of the Common Market Group carried out a survey of national laws in the area of intellectual property in 1993 and 1994, and made proposals to the Common Market Group for dealing with intellectual property at the regional level. This was subsequently adopted in Decision 8/95 of the Common Market Council, which in its Annex contains the Protocol on the Harmonization of Rules on Intellectual Property concerning marking and origin, which had only been ratified by Paraguay by mid-1997. A Protocol on Trade Marks, Indications of Source and Appellations has been finalized and is also awaiting ratification by Argentina, Brazil and Uruguay. An Agreement on Copyright and Related Rights was approved by the Council, but has been returned to Working Group No. 7 for further study.

(h) Competition policy, reform of the state and government procurement

66. Within the market, a Technical Committee (No. 4) of the Trade Commission is identifying public policies which distort conditions for competition, including government procurement, tax policies and state trading. A Common Statute on competition polices has been proposed by the Trade Commission to the Common Market Council. Efforts in these areas have been identified as crucial for the consolidation of the internal market by Machado and Markwald (1996). Indeed, the whole area of reform of the state is seen as creating a more favourable economic and institutional environment for integration (de Alemeida, 1966).

67. Privatization, one of the key elements of reform of the state, has a number of goals, including the reduction of foreign debt and the control of public sector deficits. However, a micro-economic objective is the improved allocation of resources, deriving from a more competitive environment. While trade reforms can do much to promote this objective, a pro-active competition policy is often necessary to overcome market imperfections, especially in the short term. This has been noted in GATT (1992a) for Argentina and WTO (1996b) for Brazil, but this effort needs to be carried forward across MERCOSUL in a coordinated manner. This could pave the way for competition policies to replace anti-dumping on intra-regional trade.

68. However, despite the extensive privatization that has taken place in recent years, the public sector remains very important in MERCOSUR (Baer, 1995, Shirley, 1994).<sup>27</sup> It would therefore be consistent with the goal of improving competitive conditions in the region to increase competition and transparency in public procurement for governments and remaining state-owned enterprises. This means eliminating preferences for domestic suppliers which are often granted in public sector contracts and work very much like ad valorem tariffs on imports. (Argentina generally affords national treatment, whereas there are still sectors where Brazil has to move in this regard). Apart from explicit preference margins, projects are sometimes specifically designed to favour local suppliers, working more like import prohibitions on foreign suppliers. There is often an absence of clear-cut guidelines or transparent tendering procedures, opening the way for corruption of public officials. Major welfare gains could therefore be realized by opening up domestic markets to regional, or better yet extra-regional suppliers. Little work seems to have been done in this area: Argentina presented to the Fortaleza meeting of the Common Market Group a proposal to establish an Ad Hoc Group on Government Procurement which it was decided to consider later.

69. In the WTO, government procurement is one of the few areas where participation is optional, and the MERCOSUR countries, together with most developing countries chose not to participate. Assurance of the outward orientation of MERCOSUR would be enhanced if MERCOSUR government chose to sign the WTO Agreement on Government Procurement. This would seem entirely compatible with the need for prudent management of national budgets, and the disciplines on transparency and openness so introduced would also serve as limits on any corruption in letting of procurement contracts.

(i) Infrastructure

70. Although infrastructure is not specifically covered by the Treaty of Asunción, it has been highlighted in GATT (1991, 1992a and 1992b) that the trade of MERCOSUR countries would be facilitated by improved physical infrastructure, particularly ports and airports. A particularly telling example is the degraded port and transport situation in Paraguay, described in World Bank (1993). There would also be benefits from improved road and rail connections in the MERCOSUR area. In the current financial situation of the member states, it may be opportune to look further at the possibilities for privatization in these areas, as has already been done for bulk shipments of grains and minerals.

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<sup>27</sup>Baer and Shirley, taking somewhat different views of the lessons from privatization, provide a useful overview of the importance of the state sector in Latin America. Baer mentions that there were some 353 state-owned enterprises in Argentina in the 1980s, 268 in Brazil and over 1,000 in Mexico. Shirley notes that Latin America is the major privatization area in the world, generating revenues of some US\$40 billion in the period 1988-92.

(j) Co-ordination of macroeconomic policy

71. The Treaty of Asunción provides for periodic meetings of Ministers of Economy and Central Bank Governors of MERCOSUR countries to co-ordinate of macro-economic policy and to try to establish joint approaches to common problems such as inflation, foreign investment and trade. In practice, there were no meetings between 1995 and 1997 (until a meeting in Asunción in April 1997 to consider, *inter alia*, Brazilian restrictions on the financing of imports). In the past the lack of co-ordination on macro-economic policies has been most evident with respect to exchange rates (Abreu and Bevilaqua, 1995, Pereira, 1996). For example, differential movements in exchange rates and interest rates in Argentina and Brazil caused major fluctuations in trade and financial flows, giving rise to political tensions and to new trade measures. This has sometimes led to managed trade solutions, instead of corrective macro-economic policies: for example, at one point, to reduce tensions and help to overcome rising trade deficits, Brazil made "special efforts" to buy more from Argentina (e.g., through state-owned enterprises). The Argentina-Brazil automotive arrangements, stepped-up efforts by Brazil to promote exports and, most recently, Brazilian restrictions related to the financing of imports may be seen in a similar light.

72. One approach to convergence in macro-economic management might be the establishment of targets, such as the European Union has set as a condition for participation in the planned monetary union. These cover inflation, long-term interest rates, exchange rates, budget deficits and public debt, all consistent with macro-economic stability, which, as Pereira (1996) points out must be the basic goal more than rigid targets.<sup>28</sup> However, efforts to restrain fiscal expenditure are complicated by the ineffectiveness of federal controls over the provinces in Argentina (now being brought under control) and the states in Brazil. Again, exchange rate corrections are complicated because Argentina has pegged its currency to the US dollar and Argentina's use of monetary policy is also effectively excluded by its *Ley de Convertibilidad*, requiring all currency issue to be fully backed by U.S. dollars (in essence a currency board system); this leaves economic management essentially to fiscal policy, for which financing is also limited by the outlawing of the monetization of government deficits. It is constraints such as these which have led to the use of special arrangements, lists of exceptions to the CET and safeguard actions to manage trade in recent years, going against the spirit and intent of a common market, not to mention the WTO.

73. The original Sub-Group 10 on Co-ordination of Macro-economic Policies carried out an examination of taxation issues, particularly in the area of consumption taxes. In principle, this work was handed over the Ministers of Economy and Central Bank Governors, but, as noted, there were no meetings between 1995 and 1997, and no specific actions have yet been taken along these lines, despite the range and complexity of internal taxes, including at the provincial and state levels in Argentina and Brazil.<sup>29</sup> This divergence in rates has encouraged "shopping tourism" for which Paraguay, where indirect taxes are low, is a regional centre. However, little progress has been achieved on tax harmonization, and the possibilities for agreement must inevitably be complicated by the current process of reform of domestic taxes in each member, intended to overcome tax evasion and lift tax receipts.

74. The case for co-ordination or even harmonization of indirect taxation is to avoid resources flowing from one member to another not on the basis of resource endowment but

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<sup>28</sup>These targets have prompted the comment that the conditions of membership are like a slimming' club requiring weight loss prior to admission ("From here to EMU", *The Economist*, 5 August 1995).

<sup>29</sup>da Silva (1996) points out that Brazil would probably have to make the major effort since its tax system contains elements which significantly distort the efficient allocation of resources.

rather on avoidance of potential tax liability.<sup>30</sup> Harmonization would also reduce the risks of fraud and smuggling which occurs today. Pita (1996) argues that it is necessary to accelerate the institutionalization of the processes of tax harmonization to gain the full benefits of integration. There might also be some harmonization of tax incentives for investment, domestic or foreign. However, in the present fiscal situation, it is difficult to foresee any MERCOSUR agreement on the establishment of an EU-type mechanism whereby goods would only be taxed at the point of production, passing across frontiers without border tax adjustments.

### III. Concluding remarks

75. The MERCOSUR countries have taken important steps towards the construction of a custom union, and beyond that towards a common (but not EU-style single) market. This work has been accomplished in a relatively short time-frame. Concerns about possible trade diversion should be somewhat allayed by the extensive unilateral reforms, the major increase in tariff bindings in the Uruguay Round, the removal of many non-tariff measures and the additional disciplines of the WTO, which also add a degree of security to trading conditions for third countries. So far the rapid increase in trade flows between members has been accompanied by a solid growth in trade with third countries.

76. To complete internal free trade in goods requires the elimination of the remaining tariffs on intra-trade, and a number of non-tariff measures have to be yet to be eliminated or harmonized; in most areas, this work is either on schedule or is being discussed. While the intention is to allow free circulation of goods, the weakness in administrative arrangements for free circulation represents a serious gap in the completion of a customs union; there is scope for improved implementation of agreed streamlined customs operations. The provisions for sectoral policy co-ordination, including production-sharing arrangements, need to be monitored to ensure that they do not revert to earlier import substitution policies. No agreement has yet been reached on free movement in services, capital and workers, despite the commitment to include these by January 1995. MERCOSUR needs a strong and coherent competition policy to improve the competitiveness of domestic industry, and this could also replace anti-dumping procedures in intra-trade. Opening up public procurement regionally and beyond could bring both welfare and direct fiscal benefits. A supra-national framework may be needed to advance and deepen integration in investment and services, and some steps have been taken in this direction. In the meantime it remains to be seen if formal dispute settlement procedures are sufficient protection for the smaller countries.

77. Given the history of macro-economic instability in the region, often linked to reversals of previous trade policy reforms,<sup>31</sup> one of the highest priorities for the authorities must remain co-ordination and cohesion in the pursuit of responsible fiscal, monetary and exchange rate policies to achieve economic stability with steady growth, perhaps with specific targets for key economic variables. As we have seen, the failure to achieve such co-ordination can lead to disruptive imbalances in trade, reversals of trade and/or exchange rate policies, and deteriorating political as well as economic relations. The resort to managed trade solutions, particularly in automobiles, run counter to the spirit of recent unilateral trade reforms and the common market, not to mention the WTO.

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<sup>30</sup>Tax harmonization does not necessarily imply absolutely identical rates of taxation, for example, it is possible to envisage a fixed percentage variation from an agreed norm or target across member states.

<sup>31</sup>Papageorgiou, Michael and Choksi (1991).

78. On external policy, there are still a number of important exceptions to the common external tariff, including through flexible additional lists which have provided legal cover for recent policy reversals, but the programmed elimination of these measures is still within the agreed time-table. In the longer term, greater welfare benefits could be realized by scaling back escalation in the CET and the elimination of TRIMs exceptions in the automotive sector. Between members, there seems to be more competition than coherence of approach in attracting foreign investment, and this also seems to have linkages to the outmoded import-substitution policy. While efforts are being made to agree on a common anti-dumping mechanism, consideration might be also given to use of competition policy standards on external trade to avoid possible abuse of anti-dumping actions whose use has become important, especially in Brazil and Argentina.

79. External trade relations are still centred on other LAIA countries and talks with Andean Group members, which could lead to a virtual South American FTA. There seems to be a more ambivalent interest in the proposal for a Free Trade Area for the Americas, which would have the advantage of extended market opportunities, greater economies of scale in production and distribution, the dilution of the power of national industrial lobbies and greater discipline on potential policy slippages.

80. The potential welfare gains from completing efforts on internal and external barriers, ensuring the smooth functioning of trade and looking beyond existing plans to a lower and more uniform structure of protection are very large, although their attainment will entail adjustment for these sectors which have hitherto flourished under protected, uncompetitive markets. The willingness of the member countries to confront the "hard cases" will constitute a test of the depth of change in the economic philosophies of the member states.

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