

VICISSITUDES OF A PREFERENTIAL TRADE AGREEMENT: THE CASE OF MERCOSUR

*Thesis submitted to Jawaharlal Nehru University
for the award of the degree of*

DOCTOR OF PHILOSOPHY

Prachi Agarwal



CENTRE FOR ECONOMIC STUDIES AND PLANNING

JAWAHARLAL NEHRU UNIVERSITY

NEW DELHI-110067

INDIA

2019



CENTRE FOR ECONOMIC STUDIES AND PLANNING

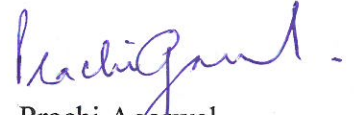
JAWAHRALAL NEHRU UNIVERSITY

NEW DELHI - 110067

Date: 23-12-2019

CERTIFICATE

This is to certify that the dissertation titled "Vicissitudes of a Preferential Trade Agreement: The Case of Mercosur" submitted by me in partial fulfilment of the requirement for the award of Doctor of Philosophy has not been previously submitted for any other degree of this or any other university.

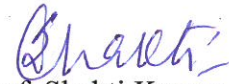

Prachi Agarwal

We recommend that this dissertation to be placed before the examiners for evaluation



Prof. Biswajit Dhar
(Supervisor)

Supervisor
CESP, SSS, JNU
New Delhi - 110067



Prof. Shakti Kumar
Chairperson (CESP)

अध्यक्ष / Chairperson
आर्थिक अध्ययन और नियोजन केन्द्र
Centre for Economic Studies & Planning
सामाजिक विज्ञान संस्थान / School of Social Sciences
जवाहरलाल नेहरू विश्वविद्यालय
Jawaharlal Nehru University
नई दिल्ली-110067 / New Delhi-110067

ACKNOWLEDGEMENT

I have incurred many intellectual debts during the writing of this thesis. First and foremost, I would like to express my profound gratitude to my supervisor, Prof. Biswajit Dhar for his excellent supervision, caring guidance and unwavering support throughout the Ph.D. journey. He has not only taught me so much about how to think analytically about the world of international economics in general, he has been a brilliant supervisor all along, offering friendly yet challenging criticism and constantly pushing me to think harder and further. I deeply treasure my endless conversations with him about everything under the sun, and will miss this time spent. I am indebted to the Center for Economic Studies Planning (CESP) that provided a stimulating intellectual environment to conduct most of my thesis. I have spent seven long years at the center and everything I know about economic research has been learnt here. The staff at CESP was always helpful and I sincerely thank them for their hard work and words of encouragement.

I also owe tremendous gratitude to Nanno Mulder at the UN-CEPAL in Santiago, Chile for offering me the opportunity to spend some time in South America and develop my thesis. His support and assistance in organization all of my interviews that supplemented my research in indescribable ways is appreciated. I am grateful to my interview partners from around the world, who were generous with their time, and to those individuals, who were willing to respond to questions over email and over skype. Without their knowledge and insights, this thesis would not have been possible. My time in Santiago was the most intellectually rewarding and fun. I met several new friends and I am glad to have shared this journey with them. I thank, among others, Sandra, Javiera, Marcelo and Francisca.

I have also benefitted from numerous conversations and late-night sessions with my closest friends and *mis compadres*, Zoya, Vaishali, Disha and Avni. You girls kept me sane and always cheered me on. Special thanks to Bushra for keeping me healthy, to Raunaq for keeping me updated about the academic world and to Sahil, for dragging me to those weekly coffee-breaks. They say that a mother's job is a thankless job. To my mother, who always ensured I was well-fed and rested every single day, has been my pillar of strength through this process. My father's motivational talks every evening, although were met with resistance, have helped me give this thesis my best. My aunt and grandma's unmatched support and warmth was all the love I needed. In the end, my partner, Sreejit, who stuck around during the worst and most-stressful times in the last three years and always had my back.

TABLE OF CONTENTS

ACKNOWLEDGEMENT	4
LIST OF FIGURES	10
LIST OF TABLES	11
LIST OF ABBREVIATIONS	12
ABSTRACT	14
CHAPTER 1: INTRODUCTION	16
BACKGROUND.....	16
RELEVANCE AND APPROACH.....	20
OBJECTIVES AND MAIN HYPOTHESIS.....	21
RESEARCH DESIGN: METHODOLOGY AND SOURCES.....	22
STRUCTURE OF THESIS.....	25
SCOPE AND LIMITATIONS.....	27
CHAPTER 2: LITERATURE REVIEW	28
I) GROWING IMPORTANCE OF PREFERENTIAL TRADE AGREEMENTS.....	29
II) RATIONALE AND BENEFITS OF PTAS.....	36
III) MERCOSUR, ITS INCEPTION AND STRUCTURE.....	44
IV) PENDING ISSUES WITH MERCOSUR.....	55
V) COMPARISON OF THE EU AND MERCOSUR.....	62
<i>Brief history of the EU</i>	63
<i>The Comparison</i>	64
CHAPTER 3: EVOLUTION OF TRADE POLICY	70
INTRODUCTION	70
ARGENTINA	73
<i>IMPORT SUBSTITUTION POLICY (1950-80s)</i>	75
<i>MACROECONOMIC FAILURES AND THE PERONIST REFORMS (1980-1991)</i>	78
<i>DEBT CRISIS AND THE END OF THE CONVERTIBILITY REGIME (1998-2002)</i>	83
<i>THE COMMODITY PRICE SUPERCYCLE (2002-2011)</i>	84
<i>TRADE POLICY IN THE NEW MILLENIUM</i>	88
BRAZIL	94
<i>EVOLUTION OF THE ISI POLICY</i>	96
<i>PLANO REAL, AND OTHER POLICIES OF THE NINETIES</i>	99
<i>EXTERNAL INFLUENCE ON BRAZIL'S TRADE POLICY:</i>	105
<i>THE POLITICAL AND EXTERNAL CRISIS (2014-2016)</i>	109
<i>MULTILATERALISM IN BRAZIL</i>	111
<i>AGRICULTURAL AND ENERGY POLICIES</i>	114
<i>Summary of Trade Trends</i>	121
<i>TARIFF REGIME SINCE 1992</i>	123
PARAGUAY	130
<i>PRE-MERCOSUR TRENDS (1960-1991)</i>	130
<i>TRADE TRENDS AND POLICY ANALYSIS SINCE CET (1995-2017)</i>	131
URUGUAY	135

<i>HISTORICAL PERSPECTIVE</i>	135
<i>CONTEMPORARY TRADE POLICY</i>	139
<i>TRADE OPENNESS AND TRADE BALANCE</i>	141
CONCLUSIONS	142
CHAPTER 4: EVOLUTION OF TRADE RELATIONS	146
INTRODUCTION	146
ARGENTINA	147
EXPORTS	147
<i>MOTOR VEHICLES</i>	150
<i>BIOFUELS</i>	151
EXPORT DESTINATIONS	152
<i>CHINA</i>	154
IMPORTS	155
<i>MINERAL FUELS</i>	157
IMPORT SOURCES	158
<i>EU 12</i>	159
<i>CHINA</i>	160
BRAZIL	162
EXPORTS	162
EXPORT DESTINATIONS	168
<i>EU 12</i>	170
<i>CHINA</i>	172
<i>UNITED STATES</i>	174
IMPORTS	175
IMPORT SOURCES	177
PARAGUAY	180
EXPORTS	180
<i>BOVINE MEAT</i>	181
<i>SOYBEAN</i>	183
<i>ELECTRICITY</i>	184
EXPORT DESTINATIONS	185
IMPORTS	188
IMPORT SOURCES	191
URUGUAY	193
EXPORTS	193
<i>BOVINE MEAT</i>	195
<i>SOYBEAN and RICE</i>	196
EXPORT DESTINATIONS	197
<i>CHINA</i>	199
<i>EU 12</i>	200
<i>BRAZIL</i>	201
IMPORTS	202
<i>PETROLEUM OIL AND PRODUCTS</i>	204
<i>MOTOR VEHICLES</i>	205
IMPORT SOURCES	206
<i>CHINA</i>	208
CONCLUSIONS	209
CHAPTER 5: EMPIRICAL ANALYSIS OF MERCOSUR'S TRADE RELATIONS: GRAVITY MODEL AND OTHER TOOLS	214
SECTION 1: GRAVITY MODEL ANALYSIS	214

EXTRAREGIONAL GRAVITY MODEL	218
REGIONAL GRAVITY MODEL	221
INTRA-MERCOSUR GRAVITY MODEL.....	225
SECTION 2: OTHER INDICES.....	228
TOP BILATERAL EXPORT BASKET	229
REVEALED COMPARATIVE ADVANTAGE.....	233
INTRA-BLOC TRADE.....	236
DEPENDENCY AMONG MEMBERS	237
TRADE COMPLEMENTARITY	239
PREFERENCE MARGINS	241
SECTION 3: WAY AHEAD	242
CHAPTER 6: GLOBAL VALUE CHAINS AND INTRA-INDUSTRY TRADE IN MERCOSUR: AN ANALYSIS OF INTRA-BLOC TRADE	246
SECTION 1: AN INTRODUCTION TO GLOBAL VALUE CHAINS	247
SECTION 2: MERCOSUR: PARTICIPATION IN GVCS.....	250
TRADE IN PARTS AND COMPONENTS	251
VALUE ADDED IN PRODUCTION AND EXPORTS	254
TARIFFS ON INTERMEDIATE GOODS.....	256
OTHER INDICATORS.....	258
SECTION 3: AUTOMOTIVE REGIONAL VALUE CHAIN IN BRAZIL AND ARGENTINA	260
SECTION 4: INTRA-INDUSTRY TRADE.....	262
SECTION 5: WAY AHEAD	267
CHAPTER 7: POLITICAL ECONOMY OF MERCOSUR	270
1. INTERPRESIDENTIALISM IN MERCOSUR.....	272
2. POLITICS OF A PERFECT CUSTOMS UNION.....	275
3. IDEOLOGICAL MISMATCH IN THE 2000S	277
EMPHASIS ON SOUTH-SOUTH RELATIONS	278
UNCERTAINTY AROUND VENEZUELA'S POSITION.....	280
4. MEMBERS' EXPECTATIONS FROM MERCOSUR	281
POWER ROLE OF BRAZIL.....	281
ARGENTINA'S PRIORITY SET.....	284
EXPECTATIONS HELD BY THE SMALLER COUNTRIES: URUGUAY AND PARAGUAY	285
5. INTERACTION WITH PACIFIC ALLIANCE.....	289
6. MERCOSUR'S EXTRAREGIONAL RELATIONS.....	290
FREE TRADE OF THE AMERICAS.....	291
MERCOSUR- EUROPEAN UNION RELATIONS	297
7. DE JURE VERSUS DE FACTO INTEGRATION: EXPECTATIONS FROM THE BLOC AND CONCLUSIONS.....	300
CHAPTER 8: CONCLUSIONS	306
KEY FINDINGS.....	307
RECOMMENDATIONS.....	315
SCOPE AND FURTHER RESEARCH	317
ANNEXURE 1	320
EXTRAREGIONAL TRADE GRAVITY MODEL: VARIABLE SUMMARY.....	320
REGIONAL TRADE GRAVITY MODEL: VARIABLE SUMMARY	321

INTRA-BLOC TRADE GRAVITY MODEL: VARIABLE SUMMARY	322
ANNEXURE 2	324
QUESTIONNAIRE ON DRIVERS OF MERCOSUR'S NEGOTIATION AGENDA IN THE PAST 30 YEARS	324
ANNEXURE 3	328
LIST OF INTERVIEWEES	328
REFERENCES	330

LIST OF FIGURES

Figure 1: Argentina- Gross Exports, Imports, Trade Balance and Openness _____	87
Figure 2: Global Prices of Main Commodity Exports (Indexed Year 2000= 100)___	108
Figure 3: Brazil- Gross Exports, Imports and Trade Balance _____	122
Figure 4: Brazil- Trade Openness _____	123
Figure 5: BRAZIL- Average Applied MFN Tariff Rate _____	124
Figure 6: Paraguayan Trade Balance (1989-2017) _____	132
Figure 7: Paraguayan Trade Openness _____	133
Figure 8: Uruguay- Gross exports, imports, trade balance and openness _____	141
Figure 9: Argentina- Composition of Exports (1993-2017) _____	148
Figure 10: Top exporters of Agricultural Products (2017) _____	149
Figure 11: Bilateral Trade between Argentina and Brazil in Automotives (Vehicles and Parts): (1989-2017) _____	150
Figure 12: Argentina- Biofuel Exports (2012-2017) _____	152
Figure 13: Argentina- Export Destinations (1993-2017) _____	154
Figure 14: Top Argentine Exports to China _____	155
Figure 15: Argentina- Import Composition (1993-2017) _____	156
Figure 16: Imports of Mineral Fuels (2001-2017) _____	157
Figure 17: Import Sources (1993-2017) _____	159
Figure 18: Top Imports from EU 12 and China (1993-2017) _____	161
Figure 19: Composition of Imports from China (1993-2017) _____	161
Figure 20: Product Composition of Exports: 1989, 2004, 2017 _____	163
Figure 21: Top Destinations for Brazilian Exports of Automobile and parts (1989-2017) _____	164
Figure 22: Top exporters of Food products _____	165
Figure 23: Top Exporters of Iron Ore (2017) _____	167
Figure 24: Top Destinations for Exports of Crude Petroleum (1989-2017) _____	167
Figure 25: Destination for Brazilian Exports: 1989, 2004, 2017 _____	169
Figure 26: Composition of Exports from Brazil to EU12 _____	171
Figure 27: Brazilian Soybean Price (US\$ per ton) - Exported to China _____	173
Figure 28: Top exports from Brazil to USA (1989-2017) _____	174
Figure 29: Composition of Merchandise Imports- 1989, 2004, 2017 _____	176
Figure 30: Top Sources for Merchandise Imports (1989-2017) _____	177
Figure 31: Export Compositon (1989, 2004, 2017) _____	180
Figure 32: Top Exporters of Bovine Meat (2017) _____	182
Figure 33: Exports of Chilled Bovine meat and Frozen Bovine meat _____	182
Figure 34: Top Soybean Exporters (2017) _____	184
Figure 35: Global Soybean Exports (1990-2017) _____	184
Figure 36: Top Exporters of Electrical Energy (2017) _____	185
Figure 37: Exports of Electricity _____	185
Figure 38: Export Destinations (1989-2017) _____	186
Figure 39: Composition of Exports to EU12 _____	187
Figure 40: Composition of total imports (1989-2017) _____	188
Figure 41: Imports of Refined Petroleum (1989-2017) _____	190
Figure 42: Top Merchandise imports (2000-2017) _____	190
Figure 43: Top import sources (1989-2017) _____	192
Figure 44: Composition of Imports from China _____	193
Figure 45: Composition of Exports (1994-2017) _____	194

Figure 46: Exports of Bovine Meat	196
Figure 47: Exports of Soybean and Rice	197
Figure 48: Export Destinations (1994-2017)	199
Figure 49: Composition of Exports to China (1994-2017)	200
Figure 50: Top exports to EU 12 members	201
Figure 51: Top Uruguayan exports to Brazil	202
Figure 52: Composition of Imports 1994-2017	203
Figure 53: Imports of Petroleum Oil and products	205
Figure 54: Imports of Motor Vehicles	206
Figure 55: : Import Sources (1994-2017)	208
Figure 56: Composition of Imports from China (1994-2017)	209
Figure 57: Intra-Bloc Trade (1995-2017)	237
Figure 58: Share of Exports and Imports from Mercosur	239
Figure 59: Trade in Parts and Components (Athukorala, 2005)	252
Figure 60: Foreign Value added in Exports (as %) (2005-2016)	255
Figure 61: Origin of Foreign Value Added in Argentine and Brazilian Exports	256
Figure 62: MFN Applied Tariff on Intermediate Goods (UNCTAD-SOP Classification)	257
Figure 63: Other Indicators of Global Value Chains	259
Figure 64: Exports in Automobile Parts and Component (1993-2017)	262
Figure 65: Grubel Lloyd Index for Bilateral Trade between Argentina and Brazil	266

LIST OF TABLES

Table 1: Bound and MFN tariff rates in Argentina	92
Table 2: Specific tariff and tax information for imports of Motor Vehicles	206
Table 3: Variable Description for Gravity Model Analysis	216
Table 4: Gravity Results (Extra-regional trade)	220
Table 5: Gravity Results (regional trade)	224
Table 6: Gravity Results (intra-regional trade)	227
Table 7: Top export and Import Baskets	231
Table 8: Revealed Comparative Advantage	235
Table 9: Trade Complementarity Index (Bi-directional)	241
Table 10: Domestic Value-Added Content of Exports as % of Gross Exports (2005-2016)	255

LIST OF ABBREVIATIONS

AFTA	Asean Free Trade Agreement
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
BICE	Banco de Inversion y Comercio Exterior
BNDES	Banco Nacional de Desenvolvimento Econômico e social
BRICS	Brazil, Russia, India, China and South Africa
CAMEX	Câmara de Comércio Exterior
CCM	Comisión de Comercio del Mercosur
CEPAL/ECLAC	Economic Commission of Latin America and the Caribbean
CMC	Consejo de Mercado Común
COP21	Conference of the Parties on Climate Change
ECA/ ACE	Economic Complementarity Agreement
ECSC	European Coal and Steel Community
EEC	European Economic Community
EU	European Union
FAO	Food and Agriculture Organization
FOCEM	Fundo para a Convergência Estrutural do Mercosul
FTAA	Free Trade Area of the Americas
G20	Group of 20
G77	Group of 77 countries
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariff and Trade
GMC	Common Market Group
GSP	Global System of Preferences
GSTP	Global System of Trade Preferences
IDB	Inter-America Development Bank
ILO	International Labor Organization
IMF	International Monetary Fund
LAC	Latin America and the Caribbean
LAFTA	Latin American Free Trade Agreement
LATAM	Latin America
MDIC	Ministry of Development, Industry and Foreign Trade
MRE	Ministério de Relações Exteriores
NAFTA	North American Free Trade Agreement
OECD	Organization of Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
PARLASUR	Southern Parliament
PETROBAS	Brazilian Petroleum Cooperation
PETROPAR	Paraguayan National Oil Cooperation
R\$/AR\$	Brazilian Real/ Argentine Peso
SACU	South African Customs Union
SAFTA	South Asian Free Trade Agreement
SECEX	Secretaría de Comercio Exterior
SICE	Foreign Trade Information System
SISCOMEX	Sistema Integrado de Comércio Exterior
TiVA	Trade in Value Added
TRIMS	Trade-related Investment Measures

TRIPS	Trade-related Aspects of Intellectual Property Rights
TTIP	Trans-Atlantic Trade and Investment Partnership
UN	United Nations
UNCTAD	United Nations Commission of Trade and Development
UNIDO	United Nation Industrial Development Organization
USDA	United States Department of Agriculture
WBG	World Bank Group
WEF	World Economic Forum
WITS	World Integrated Trade Solution
WTO	World Trade Organization

ABSTRACT

The beginning of the 1990s were characterized by trade liberalization efforts by developing countries and a simultaneous spurt in interest in bilateral and regional free trade agreements. These RTAs have created a network spanning within and across continents at regional and sub-regional level. The rising popularity of RTAs can be attributed to the myriad of potential benefits of signing such agreements including, but not limited, to greater market access due to reciprocal lowering of tariffs, improvement of terms of trade and increased production efficiency due to achievement of export-led economies of scale. One of the first regional initiatives comprising solely of developing countries was the *Mercado Común de Sur* or as it is commonly known as Mercosur. It was formed in 1991 through the *Treaty of Asunción* and included four members in South America, namely, Argentina, Brazil, Paraguay and Uruguay. This thesis aimed to fulfill three objectives using empirical analysis and political arguments to investigate historical and contemporary issues in the subregional perspective.

The *first objective* was to evaluate the extent of trade policy harmonization between members. It was found that although all four members have successfully applied the Common External Tariff (CET), there still exists a number of exceptions. Notably, the manipulation of the import tariffs has been a profound tool that drives national trade policy and has led to reduced policy alignment in the four members of the bloc. These policy measures are justified due to the occurrence of persistent economic and political crises in the members, however, the lack of harmonization is a concern and a deviation from the agenda adopted through the Treaty of Asuncion. The *second objective* was to analyze the level of economic integration achieved among Mercosur members. The analysis revealed that the level of intra-bloc trade remains very low today, despite thirty years of trade integration in the bloc. However, the smaller country narrative holds true as Paraguay and Uruguay are dependent on the bloc members for imported capital good and for exports of agricultural commodities. The *third and final objective* of this thesis was to identify the factors that influence the composition of trade in goods and trade partners over three sets of trade patterns: intra-bloc, regional and extra-regional trade. A gravity model was used to determine these factors: the results pointed to the significance of distance, common language and preferential access in all three forms of trade relations. Intra-bloc trade, although low in volume remains significant for the members, especially in trade of automobile and parts; this trade also displayed signs of vertical intra-industry trade or regional value chains. Interviews with diplomats, policymakers and academicians revealed that non-economic factors have also determined intra-bloc trade including the intergovernmental structure, political agenda in accession of Venezuela and external pressures from the United States and the European Union for preferential access to the Southern Market.

It was recommended that Members of the bloc can increase the level of economic integration by developing economic corridors that facilitate the free movement of goods within the bloc and address behind the border issues such as non-tariff barriers and protectionist policies within the bloc, issues at the border and issues beyond the border such as transportation and logistics, better roads, and inexpensive warehouse facilities. Intra-Mercosur trade is relatively low and is less diverse. Real integration will occur when members invest in regional projects, including in the creation of regional value chains. They should ideally resemble a hub-spoke system such that Brazil can import raw materials and intermediate products from the smaller partners and export finished high-value products to the rest of the world. Such a system will lead to greater forward and backward linkages within the bloc and will prove to be prosperous for all the members as well.

CHAPTER 1: INTRODUCTION

BACKGROUND

“Increasing economic integration has been one of the major forces driving the world economy's impressive growth over the last forty- five years.”

- (Summers, 1991).

International economic integration, often termed as regionalism, may be defined as the “institutional combination of separate national economies into larger economic blocs or communities”. Economic integration is basically concerned with the promotion of efficiency in resource use on a regional basis (Robson, 1998). The processes of regional integration emerged after the Second World War due to the reduction in transportation and communication costs (de Lombaerde and Van Langenhove, 2006; Summers, 1991). One of the most striking features of such integration was the “willingness of many governments to throw aside decades of protectionism and embark on new initiatives in economic integration.” It marked an attempt “to spur growth and competitiveness by at least tentatively liberalizing foreign trade policies” (Cason, 2000); and this was a major development in the area of international relations and trade (Schiff and Winters, 2003). Since then, regional integration has increased its importance in the global governance architecture (de Lombaerde, 2006).

One of the earliest such regional initiatives was the European Economic Community (EEC) established through the Treaty of Rome in 1957. In the next three decades, twenty-two new regional trade agreements (RTAs) were in force around the world. However, they proliferated at an unprecedented rate in the nineties, as several major agreements took shape during this period. De Lombaerde, and Van Langenhove (2006) also note that originally, they were mostly about trade and economics, but since the 1980s, with the so-called wave of ‘new regionalism’, regional integration turned into a multidimensional process that covered dimensions of politics, diplomacy, security, and culture, in addition to traditional issues of greater market access.

During this wave of new regionalism through the nineties, seventy-three new RTAs were added to the global system (WTO, 2019). These include, the European Union¹ in Europe, North American Free Trade Agreement² (NAFTA) and Southern Common Market (MERCOSUR) in the Americas and the ASEAN Free Trade Area (AFTA)³ in the Asia. In the next decade (2000-2010), 145 new RTA's were in force, with an average of 14 new agreements every year. By September 1st, 2019, three hundred and two RTAs were *in force* in the world, including those notified in goods, services and accessions (WTO 2019). These RTAs have created a network “*spanning within and across continents at regional and sub-regional level*” (Crawford and Fiorentino, 2005). This network has become increasingly complex with overlapping agenda, giving rise to the famous “Spaghetti Bowl” phenomenon coined by Jagdish Bhagwati in 1995.

Regional trade agreements can take various forms depending on the level of integration between members. For example, it can be in the form of partial scope agreements, which account for 10 percent of all RTAs today, free trade agreements (FTA) through elimination of tariff barriers that comprise a share of 85 percent in the total; and customs unions that involve establishment of a common external tariff and the harmonization of external trade policy vis-à-vis non-members. There were seventeen custom unions in force in 2019 (Crawford and Fiorentino, 2005; WTO, 2019). Other deeper integration efforts can take the form of a common market that additionally permits free movement of factors of production along with goods and services, including movement of persons for work or leisure; or an economic monetary union that covers all the previous provisions along with harmonization of macroeconomic policy and a common currency unit (Balassa, 1961, pp.2).

The rising popularity of RTAs can be attributed to the myriad of potential benefits of signing such agreements including, but not limited to, greater market access due to reciprocal lowering of tariffs (Crawford and Fiorentino, 2005), improvement of terms of trade and increased production efficiency due to achievement of export-led economies of scale (WTO, 2011b). Other indirect economic welfare gains include

¹ The European Union was formed with the adoption of the Maastricht Treaty in February 1992.

² Preliminary agreement between the NAFTA members was reached in August 1992

³ The agreement for the formation of AFTA was signed in January 1992 in Singapore. When the AFTA agreement was signed, ASEAN had six members, Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand. Vietnam joined the grouping in 1995, Laos and Myanmar in 1997 and Cambodia in 1999.

deeper regional integration and development (Bruhn, 2014), benefits from cross-border spillovers in private activities such as development of intra-industry trade, regional value chains, technology transfers and in public policies, increased attraction of foreign investment to regional clusters, increased product differentiation, larger internal market, and reduced barriers to factor mobility especially professionals (WTO, 2011c).

One of the most successful⁴ regional integration schemes comprising solely of developing countries⁵ is *Mercado Común del Sur* or as it is commonly known as Mercosur (Caichiolo, 2017). It was established in 1991 through the *Treaty of Asunción*⁶ as an economic and political agreement among four South American countries: Argentina, Brazil, Paraguay, and Uruguay (SICE, 1991). It can be characterized as a customs union with a common external tariff (CET) applied since 1995, with some features of a common market that permits unrestricted movement of factors of production. It was established under the umbrella of ALADI or the Latin American Integration Association⁷ (Kaltenthaler and Mora, 2002). The Protocol of Ouro Preto⁸ signed in 1994 gave the bloc an institutional and legal structure, followed by the establishment of the FOCEM in 2005 to tackle the asymmetries that exist in the bloc, geared towards providing funds for the development of the smaller members of the bloc- Paraguay and Uruguay (Lazarou and Luciano, 2015; Doctor, 2013).

However, the process for regional integration and strategic cooperation between the members of the bloc began several years before the inception of Mercosur. For example, starting from 1985, there was an attempt to increase bilateral integration on

⁴ Caichiolo (2017) emphasized that “*The fact that it has existed for about a quarter of a century attests to the fact that it has positioned itself successfully and effectively in the international community.*”

⁵ There were other regional initiatives by developing countries prior to Mercosur including Central American Common Market (CACM), Caribbean Community and Common Market (CARICOM), Asia Pacific Trade Agreement (APTA), South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), Latin American Integration Association (ALADI) and Andean Community (CAN). But there was one agreement that predates all of the above, and this was the Latin American Free Trade Association (LAFTA), which was established in 1960, and was transformed into ALADI.

⁶ *Treaty of Asunción*, available at SICE: http://www.sice.oas.org/trade/MRCSR/treatyasun_e.asp

⁷ ALADI or the *Asociación Latinoamericana de Integración*, is the “largest Latin American integration group”. It covers thirteen member countries in the region namely: Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Panama, Paraguay, Peru, Uruguay and Venezuela. The Treaty of Montevideo, signed on Aug. 12, 1980, established the constitutive and regulatory global legal framework of ALADI. It was based on the following general principles: “*pluralism in political and economic matters; progressive convergence of partial actions towards the formation of a Latin American common market; flexibility; differential treatments based on the level of development of the member countries; and multiplicity in the ways of agreement of commercial instruments*” (ALADI webpage: http://www.aladi.org/sitioaladi/?page_id=148)

⁸ Protocol of Ouro Preto, 1994, available at http://www.sice.oas.org/trade/mrcsr/ourop/ourop_e.asp

security and economic matters between Argentina and Brazil (Manzetti, 1993). In July 1986, following the *Iguaçu Act* of 1985, the Presidents of both the countries signed the *Act for the Integration of Argentina and Brazil* consisting of 12 protocols including capital goods, land transport, binational enterprises, food complementarity, iron and steel industry, energy, among other (GATT, 1992). Till 1989, twenty-four such protocols were already signed. Finally, a *Treaty of Integration and Cooperation* was signed in 1989 to create *free trade zones* in the next five years, followed by the creation of the *Common Market Group* in December 1990. The Partial Scope ECA No. 14 that included all previous agreements and the *Treaty of Asunción* that created the *Mercado de Sur* or the Southern Common Market. It was broadened to include Paraguay and Uruguay and was finally signed in March 1991 (GATT, 1992).

Paraguay and Uruguay decided to join the grouping because of their economic dependency on Brazil and Argentina, their main trade partners, as well as their neighbors and the largest countries in the region. Mercosur offered these relatively smaller countries direct access to the markets of these large economies and supplemented their power in global negotiations with additional political clout (Kaltenthaler and Mora, 2002).

Mercosur was also attractive for the larger players like Brazil. The large internal market resulting from this initiative was a step closer to its idea of a Unified South America. To further the process of integration in the South American region and to promote the idea of a unified South America, Mercosur admitted Venezuela in 2012. Mercosur membership was divided over inclusion as Venezuela took its accession as an opportunity to propagate its Bolivarian mandate in the region⁹ (Christensen, 2007). Eventually, Venezuela was suspended in 2016 primarily due to human rights violations (Felter, Renwick, and Chatzky, 2019). Today, the integration in the bloc has assumed a social and dimension as well, with an emphasis on upholding human rights, need for

⁹ The Bolivarian mandate is synonyms with opposition to capitalist elitism and reduction of structural asymmetries in the Latin American region. It was conceptualized on the basis of “cooperative advantage” as a way to increase solidarity in the region and strengthen the unity of Latin America, as opposed to the classical economic concept of “comparative advantage” (Christensen, 2007). Hugo Chavez, the Venezuelan President at the time had said that “*Neither Venezuela alone, nor Brazil alone, nor Argentina alone can become a world power. We can only achieve that together.*” This was a manifestation of the Bolivarian mandate (Brown, 2010; Kozloff, 2008).

education, and increased role of the civil society region (Hoffmann, 2015; Klonsky, Hanson and Lee, 2012; Freymann, 2007).

RELEVANCE and APPROACH

Mercosur was one of the most ambitious Latin American regional in its scope and depth (Manzetti, 1993). Although it was not the first such initiative in South America¹⁰ (Vervaele, 2005), it was one of the successful ones due to the determination of the members to support a regional identity and coordinate on external trade policy and negotiations. Since its inception, the main objectives have been to promote trade, business and investment opportunities by building national competitiveness and raising regional integration. The four members of the bloc accounted for 3 percent in global GDP, 1.6 percent of global trade and 8.6 percent of global FDI inflows in 2018 (World Development Indicators). Moreover, in June 2019, Mercosur successfully signed the first bi-regional free trade agreement with the European Union (European Commission, 2019). The European Commission described it as a landmark trade agreement that is ambitious, balanced and comprehensive in nature. This agreement has placed Mercosur “back on the map” after a brief hiatus in its growth pattern due to persistent economic and political crisis in the last two decades. Earlier, Mercosur had also signed a preferential trade agreement with India in 2009 (came in effect) that was preceded by a Framework Agreement signed in 2003 at Asuncion, Paraguay. It aimed to create “*conditions and mechanisms for negotiations by granting reciprocal tariff preferences in the first stage and, in the second stage, to negotiate a free trade area between the two parties*” (Department of Commerce, India, 2019). Hence, it is important to conduct this analysis from the perspective of an Indian researcher.

Today, Mercosur is one of the top regional initiatives¹¹ comprising solely of developing countries and this thesis conducts an in-depth analysis of its integration process that has been defined by the interplay of internal dynamics and external pressures. Although many studies have been conducted assessing Mercosur’s growth patterns and its

¹⁰ Cason (2000) noted that “*The history of Latin American economic integration has been a checkered one. Periodic efforts have been made since the early 1960s, but most have had only very limited success. Inward-oriented development strategies, national security concerns, or wildly fluctuating macroeconomic policies have frequently derailed these attempts.*”

¹¹ Total trade in 2018 in Mercosur was the second highest among other RTAs of developing countries. For example, for ASEAN, total trade in 2018 was US\$ 2,886 billion, for Mercosur it was US\$ 633 billion, for SADC it was US\$ 372 billion and for ECOWAS, it was US\$ 215 billion.

relevance today, this thesis seamlessly incorporates an empirical analysis and political arguments to investigate historical and contemporary issues in the subregional perspective. Further, some of the data collected during the primary research has not been presented in earlier studies and adds a new dimension to the ongoing discussion about Mercosur.

OBJECTIVES and MAIN HYPOTHESIS

The objectives of this thesis are threefold. They are presented below along with the null hypotheses:

Objective 1: to evaluate the extent of trade policy harmonization between members:

Hypothesis - Drive towards a common external trade policy amongst members of an RTA results in greater policy harmonization among the member states of the bloc. Policy harmonization among member can be better achieved if an RTA is able to establish strong institutions for the implementation of the agreement. In the absence of such institutions, the trade policies pursued by the bloc members is determined by the interplay of policies formulated by national authorities. Further, smaller economies of the grouping will display greater adherence to the rules of the agreement as compared to those that are larger.

Objective 2: to analyze the level of economic integration achieved among Mercosur members:

Hypothesis- Smaller countries, Paraguay and Uruguay are highly reliant on trade with their partners, Argentina and Brazil, as major destinations for their exports as well as sources for imports. They are dependent on their large neighbors for cheap imports of capital goods including motor vehicles produced locally in Argentina and Brazil. In contrast, the two large economies, namely, Argentina and Brazil, have forged strong extra-regional trade relations and they are less-reliant on the members of the bloc.

Objective 3: to identify the factors that influence the composition of trade in goods and trade partners over three sets of trade patterns: intra-bloc, regional and extra-regional trade.

Hypothesis – Traditional theory says comparative advantage should reveal the content of export and import baskets, while the members would seek the most efficient trade partner. For exports, a country will pick markets that are the closest, easily accessible, offer the simplest customs procedures and lowest post-duty price to remain competitive in the importer’s market. On the contrary, for imports they would select the source based on the nature of the good imported. For example, in case of imports of capital goods and inputs, a country will choose a supplier that can help boost the domestic industrial sector, while for imports of consumer goods, it will choose a supplier that meets the domestic demand and preferences adequately.

Moreover, the historical import-substituting policy followed by all the members would traditionally give rise to fewer exports of raw materials to promote industrial development at home and fewer imports of capital goods to continue supporting manufacturing sector at home. Last, the internal asymmetries in the bloc, political processes and external events can trigger changes in the content of exports and imports and composition of trade partners. As predicted by theory, an RTA would lead to high volumes of intra-bloc trade due to reduced barriers and harmonized customs procedures. Further, trade with regional partners will be greater than trade with extra-regional partners due to the geographical closeness, historic-cultural ties and similar preferences. The top extraregional partners will be located in the global economic hubs in Europe, the United States and South-east Asia. Countries that have a PTA with the bloc will be preferred destinations for exports due to lower and preferential tariffs offered by them. Similarly, the bloc will purchase higher volume of imports from these countries due to simplified customs procedures and lower import prices as a result of elimination or lowering of customs duties.

RESEARCH DESIGN: METHODOLOGY and SOURCES

The extensive literature relevant to this study such as academic research paper, reports by international multilateral organizations such as the World Bank Group, World Trade Organization, United Nations, and official documents by the government, ministries and Mercosur Secretariat will be reviewed and analyzed to establish the state-of-art in regional integration agreements, with a focus on Mercosur. Next, various statistical tools will be used to answer the three objectives mentioned above. This empirical analysis will be conducted using secondary data sources such the World Integrated

Trade Solutions (WITS), DataBank at the World Bank, UN COMTRADE database, TradeMap by the International Trade Center, Regional Trade Database by WTO, and the Trade in Value Added database by the OECD.

First, the trend of exports, imports, balance of trade and the share of trade in GDP (trade openness) will be examined for each of the four members. Then, secondary data will be used to discuss the composition of exports and imports along with the share of top export destinations and import sources. This analysis will trace the changes in these two parameters and determine the cause of any inflection points in the trends. Once the top partners are identified in three groups, namely, intra-bloc, regional and extraregional partners, a gravity model will be used check for the significance of some of the common explanatory variables specified in the model in explaining the pattern of bilateral trade. Some standard variables include distance between partners in the form of geographical distance, cultural distance, language barriers and shared border (contiguity), size of the partners in terms of geographical area, GDP, population and GDP per capita, and dummy variable for positive or negative shocks that could affect bilateral trade patterns. Three separate gravity models will be used to assess intra-bloc, regional and extraregional trade. Two types of models have been selected that are suitable for the panel data for the time period 1991-2017, a fixed effects model and a random effects hybrid model.

The Gravity model will take the following form; however, some minor changes could be expected:

$$\begin{aligned} \ln(T_{ij}) = & \beta_1 \ln Distance_{ij} + \beta_2 Contiguity_{ij} + \\ & \beta_3 Language_{ij} + \beta_4 RTA_{ij} + \beta_5 \ln(1 + Tariff)_{ij} + \beta_6 Colony_{ij} + \\ & \beta_7 \ln POP_{it} + \beta_8 \ln POP_{jt} + \beta_9 \ln GDP_{it} + \beta_{10} \ln GDP_{jt} + u_i + u_j + \varepsilon_{ij} \end{aligned}$$

where,

T: bilateral trade between the partners

Distance: all barriers to trade, including geographical distance, cultural difference

Contiguity: whether the two countries share a common border (0 or 1)

Language: whether they speak a common language (0 or 1)

RTA: whether they are a part of the same regional agreement (0 or 1)

Tariff: the effective tariff rate

Colony: whether they have a colonial past (0 or 1)

POP: Population (time variable)
GDP: Gross domestic product (time variable)
ε: Error term
u: Fixed effects

The results of the gravity modelling exercise for intra-bloc trade will be further assessed to establish the extent and nature of intra-bloc trade. This assessment will be supplemented with other statistical measures such as trade complementarity index to check for the match between trade structures of the members, and level of dependency between members vis-à-vis other such regional blocs around the world, calculated as the share of intra bloc in total trade of the bloc. Next, the intra-bloc trade will be checked for the existence of intra-industry trade (IIT) with a focus on vertical IIT or regional value chains. Variables such as trade in intermediate goods, forward and backward linkages, share of foreign value added as physical inputs and services in domestic production and exports will be calculated to assess the nature of value chains. Existence of sectoral IIT will also be examined using the Grubel-Lloyd index on industry level.

An important source for the study is the primary data that collected through interviews conducted by the author during 2017 in three out of four Mercosur member states: Argentina, Brazil and Uruguay. The interviews will form the basis of analyzing issues relating to the political economy of the bloc. These interviews were conducted in person and via skype with diplomats, ministers and policymakers who have been directly associated in implementation of Mercosur, as well as academicians. Based on the theoretical and empirical literature, the interview questions were divided in four broad areas:

1. Domestic and subregional dynamics of the bloc that explain the integration process among the members, with a focus on its drivers and failures,
2. Economic factors that have influenced trade patterns in the bloc,
3. Political and strategic priorities of the bloc including the rationale for trade agreements in the recent past, and determinants of the negotiating agenda since 1991,
4. Global and regional developments that have affected the integration process.

STRUCTURE OF THESIS

The chapters are organized as follows, first the literature review is presented in Chapter 2 that provides an overview of the proliferation of RTAs over the past three decades and the possible economic, strategic and political benefits of signing such an agreement. These benefits have provided a substantive rationale for countries be part of an RTA such that, today, each WTO member is party to at least one RTA. These agreements now go beyond the traditional reduction or elimination of tariffs and cover policy areas such as investments, services, competition, and sustainable development goals of environment, human rights and labor protection (Mattoo, Mulabdic and Ruta, 2019; Draper, Khumalo and Tigere, 2017).

Next, this chapter also introduces the special case of *Mercado Común de Sur* or Mercosur; it highlights the steps in the bloc's formation and its integration process. It then presents an array of arguments in favor and against the integration process from the expansive literature available on this subject, highlighting the pending issues in the bloc that hinder integration. Finally, the chapter presents the comparison between Mercosur and one of the most successful regional blocs, namely, the European Union. Although many structural and historical differences exist between the two blocs, members of the two blocs initiated their respective processes of integration with a number of common objectives. The trajectories of the two blocs became divergent over time, the reasons for which will be explained in this chapter.

Next, Chapter 3 presents a thorough trade policy analysis of the four members of the bloc, Argentina, Brazil, Paraguay and Brazil. The first two subsections are focused on the large countries; these are the two major economies around whom the bloc was conceptualized in the late eighties. Events such as the move from an import-substituting industrialization policy to trade liberalization in the nineties, followed by a regional crisis and later by exponential growth in trade due to the commodity supercycle have shaped the trade policy of these two countries. The next two subsections focus on the smaller countries of the bloc. Together, this study highlights the evolution of the tariff policy, including the nature of the application of the common external tariff (CET) and comments on the level of policy alignment in each member with the overall agenda of Mercosur set forth by the Treaty of Asunción; finally, it also checks the *extent of policy harmonization* between the four members of the bloc (Objective 1 and 2).

Subsequently, Chapter 4 analyzes the evolution of trade relations in the four Mercosur members from 1989 to 2017. It examines the composition of export and import baskets as well as of export destinations and import sources for the four members. This analysis will comment on the reliance of members on agricultural exports and imports of capital goods; and on the level of trade dependency on extraregional markets and Mercosur partners. Therefore, it will evaluate the *level of economic integration* achieved among Mercosur members (Objective 2 and 3).

Given the analysis in the previous two chapters on the evolution of respective trade policies and relations in the last few decades, Chapter 5, empirically analyzes the extent and nature of these trade relations including intra-bloc, regional and extraregional trade with countries already identified. It uses the gravity model to comment on the determinants of trade, along with several other statistical tools mentioned in the methodology of this chapter to analyze the nature of trade (Objective 3). Later, in Chapter 6, a deeper analysis of the intra-bloc trade is conducted, in particular, it checks for the existence of regional value chains by employing the tools mentioned in the previous methodology section including trade in parts and components, forward and backward linkages between industries in Argentina and Brazil, and scope for intra-industry trade. It then comments on the need for greater trade facilitation to enhance regional integration among the members.

The previous chapters have presented the economic determinants of Mercosur's trade policy and has used standard statistical tools to determine the nature of trade relations that exists between the bloc members, as well as with other global partners. This analysis is supplemented by [Chapter 7](#) that presents political economy arguments to better understand the rationale for the formation of the bloc in 1991 by drawing on the historical political relations between Argentina and Brazil that lay the foundation of the Treaty of Asunción. Next, it assesses the impact of the internal dynamics such as the accession and suspension of Venezuela, and the external global pressures in the form of the hegemonic tendencies of the United States in South America, the negotiations with the European Union to cement historical as well as cultural ties, and the rise of China that led to an exponential growth in global commodity prices and a subsequent rise in Mercosur's trade with the world. Last, the integration process as a result of these pressures is analyzed in the classical *de jure versus de facto* framework to comment on

its apparent success as a bloc. This chapter is based on the responses from the interviews conducted in Brazil, Argentina and Uruguay. The questionnaire used during the interview, along with the list of the interviewees are included as annexure to the chapter.

Finally, Chapter 8 provides the concluding remarks and sums up the arguments made in the previous chapter in favor of the integration process. However, it points out that Mercosur members need to make efforts to enhance the present level of integration. Such efforts can be in the form of regional development plans that foster cooperation in border issues, connectivity and overall trade facilitation.

SCOPE AND LIMITATIONS

This thesis is limited to economic and political determinants of the trading agenda of Mercosur. Other factors that may affect the integration process include social, environmental, sectoral and industrial factors, however, they are beyond the scope of this thesis. There is further scope to study the impact of the regional agreement on industrial production and development in Mercosur members that analyzes the nature of shift in industrial policy over the years, with focus on macroeconomic trends such as wages, employment, profits, and investment- both domestic and foreign (FDI). Further research can also be conducted to examine the legal and institutional structure of the bloc, and highlight the inadequacy of the integration process. Mercosur members are entering into new-age agreements on intellectual property rights, government procurement and competition law; an analysis of these agreements can comment on their level of preparedness in adopting international standards.

Moreover, Mercosur has recently signed the first bi-regional free trade agreement with the European Union in 2019. It is obvious that this agreement will create some winners and loser inside the bloc; there will also be impediments to the ratification process, for example, in terms of importance given to bilateral safeguard measures and the role of the civil society in the implementation of the terms of the treaty. An impact assessment of the Mercosur-EU free trade agreement can draw relevant policy implications from the economic analysis, and recommend ways to minimize the losses from it; it could also comment on the scope for bi-regional value chains especially in the area of automobiles and agro-industries between Mercosur and the European Union members.

CHAPTER 2: LITERATURE REVIEW

The beginning of the 1990s were characterized by trade liberalization efforts by developing countries and a simultaneous spurt in interest in bilateral and regional free trade agreements. Although some of these agreements fructified in the nineties, a majority of them took shape in the subsequent decade. The inception of the idea of regionalism was nested in the definite initiatives taken by the advanced nations during the 1980s and the early 1990s (Crawford and Fiorentino, 2005). The most significant development that took place in this period was the formation of the European Union as a single market. These countries, which were already a *de facto* customs union, with a common external tariff, began the ambitious exercise of forming an economic union that was finally established in 1992 through the *Maastricht Treaty* (Ginsberg, 2007). At the same time, three North American countries, United States, Canada and Mexico, also prepared themselves for signing of the North American Free Trade Agreement (NAFTA) (Villarreal and Ferguson, 2017)¹². Coinciding with these two processes was the initiative taken by Australia to bring countries on the Pacific Rim closer on to a common economic platform, which was subsequently institutionalized as the Asia Pacific Economic Community (APEC) in 1989¹³, wherein, countries were looking to coordinate economic policies rather than synchronize trade through reciprocal tariff elimination.

While most of these initiatives were taken by the advanced economies, four major economies from South America, namely, Brazil, Argentina, Uruguay, and Paraguay, created their own framework of regional economic cooperation. Mercosur was the first of its kind, formed by only developing countries, to promote and strengthen the idea of a *unified Southern Market*. The founders of the bloc conceived it as an eventual customs union, modeled after the success of the European Union (Lenz, 2016). Although the bloc has made tremendous progress in the region, it still has many internal asymmetries

¹² Full legal text available here: <https://www.nafta-sec-alena.org/Home/Texts-of-the-Agreement/North-American-Free-Trade-Agreement>

¹³ Full legal text available here: <https://dfat.gov.au/trade/organisations/apec/Pages/asia-pacific-economic-cooperation-apec.aspx>

and external pressures to deal with in this new era of the globalized world (Carranza, 2003a).

This chapter provides an overview of the origins of Mercosur and captures the progress made by the bloc in the decades that followed through the discussions in the received literature. The chapter is divided into several sections. Section 1 highlights the growing importance of preferential trade agreements in the post-globalization era and distinguished between the different types of preferential access granted by countries, while Section 2 presents the myriad of explanations offered by economists to establish the rationale for existence of such agreements among developed and developing countries. It also discusses the barriers to trade that countries aim to eliminate through these agreements. Section 3 discusses one of the more common forms of preferential trade agreements, those that are forged between countries in a region, namely, the regional trade agreements (RTAs). In this section we would trace the discussion on the integration efforts made by Mercosur member countries. However, literature suggests that Mercosur is yet to achieve its objectives and faces pending issues that need to be addressed; these have been examined at length in section 4. Moreover, a thorough comparison has been made between the bloc and the prototype it owes its origin to, the European Union in the last section.

D) Growing Importance of Preferential Trade Agreements

In this new era of a globalized and inter-connected world, countries have forged closer ties with each other for a variety of reasons. Most of these arrangements are focused on eliminating barriers to trade in both goods and services either between two countries (bilateral) or among a group of countries within a region (regional). In the last few decades, countries have begun to foster deeper integration with their geographical neighbors in the form of regional economic integration. As a result, countries have liberalized more through regional agreements than in the multilateral forum (Baldwin and Venables, 1995). These agreements now go beyond the traditional reduction or elimination of tariffs and cover policy areas such as investments, services, competition, and sustainable development goals of environment, human rights and labor protection (Mattoo, Mulabdic and Ruta, 2019; Draper, Khumalo and Tigere, 2017).

There exist different forms of regional economic integration and although all such integration efforts are aimed at securing the benefits of free trade, they are quite diverse in their coverage and scope. Balassa (1961, pp.2) notes there are five main types of integrations implemented by their corresponding trade agreements, ranging from simple association of trade partners to a fully integrated group of nation states. These agreements can take the following forms: Preferential trade agreements (PTAs) eliminate selective tariffs between countries¹⁴, while free trade agreements (FTAs) eliminate tariffs covering “substantially all trade”, in other words, trade barriers between countries are either subsequently lowered or completely eliminated. Traditionally, FTAs covered trade in goods. However, many of the contemporary FTAs are substantially more expansive and cover almost the entire *gamut of trade rules*, both at the borders and behind the borders through trade facilitation that includes simplifying customs procedures, reducing logistic costs and time delays, harmonizing export-import measures across countries (WTO, 2015; OECD, 2018). The most successful FTAs in the world can be found in the North American Free Trade Agreement (NAFTA) and the Association of South East Asian Nations (ASEAN). One step further is the Customs Union (CU) model where in addition to eliminating tariff barriers, countries also establish a common external tariff (CET) vis-à-vis third countries by coordination of trade policy, homogenization of customs procedures and establishment of a custom distribution system between members. MERCOSUR is an example of such an integration.

When a customs union also provides for free movement of factors of production including capital and labor along with goods and services, such an integration model is called a Common Market (CM). It also ensures elimination of non-tariff barriers through homogenization of standards. Common Market requires coordination on a number of policy areas between countries including labor laws, mutual recognition of education and professionals, and legal protection to investors from other members of a common market. This enables people to relocate for work opportunities and results in a more efficient allocation of resources. As a consequence, it can lead to convergence in monetary and fiscal due to high level of dependence between members; as a result,

¹⁴ They have also been termed as Partial Scope Agreements by the WTO and are notified under the Enabling Clause. Exact definition can be found here: [https://rtais.wto.org/UserGuide/RTAIS_USER_GUIDE_EN.html#:~:targetText=%C2%A8%20A%20%22Partial%20Scope%22%20Agreement,a\)%20of%20the%20Enabling%20Clause.](https://rtais.wto.org/UserGuide/RTAIS_USER_GUIDE_EN.html#:~:targetText=%C2%A8%20A%20%22Partial%20Scope%22%20Agreement,a)%20of%20the%20Enabling%20Clause.)

economic crisis in one country can adversely affect other members through series of contagions (Holden, 2003).

An Economic Union is the deepest form of regional integration. Along with the features presented by a customs union, it also calls for the unification of member's general objectives in respect of economic growth, through harmonization of monetary, fiscal and other policies. Usually, such an integration model would require the presence of a supranational agency to coordinate the implementation of a rule-based system and common economic policies. Members are also expected to cooperate on formation of industrial policy to ensure adherence to a common agenda. The most successful economic union is the European Union. Members of the grouping have also implemented a unified monetary unit and have a common currency called the euro that covers 19 out of the 28 countries in the European Union.

Pertinent to mention, the term '**Preferential Trade Agreement or PTA**' is often used in a generic sense for all economic integration agreements as they always involve exchange of preferences between two or more countries, although the General Agreement on Tariffs and Trade (GATT), the predecessor organization of the World Trade Organization (WTO), use the term '**Regional Trade Agreement, or RTA**', to describe the preferential trade agreements. *These two terms will be used interchangeably throughout this chapter.*

Adopted in 1947, the GATT (henceforth, GATT 1947) recognized the existence of RTAs and included provisions for their adoption and functioning in Article XXIV of the GATT, 1994¹⁵. "*Customs unions and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade*" (GATT, 1994). Article XXIV is based on the premise that "the contribution to the expansion of world trade made by closer integration between the economies of the parties to such agreements increases if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminishes if any major sector of trade is excluded". Article XXIV also reaffirms that the purpose of such agreements should be to facilitate trade between the constituent territories and not to raise barriers to the trade

¹⁵ More information at https://www.wto.org/english/docs_e/legal_e/10-24_e.htm

of non-parties and the parties to them and avoid creating adverse effects on the trade with non-parties to the agreement (Kaltenthaler and Mora, 2010).

Preferential trading agreements have spread like wildfire. As on September 1, 2019, three hundred and two RTAs are in force in the world, and a single country is usually party to numerous such RTAs (WTO, 2019; Mashayekhi, Puri and Ito, 2004); this has led to a complex array of overlapping rules for countries to follow, with multiple and complicated protocols as well as rules of origin that add to the transaction costs, resulting in the famous *Spaghetti Bowl Phenomenon* coined by Bhagwati (1995). Scholars and researchers continue to debate on the benefits of preferential agreements, whether they reduce barriers to trade or create restrictive policies towards non-members to such agreements. In such a way, they could either be termed as *building or stumbling blocks* towards of multilateral liberalization of trade (Bhagwati and Panagariya, 1999).

The stumbling block argument asserts that regionalism hinders MFN tariff cutting. Trade blocs are stumbling blocks if they prevent or slowdown multilateral tariff cutting, while, they are building blocs if they accelerate or at least do not hinder multilateralism (Bhagwati, 1991; Bhagwati and Seghezza, 2010). Building on this idea, Summers (1991) and Bergsten (1991) viewed regionalism as a largely benign or even as a constructive force in the world trade system. This is the Building bloc logic and states that liberalization begets liberalization according to the juggernaut building-bloc logic. Baldwin (2002) further explains this as: “For exporters, lobbying against domestic tariffs becomes a means of lowering foreign tariffs. Because the MFN rearranges the political economy forces inside every nation, all governments find it politically optimal to choose tariff levels that are lower than the unilaterally optimal tariffs. *This is the first part of the juggernaut theory. The second part of the juggernaut logic* concerns the impact of the tariff cuts on openness. The tariff cuts make all nations’ more open – export sectors expand with the foreign tariffs cuts, and import- competing sectors contract with domestic tariff cuts”. Thus, once the liberalization juggernaut starts rolling, it crushes all tariffs in its path. (Baldwin, 2008; Baldwin and Robert-Nicoud, 2008)

The controversy over the desirability of regionalism is not new. Trade is a result of globalization, with its positive and negative effects. Through mutual interdependence, countries have understood the benefit of removing barriers to trade, with regional

integration being one such move to promote free trade. In recent years, the discussion has been about the merits of regional trade agreements like the NAFTA and the European Union on one hand and the propagators of multilateral agencies, like the GATT and the WTO on the other. However, Lipsey and Lancaster (1957) have emphasized that **bilateralism is still the second-best option**, because removal of tariffs from some imports may cause a decrease in the efficiency of the world production.

Viner (1950, pp.43-44; also, in Oslington (ed.), 2014, pp.53-54) notes that the formation of a customs union would eliminate tariffs between members, while maintaining non-zero tariffs against non-members. This would lead to two effects: trade creation effect is the amount by which a more competitive producer in the partner country replaces domestic supply of a commodity, or the tariff preferences granted to members would lead to greater trade between them. On the contrary, the trade diversion effect is the amount by which the home country is forced to trade with preferential partners, by forgoing a cheaper and more efficient third-party producer in a non-member. Trade diversion could also lead to a loss in customs revenue for the members. This theory of customs union can also be extended to other preferential trade agreements. Many of the PTAs that exist create both these effects, and it will raise or lower total welfare depending on the relative strength of these two opposing forces; this is known as the *Viner-Meade conclusion* (Lipsey and Lancaster, 1957; Viner in Oslington (ed.), 2014, pp. 54-55; Lipsey, 1960, pp.498).

Krugman (1991) framed this debate in a succinct way:

“.....in a fundamental sense, the issue of the desirability of free trade areas is a question of political economy rather than of economics proper. While one could argue against the formation of free trade areas purely on the grounds that they might produce trade diversion the real objection is a political judgment: fear that regional deals will undermine the delicate balance of interests that supports the GATT.” (Krugman 1991, p.23; also quoted in Baldwin, 2008, p.4)

It was earlier believed that multilateralism is the only way to achieve trade liberalization within the structure provided by GATT and later by the WTO. But after the proliferation of preferential agreements, it was advocated that these agreements may be understood as a way of achieving free trade through *“a two-step strategy of first*

building blocs and then reducing barriers between those blocs”. Hence, regionalism can lead to multilateralism. These two approaches can be summarized as *Rounds*, where a country reduces trade barriers to all other WTO members on an MFN basis versus *Blocs*, i.e.; the preferential removal of barriers to a few partner countries (Kim and Smith, 1997).

They can either be complementary and coherent with each other and facilitate trade or they can be conflicting and undermine the commitments made by countries on either of the platforms. The convergence of these two ideas can create opportunities for development, while the divergence will exhaust the limited negotiating capability of a country. Developing countries in particular are faced with another dilemma to either promote national development or maintain their international commitments. Thus, in that sense, it would be beneficial for such countries to formulate development strategies that carefully weave all these policy considerations through deliberation and in-depth study (Mashayekhi and Ito, 2005).

Moreover, it appears that all WTO members are now party to at least one regional arrangement, and most of them flourished during the Uruguay Round of the WTO. This suggests that governments clearly joined RTAs to create a safety net, an insurance against the possible failure of the multilateral rounds (Sampson, 2003; Bhagwati, 1993). Regionalism was perhaps a response to the threats posed by multilateralism. Thus, it doesn't belie the fact that creative regionalism can lead to a one-world bloc, just as multilateralism posed in the first place. It asserts that regionalism was born out of the need for countries to form closer bilateral ties with their age-old rivals, and mitigate the possibility of a future war (Mansfield and Solingen 2010), ; it does not necessarily imply that these two ideas are non-cooperative, in the sense that they cannot co-exist.

Today, countries regard both regional and multilateral approaches as complementary policies. Sampson (2003) also emphasized that preferential agreements promote deeper liberalization of the regulatory system that may not have been possible at the multilateral level. PTAs now address issues 'within' and 'beyond' the border and lead to overall easing of barriers to greater market access. They also promote regulatory best practices based on transparency and institutional building. Historically, parties to the multilateral trading system chose to speed up the liberalization process by engaging in

preferential agreements including regional arrangements (Heydon, 2016); the WTO also confirmed that regionalism supports multilateralism, as opposed to the commonly held view that the two systems undermine each other. Moreover, usually, PTAs restate the obligations of the multilateral regime in their agreement texts, thereby facilitating the participation of its members in the multilateral trading system.

History has witnessed that countries find it easier to adopt rules and regulations of a preferential trading agreement rather than at the WTO. Also, it is easier to reach a consensus between two-three partners than all 164 at once; bilateral trade agreements are often preferred over long and tedious multilateral negotiations and hence are less costly. Sampson (2003) also noted that PTAs can act as ‘soft’ liberalization for developing and least developed countries before stepping into the multilateral trading system. In this new era of the global trading system, the relevance of multilateralism today stands at maintaining mediation, enforcement of multilateral disciplines and dispute resolution in preserving the predictability and security of the rule-based trading system (McDougall, 2018 and Odell, 2013).

The idea of soft liberalization for developing countries (Sampson, 2003) is confirmed by the Enabling Clause¹⁶ in the GATT, according to which, contracting parties may accord differential and more favorable treatment to developing countries, without according such treatment to other contracting parties. Developed countries can accord this preferential tariff treatment to products originating in developing countries in accordance with the *Generalized System of Preferences* (GSP)¹⁷, and differential and favorable treatment with respect to non-tariff measure.

According to the clause, this treatment should be designed to facilitate and promote the trade of developing countries and not to raise barriers or create undue difficulties for the trade of any other country. They must also consistent with the *Most Favored Nation* clause¹⁸. These preferences can also be modified to respond to the development,

¹⁶ “The Enabling Clause was adopted under the GATT in 1979 and enables developed members to give differential and more favorable treatment to developing countries”. More information at: https://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm

¹⁷ The Generalized System of Preferences (GSP) is an autonomous, country-specific policy that permits non-reciprocal tariff reductions or possibly duty-free entry of certain imports from designated developing countries. Available at: <https://unctad.org/en/Pages/DITC/GSP/About-GSP.aspx>

¹⁸ “Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favor (such as a lower customs duty rate for one of their products) and you

financial and trade needs of the developing countries. The developed countries do not expect reciprocity for the commitments made by them in trade negotiations under the enabling clause, and should not seek concessions that are inconsistent with the developing country's needs (UNCTAD Resolution 21 adopted at UNCTAD II, New Delhi in 1968)¹⁹. In addition to these efforts made to assist the developing countries, UNCTAD developed the GSTP (Global System of Trade Preferences) in 1988, for the exchange of trade preferences among developing countries, in order to promote intra-developing-country trade. It is reserved for the exclusive participation of members of the G77 and China such that the benefits accrue only to those members on the principle of mutuality of advantages.

II) Rationale and Benefits of PTAs

A PTA²⁰ may serve a country's needs in several ways, and these potential benefits have attracted many nations in the recent past to sign multiple agreements. The motivation and rationale can be of three distinct types: Economic benefits, and security-related concerns including the political economy of agreements.

ECONOMIC

Countries may use the signing of a preferential agreement **to underpin domestic policy reforms**, especially those that liberalize strategic sectors that were earlier protected by the import-substitution policy (Whalley, 1998; Heydon, 2016). For example, that Mexico's negotiating position with NAFTA was clearly to help lock in domestic policy reforms.

It may also be signed to either restore trade links and preferences with traditional trade partners, or in a quest to find new market access in non-natural trading partners. When an agreement is signed between a small and a big country, the smaller one may make implicit side payments by undertaking reforms or formulating policies, which are closer

have to do the same for all other WTO members. This principle is known as most-favored-nation (MFN) treatment". More information is available at:

https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm#seebox

¹⁹ Text available at: <https://unctad.org/en/Pages/DITC/GSP/About-GSP.aspx>

²⁰ The term PTA is often used interchangeably with FTA and RTA. However, they mean different kinds of trade agreements. "Preferential agreement" is a generic term used, which covers all three kinds, as all stages of economic integration are preferential in nature. However, a PTA is necessarily not a stepping-stone to further forms of integration.

to the big country's preferences, only **to secure greater market access to the larger country's markets or to get exemptions from its stringent market norms**. It may also act as an insurance against future trade wars among countries (Perroni and Whalley, 1994; Kose and Riezman, 1997).

Generally, an RTA results in the **gains from trade that occur through reciprocal lowering of tariffs**, and the consequent increase in market access for all parties involved in the agreement. It has the potential to increase competition that could raise efficiency of production and achieve economies of scale, remove frictional trade barriers and lower the cost of doing business (WTO, 2011b; WTO, 2011c). FTAs can be used by countries to strengthen industrial networks and business production chains. Moreover, they may also trigger **intra-industry trade and help establish regional production networks**. These production networks could lead to economies of scale through concentration of technical know-how along a network, and economies of scope through spillover effects of learning-and-doing (Coe, et. al. 2004). Arndt (2001) also emphasizes that innovation in transportation technology has “facilitated cross-border sourcing”, allowing countries to move from an “nationalistic industrial policy” to a more “regional policy”. This could raise efficiency of production, reduce production costs, create more jobs. In all, such production networks can compensate for small domestic market and help countries develop technology and management capabilities along the network (Ernst, 2004).

As mentioned, PTAs encourage integration by eliminating tariffs and non-tariff barriers (Bruhn, 2014). If the FTA preferences coincide with the already existing business production chains (suppliers, retailers, buyers), the relationship will become stronger. Additionally, countries that produce similar but slightly differentiated products, can benefit from signing a preferential agreement, especially one that established a common market and allows free movement of factors of goods and factors of production. However, if an FTA leads to new access to preferential trading with a country, businesses may be forced to form new production chains with companies, they have never traded with before, and transaction costs of which are usually enormous.

A PTA also impacts the domestic industries: when it does not induce entry of firms, an exporter experiences a reduction in total costs. If he is able to maintain his market share, he can continue to charge a higher price, such that his cost-price margins increase.

These high margins may attract entry of firms in a long-term dynamic framework and reduce the market power of a single firm, leading to greater competition in a domestic industry as well. On a regional level, the signing also affects the overall economic geography. The concentration of industries post-signing of a treaty is determined by labor market pooling, supply of non-tradables, and the level of technology spillovers (Matthew, 2003). However, it is essential that negotiators make the trading environment more suitable for conducting businesses. If an agreement leads to greater complexities, the businesses will find ways to escape it.

In general, an RTA could mean greater market access to export-oriented producers, with easier and cheaper customs procedures, lower production costs due to achievement of economies of scale and increased efficiencies, cheaper imported raw materials and new competition from a more efficient foreign competitor (World Bank, 2005). All these also translate into benefits for the consumer with the luxury to choose from a greater variety of cheaper goods (Matthew, 2003). This argument works as a rationale behind the surge in *South-South* agreements in the recent past, wherein, smaller countries benefit from economies of scale and increased competitiveness (Greenaway and Milner, 1990).

As mentioned earlier, Viner (1950) commented on how countries may benefit by calculating the trade creation and trade diversion effects resulting from an agreement. It is however, essential to calculate the trade creation effect along with the price effect of cheaper imports and the trade diversion effect along with the total damage from it. There is also a cyclical component in trade creation, such that potential gains from an RTA may itself lead to negotiations of an agreement (WTO, 2011b).

Venables (2003), built on this theory and stated that in the case of an FTA between *two low-income countries*, of which, one has an extreme comparative advantage, say in unskilled labor, and the other has an intermediate comparative advantage, the country with the intermediate comparative advantage will necessarily experience trade creation, such that it will now be trading with a global, and not just an intra-union, lowest-cost supplier. On the contrary, the country with the extreme comparative advantage will now, because of the agreement, have to trade with a supplier, that has only an intra-union and not a global comparative advantage, and thus, will experience trade-diversion. This “*unequal division of costs and benefits*” will cause an income

divergence between the countries. The one with the extreme advantage, and a lower income, will be worse-off, while the other will be better off. However, if both the countries are high-income, then an income convergence will occur, such that the country with a higher skilled/unskilled labor ratio will experience trade diversion and the other, trade creation.

He further provides the rationale behind *North-South agreements*. According to him, the best partner for a low-income country is a high-income country, as there exists a huge difference in factor endowment between them. Thus, they experience maximum trade creation, are able to minimize trade diversion and the income level of the low-income country rises because the agreement stimulates export demand in the high-income country for the unskilled labor-intensive products. This argument needs to be read with caution, because Venables (2003) assumes that the only difference between countries is their respective factor endowments and comparative advantages are systematically related to incomes per capita.

Another economic rationale for countries to join PTAs is that countries may want to capture the **first-mover advantage** in signing a PTA with another country. The formation of a trade bloc provides strong incentive to outsiders to join it or sign their own PTAs, to ensure market access and to gain substantial preference margin. Thus, a PTA helps counter the discrimination they would otherwise face and leads to a phenomenon where non-members are induced to joining new PTAs, creating a contagion. Say, country A is negotiating an agreement with country B, an outsider, country C may think that if it doesn't sign a PTA with country A soon, it will face exclusions from its markets and non-member disadvantages. This was termed as the **Domino Effect** by Richard Baldwin (1993). However, the aggressive signing of multiple PTAs may lead to a **Spaghetti Bowl** as predicted by Bhagwati (1995) and an erosion of the preference margins on an existing agreement (Menon, 2014).

Also, according to a theory, the cost of joining a bloc increases with accession of every subsequent member. Baldwin (1995) and Panagariya (2000) explain that outsiders may have an incentive in seeking entry into preferential trading bloc early. Existing regime members determine applicants' entry terms on a case-by-case basis. Because existing trade regime members have discretion over membership terms, some non-member states apply with the expectation that they will receive lenient conditions, such as

foreign policy benefits and market access, without being required to undergo domestic economic liberalization, which may be viewed as a “cost” to a non-member state. In some cases, the “cost” of entering an existing trade regime may be in the form of certain policy changes, which are expected to be executed once a country becomes a member to a trade regime, for example, members must follow stringent norms, open up sensitive sectors, and liberalize labor laws, among others. These costs to the new entrant may outweigh the benefits of joining the bloc altogether (Robson, 1998). It may also be the case that a bloc may deter entrance to maintain its size and mutual level of cooperation.

The share of trade conducted under MFN conditions has shrunk over the years. Much of this is attributed to preferential trading in the form of bilateral FTAs or one-way PTAs. Given an FTA is in place, a phenomenon called **preference erosion** could occur over time. As MFN tariffs decline over time, unilaterally or multilaterally, the preference of margin will fall subsequently. This means the value of the FTA will erode as it becomes older. Because of the possibility of such a scenario, countries with older FTA will eventually have to include other benefits like investment provision in the traditional form of an FTA of only goods. This scenario of preference erosion could also occur when too many preferential agreements are signed.

Hence, countries may sign preferential trade agreements as a stepping-stone to deeper integration by including trade in services, labor mobility, law and governance in the future. This sort of arrangement may enable the bloc to collectively attract foreign direct investment because it instills confidence in the investors when policy reforms are locked in because of a PTA and due to the concentration of a large market (Medvedev, 2006). Fernandez and Portes (1998) emphasize that this phenomenon works in two ways, countries are better able to attract foreign investment and are able to stimulate domestic investment as well. This particularly helps developing countries to boost their investments, internally and externally. As countries sign an RTA, the size of the potential market for a foreign investor also increases. This gives them a signal of stability, greater investment avenues and credibility. Moreover, with the declining dependence on public sector lending in developing countries for businesses, it has become imperative for them to be able to attract foreign investors. In many cases, when a country, due to its small size is unable to attract enough investors, it is in its benefit to sign an agreement with other countries, to attract foreign investment collectively.

POLITICAL ECONOMY

The rationale for signing an agreement, especially in the case of a customs union could be to **increase their political leverage in future negotiations with other countries, especially developed countries**. The proliferation of South-South blocs, like, Mercosur, wherein countries have accumulated the market power of other developing countries to help them better influence the negotiations with third countries is the perfect example of this (Fernandez and Portes, 1998). In Mercosur, each country would be better off being a member of a customs union when negotiating a trade deal with either the United States or the European Union. This was in fact one of the main rationales for the smaller countries Uruguay and Paraguay to join Brazil and Argentina in the *Treaty of Asunción*. They had relatively low bargaining power and there was a clear incentive to ‘*band together*’ and increase their leverage (Mansfield and Reinhardt, 2003).

Forming strategic alliances with neighbors helps in avoiding future wars and in gathering political support on shared interests. The objective would be **to enhance political relations between the countries and to underpin security arrangements among the nations**, such that the economic and security gains are complementary. Thus, a PTA will improve the leverage of countries in conflict and reinforce peace-making processes (Mansfield and Reinhardt, 2003). Economic interdependence as a result of a PTA can promote collective security among trade partners; studies illustrate that trade partners are less likely to engage in war than countries that do not trade. Additionally, institutionalizing trade relations could reduce the probability of future wars and creates trust among members (Hafner-Burton and Montgomery, 2012). Historically it is evident that this rationale holds in the formation of Mercosur in 1991 and this has been highlighted in detail in the subsequent section as well.

It is believed that **PTAs are likely to be signed by nations in close proximity as a way to monitor each other and reduce opportunism by the other government** (Grossman and Horn, 2012). For example, if one country’s primary products are solely being processed by an industry in country B, the government of country B may use this opportunity to extract illicit benefits from the other country by increasing the import tariff. PTAs thus can be used to limit this opportunistic behavior by agreeing to trade preferentially and locking in the tariff rate. Further, if a country undertakes new

investment as a result of increased exports to another country, it is beneficial for it to engage in a preferential agreement with the other, to ensure future stream of exports.

Final Remarks

There exists a wide range of reasons as to why countries would seek to negotiate regional trading agreements and these include strategic, economic, or political rationales. Nations may rationalize the signing of an agreement as a way of obtaining greater access to markets of larger countries, securing political stability or to help lock in domestic policy reforms so as to abstain from reversing them in the future. In many cases it has been noted that regional agreements are further used to influence subsequent multilateral negotiations and to form strategic alliances for greater security in the future. Recently, a new form of RTA involves parties that are regional agreements themselves; this indeed is a step closer to the idea of a multilateral trading system that can help tackle barriers to trade (Sampson, 2003).

Given the myriad of bilateral agreements that exist today, it is imperative to be sensitive to the differences that may exist between agreements while analyzing them. They may differ on the coverage, the balance of concessions agreed by the parties, and whether the partners agree to further the integration process by including a wider scope of issues such as services sector, environment, labor mobility and laws, etc. The various motivations behind their formation will not only shape the negotiations, but the judgement of effectiveness in meeting its objectives will also vary (Sampson, 2003).

The transaction costs to trading have evolved over the years, earlier, they were limited to traditional trade barriers, and now, they have come to include domestic policies, regulations, norms, and property rights. A country will do a cost-benefit analysis before it enters negotiations with another country. There exists a tradeoff between the political costs of negotiations and the amount of new market access is gained. Liberalization has led to greater market-power distortions, but it seems that the positive welfare received from declining prices is more important to policymakers.

A PTA also affects the non-members. If the goods exported by a non-member are not substitutable, the exporters located in that country will be able to maintain their market share in the members' market. However, with the new preferential access to a member,

if a substitute is found without any tariffs, the old exporter (non-member) will experience trade diversion and will be forced to reduce his export prices to match the new prices of exporters located in the preferential partner. Thus, the demand for his product will fall in the market. This price effect of integration will be significant for a non-member (Wong and Chang 2002). This discriminatory bias against the exports from the rest of the world can also be interpreted as a *negative externality* imposed on non-members (WTO, 2011c). Regional Integration directly implies welfare loss to non-integrating regions and perhaps, the best response to trade bloc forming elsewhere, is to be a part of it as well.

The rationale for seeking PTAs is built on the need to circumvent various kinds of barriers that exist behind, at and beyond borders. The standard trade barriers for goods are either rent creating or cost increasing. Barriers that raise the price of the imported good in the domestic market in the form of tax on imports, quantitative quotas, import licensing, voluntary export restrictions and orderly marketing arrangements, are by definition rent creating. Further barriers such as complicated customs procedures, difficulty in obtaining import licenses, and foreign exchange, delays in verification of standards, imposition of various health, industrial, and environmental standards are cost-raising barriers. Sometimes, there is an economic and political necessity to impose barriers such as temporary safeguard measures in case a sudden influx of imports harms the domestic industries; anti-subsidy duties on imports to offset subsidies paid to an exporter in the form of direct export subsidies and production subsidies; and antidumping or countervailing duties to protect against dumping of cheap goods by another country in the domestic market.

According to the WTO definition, non-tariff measures are policy measures, other than ordinary customs tariffs that can potentially have an economic impact on international trade in terms of changing quantities traded, or prices or both. These measures include environmental, health, human rights concern and strict labor laws. Some of these measures may constitute restrict trade and can be termed as non-tariff measures (NTMs). NTMs are measures that have protectionist intent and include quotas, tariff-rate quotas, licensing regimes, and price bands. The domestic government may also engage in activities, which make the environment non-conducive for foreign firms, this can be in the form of government procurement that favors domestic produce over

foreign ones, and over-subsidizing the local industries, to make them more competitive in the domestic market space.

III) Mercosur, its inception and structure

The breeze of regionalism in the early 1990s witnessed the inception of *el Mercado Común de Sur* or the Southern Market, Mercosur. Four developing countries from the Latin American region namely, Argentina, Brazil, Paraguay, and Uruguay took the first initiative to co-sign an economic integration agreement. “*Mercosur seems to be quite different from the previous Latin American RTAs as it radically departs from the protectionist views to justify inward-looking policies and follows the general trend towards economic reform and more open trade regimes*” (García, Pabsdorf and Herrera, 2013).

The idea of Mercosur was based on the success of the regionalism in the European Union, and it is considered as a natural comparator for Mercosur. The large community of the EU provided for spillover effects in the entire world that also motivated Mercosur in adopting the institutional structure of the EU (de Oliveira, 2005; Lenz, 2011; Sammon, 2005). Thus, the nineties were characterized by EU’s efforts to extend the idea of regionalism to the rest of the world. Historically, Argentina and Brazil were traditional rivals and perceived trade interaction to be a zero-sum game; the rivalry meant that the winner gaining significant political strength and dominance in the region. But, the zero-sum ideology began to change in the eighties as the two big rivals realized that cooperation could be mutually beneficial.

The eighties were a lost decade for South America with massive international borrowings, government mismanagement, faulty exchange rate mechanisms, hyperinflation, debt accumulation and loan defaults²¹. Despite these economic setbacks, the following regional dynamics and the trade liberalization policy of the nineties paved the way for regional cooperation and integration (Lorenzo and Vaillant, 2003). Brazil backed Argentina’s claim to the *Falkland Islands* in 1982 with a growing sense of unity based on regional relations. It permitted Argentine businesses to use Brazilian resources in order to maintain fluidity of trade, and with this Argentina began

²¹ These have been highlighted in the subsequent chapters 3a and 5.

to trust Brazil. The *Tripartite Agreement on Technical Cooperation* had already been signed in 1979, and had been preceded by *several nuclear accords* in 1978 for joint nuclear development (Caichiolo, 2017). Additionally, the second oil crisis of 1979, in addition to the debt crisis in both the countries imposed a period characterized by shortage of foreign currencies in most Latin American countries. Thus, reduced trade performance, coupled with idle capacity in some countries and excess demand in others led to regional integration gaining momentum in the political agenda of the Latin America region after the mid-1980s (CEPAL 1994).

“In this new era, regional integration was seen as not only a means to widen domestic markets and allowing for scale gains, but it also proved a way out of crises: regional trade made it possible in the short run to use installed capacity, and clearing schedules adopted by central banks in the region allowed for conducting regional trade with no need of scarce foreign currencies. Furthermore, in the long run what made integration sustainable was not the unlimited elimination of trade barriers, but rather the efforts to create complementary productive structures and common economic spaces” (Baumann, 2008; CEPAL, 1985; ECLAC, 1984).

Following the end of military rule in Argentina and Brazil in 1983 and 1985 respectively, these two former adversaries began to make amends, through political harmony and closer economic ties. The process of re-democratization in Argentina and Brazil in the mid- 1980s enhanced the degree of shared interests and experience that resulted in a closer alignment. It was at this point that the long process of integration and bilateral cooperation began that culminated with its institutionalization in the form of Mercosur in 1991 (Kaltenthaler and Mora, 2002). The liberalization of trade was thus, seen in a different light and was not solely about bigger markets and economic growth. Rather, the integration promoted domestic political stability, democratic consolidation and promotion of regional economic interdependence.

Subsequent negotiations between government officials led to the *Declaração de Iguazu* that was the first step in the period 1985 and 1989 and led to signing of twenty-four bilateral agreements that covered most trade issues between Brazil and Argentina (GATT, 1992). These agreements reinforced the need for political and economic integration as well as their joint position on international issues. This was also a way of strengthening their respective democratization processes. They began to realize that

despite this integration effort they would continue to remain an unstable region due to severe external pressure, especially from the United States in terms of trade competition and came together to protect the region from this external pressure (Mecham, 2003). Hence, on 29 July 1986, in Buenos Aires, Presidents Jose Sarney (Brazil) and Raul Alfonsin (Argentina) formally signed the *Program for Integration and Economic Cooperation* (PICE), with the hope that it would serve towards regional stability. However, this was met by a string opposition from the industrial sectors in both the countries (Manzetti, 1993). In 1988 this was followed by the *Treaty on Integration, Cooperation and Development*, with the intention of forming a common market in 10 years. Paraguay and Uruguay also accepted the offer and joined in these negotiations (Kaltenthaler and Mora, 2002).

However, the economic and political obstacles of the late eighties hindered the integration process until the new administration of President Carlos Menem in Argentina in 1989 and President Fernando Collor de Mello in Brazil in 1990. In July 1990, President Menem and de Mello signed the *Buenos Aires Act*, which broadened the scope of integration. The early nineties were marked by unilateral liberalization efforts to increase competitiveness and eliminate barriers to trade; soon after, both the smaller countries, Uruguay and Paraguay were integrated under the *Buenos Aires Act* (Kaltenthaler and Mora, 2002). These agreements were notable for indicating an apparent willingness to set aside a long history of sometimes-bitter political-economic competition in the Southern Cone (Chudnovsky and Porta, 1989).

The new wave of regionalism and globalization was seen as an opportunity by the South American nations to come from the periphery into the newly integrated, global economy. The creation of Mercosur was based on this very motivation and challenge to achieve integration (Mecham, 2003). At first, it was a strategic geopolitical project aimed at bringing Argentina and Brazil together, but it soon developed strong economic objectives, as both the countries returned to democracy and began economic liberalization. Finally, on March 26, 1991, MERCOSUR officially appeared when the *Treaty of Asuncion* was signed by the Argentina Republic, the Federal republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay, which came just 3 years after the first effort through PICE in 1988 (García, Pabsdorf and Herrera, 2013). Doctor (2013) notes the three main features of Mercosur integration: (i) mixed

objectives (both economic and political); (ii) exclusively inter-governmental decision-making structure; and (iii) incremental process of integration.

The treaty constituted a free trade agreement for the gradual establishment of a customs union and then a common market. It differed from earlier attempts at integration in its universal approach; its aim is to integrate in order to achieve growth and promote economic and social development of member states (García, Pabsdorf and Herrera, 2013). The treaty involved the free movement of goods, services and factors of production between countries through, the elimination of customs duties and non-tariff restrictions on the movement of goods, the establishment of a common external tariff (CET) and the adoption of a common trade policy in relation to third States or groups of States.

Chapter 1 of the *Treaty of Asuncion*²² (SICE, 1991) stated that:

“the agreement also involved the co-ordination of positions in regional and international economic and commercial forums; the co-ordination of macroeconomic and sectorial policies between the States Parties in the areas of foreign trade, agriculture, industry, fiscal and monetary matters, foreign exchange and capital, services, customs, transport and communications, in order to ensure proper competition between the States Parties. It also included a commitment by States Parties to harmonize their legislation in the relevant areas in order to strengthen the integration process (SICE, 2016).”

“The member states considered that the expansion of their domestic markets, through integration, was a vital prerequisite for accelerating their processes of economic development with social justice. Further, they believed that this objective must be achieved by making optimum use of available resources, preserving the environment, improving physical links, coordinating macroeconomic policies and ensuring complementarity between the different sectors of the economy. This expansion was to be based on the principles of gradualism, flexibility

²² *Treaty of Asunción*, available at SICE: http://www.sice.oas.org/trade/MRCSR/treatyasun_e.asp

and balance, bearing in mind international trends, particularly the integration of large economic areas, and the importance of securing their countries a proper place in the international economy”.

“Furthermore, they were of the opinion that this integration process is an appropriate response to such trends, while being aware that, this treaty must be viewed as a further step in efforts gradually to bring about Latin American integration. In keeping with the objectives of the Montevideo Treaty in 1980, they were convinced of the need to promote the scientific and technological development of the States Parties and to modernize their economies in order to expand the supply and to improve the quality of available goods and services. They were convinced that the treaty will enhance the living conditions of their populations; and reaffirm their political will to lay the bases for increasingly close ties between their peoples belonging to all the members states”.

“It was further decided that the common market shall be based on reciprocity of rights and obligations between the States Parties; and shall ensure equitable trade terms in their relations with third countries. To that end, they shall apply their domestic legislation to restrict imports whose prices are influenced by subsidies, dumping or any other unfair practice. At the same time, States Parties shall co-ordinate their respective domestic policies with a view to drafting common rules for trade competition” (chapter 1).”

There are three main objectives of a customs union that complement each other. These are, a free trade zone among members, application of a common external customs tariff for third countries and coordination of customs and trade policies (Balassa, 1961, pp. 21). The main aspect of defining a perfect customs union is the distribution of customs rents between partners, defined as the “revenue-sharing mechanism” by Ovádek and Willemyns (2019). In Mercosur, the Common External Tariff (CET) is harmonized and internalized by all the four countries. However, there exists a list of national exceptions in addition to complete exclusion of the automobile and sugar industries (Laird, 1997). The exceptions provide flexibility to the members states for generating targeted benefits in a customs union. The duties are payable at the border of the members and it may

sometimes lead to payment of double-customs duty at every member's border checkpoint (Mukhametdinov, 2018; European Commission, 2008).

All members follow the CET with a lot of special provisions and exceptions, temporary admissions, and permission to import tariff-free inputs (Laird, 1997). This flexibility allows members to follow an independent trade policy. Mercosur also frequently uses the Infant Industry argument to formulate its trade policy. The countries are very different, and the trade integration efforts have been very difficult as well (Leipziger, Frischtak, Kharas and Normand, 1997). Argentina and Brazil have unilateral macroeconomic policies that made them very protectionist (Carranza, 2003a). Today, there are no tariffs for intra-Mercosur trade; members use *non-tariff barriers* and *trade remedies* from time to time. For example, although 50 percent of Uruguay's dairy industry's produce ends up in Brazil and Argentina, in 2017, Brazil suspended Uruguayan dairy imports (FAO, 2017)²³ due to fear of violation of technical barriers and rules of origin. Uruguayan critics believe that the suspension was because of pressures from the national dairy producers in Brazil as they were unable to compete with the low prices of Uruguayan dairy imports.

The *CMC decision 32/00* dated 30th June 2000²⁴ "restricts Mercosur members from signing unilateral external agreements that involve reduction/elimination of tariffs on goods". To negotiate a PTA for example, Brazil needs the authorization of the other three countries. Countries can however sign other kinds of agreements with third parties. For example, Uruguay signed a framework agreement with the United States in 2004²⁵ and Brazil signed it as well in 2011-2012²⁶. However, if an agreement exists between Mercosur and a third country, any member of the bloc is permitted to sign an additional protocol within the previous umbrella agreement. For example, Mercosur

²³ Feature available at: <http://www.fao.org/in-action/agronoticias/detail/en/c/1045720/>

²⁴ Legal text available at <http://www.sice.oas.org/trade/mrcsrs/decisions/dec3200s.asp>

²⁵ Legal text available at

http://www.sice.oas.org/TPD/URY_USA/URY_USA_e.ASP#:~:targetText=It%20was%20signed%20on%2025%20October%202004.&targetText=During%20the%20VI%20meeting%20of%20bilateral%20trade%20and%20investment%20relations.

²⁶ More information available at: <https://ustr.gov/countries-regions/americas/brazil>

already has an FTA with Peru (ACE#58), and Brazil signed a new protocol with Peru under that agreement²⁷.

The Mercosur agreement also ensures that the bloc is permitted to make external commitments on issues that have not been agreed on internally in the bloc. For example, although automobiles and sugar are excluded from the free trade area, countries have signed automobile agreements under the ALADI, for example, Argentina-Brazil and Uruguay-Brazil. According to renewed Automotive Agreement between Brazil and Argentina²⁸, “for every \$1 exported by Argentina to Brazil, Brazil can export \$1.5 to Argentina without tariffs. Any excess value attracts 35 percent tariff on imports”. However, the sugar sector remains separate from the CET. Other sectors excluded are peaches, toys, capital goods, ICT goods.

The exclusion of ICT/capital goods²⁹ translates into zero import tariffs on such imports under the rule that if no member of Mercosur produces a certain ICT good, all members are permitted to apply zero tariffs on such imports (no substitute is produced locally). However, a certain degree of flexibility exists. For example, Brazil wants to promote domestic production of capital goods, but Paraguay and Uruguay are net importers of capital and ICT goods. Hence, they have maintained a zero tariff on such imports, while Brazil has the flexibility to protect its industry with a non-zero tariff. In general, the CET was implemented on a product-by-product basis. Had members focused on homogenizing fiscal, monetary and trade policy first, the CET would have been more inclusive and effective. According to the new-age preferential agreements signed by the developed countries, “Mercosur needs to deal with non-tariff measures, sensitive products and services” (UNCTAD, 2016).

The creation of Mercosur accompanied the trend of *New Regionalism* (Esteradeordal, Goto and Saez, 2001) that characterized the international scene in the beginning of the 1990s. It marked a new form of integration of several economies of the world. Devised to lead to the creation of a customs union and, eventually, a common market, the treaty activated the most important integration strategy in Latin America. Mercosur

²⁷ More information available at: <http://www.mdic.gov.br/index.php/comercio-exterior/negociacoes-internacionais/9-assuntos/categ-comercio-exterior/1508-acordo-de-ampliacao-economico-comercial-brasil-peru-ainda-sem-vigencia>

²⁸ Press release: <http://investinbrazil.biz/news/brazil-and-argentina-renew-automotive-agreement-2020>

²⁹ Legal text available at: <https://www.impo.com.uy/bases/decretos-internacional/282-2015/1>

experienced an increase in *intra-industry trade* in its early years, combined with a substantial opening to the rest of the world, the encouragement of *structural reforms* designed to boost the role of the market in resource-allocation, and the opening of all the areas of the economy to *foreign investment*. (Machinea, 2004).

Additionally, the founding members also signed the *Protocol of Ouro Preto*³⁰ in 1994 in compliance with the provisions of the Treaty of Asuncion, which established the institutional and legal structure of the common market. It reaffirmed the principles, objectives and protocols of the *Treaty of Asuncion* and gave special consideration to the less developed countries and regions of Mercosur.

García, Pabsdorf and Herrera (2013) note that although there was some slippage in achieving the slated objective, but when the MERCOSUR “customs union” officially began operating on 1 January 1995, approximately 80% of all products traded between its members were no longer subject to tariffs, while their external tariffs were also substantially reduced in a general trend towards increased multilateral openness. This group of countries was the fourth largest economic block in the world after the European Union (EU), the North American Free Trade Agreement (NAFTA), and the Association of Southeast Asian Nations (ASEAN). However, over the decades, Mercosur slowly transformed into a political agenda, with a new broader objective of creating a unified South American identity. The admission of Venezuela was foreseen to further politicize the region (Klonsky, Hanson and Lee, 2012; Freyemann, 2007).

Lazarou and Luciano (2015), along with Doctor (2013) highlight that Mercosur was a heavily state-led process and it was launched as a strictly *inter-governmental* organization with three decision making organs: The Common Market Council (CMC) is responsible for outlining Mercosur’s political direction and making joint decisions, the Common Market Group (GMC) is accorded with some implementation functions and ensures enforcement of protocols and agreements, and the Mercosur Trade Commission (CCM) is restricted to dealing with trade issues. Subsequently, in need of a dispute settlement mechanism, first the Protocol of Brasilia was signed in 1991 and later repealed by the Protocol de Olivos of 2002. Among the new organs set up after

³⁰ Protocol of Ouro Preto, 1994, available at http://www.sice.oas.org/trade/mrcsr/ourop/ourop_e.asp

2003 were the Technical Secretariat (upgrading the previous small administrative secretariat), Mercosur Commission of Permanent Representatives (CRPM), Joint Parliamentary Commission, Mercosur Parliament (ParlaSur), Advisory Forum on Economic and Social Matters, Permanent Review Tribunal (TPR) as well as procedures for the ad hoc arbitration tribunals, and the Mercosur Structural Convergence Fund (FOCEM). These were established to guarantee the incorporation of social and political actors, of a common legal framework and of an asymmetry reduction program to the regional mechanisms. Nevertheless, despite the proliferation of such bodies, Mercosur often relied on presidential diplomacy and government-led decision-making to maintain national autonomy within the working of the bloc (Doctor, 2013).

Integration Efforts:

Cason (2000) emphasizes that in the first decade of the agreement, Mercosur seemed to be “*well on the road* to becoming Latin America's first robust trading organization”, and the sheer volume of trade would make it hard for the members to turn back. Hence, the “importance of the Mercosur export market for the four individual member states created significant incentives to resolve crises that may erupt” within the bloc rather than encourage withdrawal from it (Carranza, 2006). The bloc was indeed a political integration project born out of *strategic regionalism* (Briceño Ruiz, 2006) that had permanently banished border conflicts and arms races while uniting member states in their commitment to democratic forms of governance (O'Keefe, 2000). The pressures of globalization including US hegemonic pretensions, and the challenges to the integration effort, forced Mercosur to reconfigure itself as a *political unit*, seeking to offset internal divisions by making external negotiations the new *glue* of the Mercosur (Phillips, 2001; 2003a; Carranza, 2006; Doctor 2013).

However, the bloc did make progress on economic issues as well. The Protocol of Montevideo on Trade in Services was signed by the members in 1997 and finally came into force by 2005; it aimed at the phasing-out of restrictions on trade in services and required members to grant national treatment to service providers from another member (SICE, 2002). Opening up of government procurement markets (Article XV) and harmonization of competition policy (Article II) were already included in the Protocol, while the CMC Decisions 8/95 (of 1995), and 16/98 (of 1998) adopted two additional protocols for the harmonization of IPR norms in Mercosur (WTO, 2008). The CMC

Decision 11/93 (of 1993) has already adopted the Protocol of Colonia del Sacramento on Reciprocal Promotion and Protection of Investments within MERCOSUR³¹ that ensured national treatment for all investment in the bloc. However, limited progress has been achieved in the effective harmonization of rules as national restrictions and non-tariff barriers continue to hamper integration efforts inside the bloc (SICE, 2002).

To further the process of integration in the South American region and to promote the idea of a unified South America, Mercosur admitted Venezuela while Bolivia was in the accession phase. Brown (2010) notes that although Mercosur intended on being an economic-trade oriented bloc, its members were divided over inclusion of a political mandate at the time. Thus, the move to access new members, had worked in the same direction, as Venezuela took this accession as an opportunity to propagate its Bolivarian mandate in the region. Moreover, Venezuela was not only very rich in oil and founding member of the OPEC, but also provided an internal market for the other members and strengthened Mercosur's capabilities in negotiating with other powers.

The Argentine currency crisis and Brazilian devaluation in the period 1999-2002 led to diminishing economic growth in the entire region and "*for a while it seemed that Mercosur's fate has been sealed*" (Vervaele, 2005) but the region recovered and the bloc members emphasized on increased macroeconomic coordination between Argentina and Brazil. The Mercosur partners reaffirmed their countries' commitment to strengthen the bloc. Mercosur survived because member states, particularly Argentina and Brazil have invested "*political capital*" in the regional agreement; for the moment, ending it would impose higher costs on them than dealing with regional asymmetries and intra-bloc trade disputes. (Mera, 2005; Cason, 2000).

As per the renewed commitment in 2003, the four presidents (Argentina, Brazil, Paraguay and Uruguay) recognized the need to deal with flexibility with asymmetries between member states. This recognition paved the way for the launching of a working program "*Objetivo 2006*", with specific targets and deadlines to implement an ambitious internal agenda (Carranza, 2006); it focused on consolidation of customs union and the common market. The program was divided into three specific themes: economic-commercial, social and institutional. Economic and commercial theme

³¹ Full legal text available at: <http://www.sice.oas.org/trade/mrcsrs/decisions/dec1194e.asp>

included the reduction in exceptions of the CET and establishment of a joint import regime, harmonization of customs procedures, the elimination of trade defense instruments including antidumping and countervailing duties in intra Mercosur trade, promotion of productive integration, establishment of a structural fund to help the small enterprises and less-developed regions of the bloc, a common trade defense and competition policy, enhance business facilitation, foster a broader participation of the civil society, the harmonization of macroeconomic indicators, and; the strengthening of the bloc's institutional structure (Vervaele, 2005; Taccone and Nogueira, 2004). It was hoped that if the Southern Cone's economic recovery continued, rising interdependence between member states would facilitate the implementation of *Objetivo 2006* (Carranza, 2006).

The end of the decade pushed the bloc into another crisis due to the contagion from the financial crisis that originated in the United States in 2008-09. As commodity prices crashed, so did external demand and the export earnings that were responsible for the growth in the decade since 2003. Although they still benefitted from the Chinese-backed demand, the breakdown in the US financial system disrupted the inflow of international funds. However, the Mercosur economies remained fairly stable due to an equal reduction in imports, backed by a rise in demand for domestically-produced goods (IDB-INTAL, 2009).

The Mercosur nations stepped forward together to overcome the global financial crisis of 2009, following which, they agreed to promote financial stability through de-dollarization of all intra-region dealings, i.e., they agreed upon using only local currencies with a mix of *pesos, reais, guaranies* for all intra-Mercosur trade. This was a positive step towards greater monetary integration in the region. Further, the member countries set up Banco del Sur in 2009, with an initial capital of \$20 billion, to promote social programs and infrastructure in the region, thus building a unified South America. This obviously came as a step to reduce financial dependency on international financial institutions and to compete in the international market for development lending (Carranza, 2010). By late 2011, *“the Southern Cone stepped up efforts to develop a joint strategy in response to the worsening global scenario and announced proposals to increase regional trade in the short term. The common themes present in revival schemes related to overcoming the institutional deficit, ameliorating the consequences*

of economic asymmetries, and reviving the trade agenda” (Doctor, 2013).

It is apparent that Brazil has invested a lot of time and diplomacy in trying to unify the southern market, especially by reconciling its differences with Argentina. Mercosur has always been a state-led project, and the pace of Mercosur's external agenda has been marked, to a significant extent, by Brazil's foreign policy. The research by Carranza (2006) and Taccone and Nogueira (eds) (2001) summarizes Brazil's expectations from the bloc. The trade policy of the bloc is highly influenced by Brazil's “*geopolitical vision of the bloc*”. With the permission to enlarge the bloc, Brazil strongly believed that a unified south would be able to defend itself in global negotiations, and will be able to counter the security issues related to the hegemony of the United States in the Americas. Thus, Brazil began to project itself as the leader of the south. Another piece of the Brazilian “*grand strategy*” was the effort to strike an EU-Mercosur strategic partnership that would help it to achieve the geopolitical vision. The historic dispute with Argentina and repetitive trade wars was something Brazil wanted to avoid in the future as that would undermine the agenda of the bloc, and Brazil had already invested a lot of “*diplomatic and political capital in Mercosur*”.

A regional identity is slowly emerging within the bloc, and can be attributed to the commitment towards democratic governance, protecting human rights and building citizenship (Crawley, 2004; Grugel 2007). There are also signs of cultural forums and exchange through language spillover and increased intra-regional tourism. In a nutshell, what was an “*elite statist project*” gradually began to penetrate the society and the working class (Doctor, 2013).

IV) Pending issues with Mercosur

The bloc set out to establish a customs union and a common market, very much like the EU, but the degree of integration has been limited since its inception in 1991. This has led to a clear contradiction of the bloc's original accords, and has led to the development of an array of political and economic issues. There exists a view that rather than representing an autonomous project of sub-regional development, Mercosur has served the function of incorporating the member states within the world system while preserving their subordinate status” (Mecham, 2003; Doctor, 2013; Richards, 1997; Cammack, 1999).

The failure to fulfill the objectives of Mercosur has been attributed to recurring crises in the members that led to the adoption of unilateral measures in the form of devaluation and trade defense by them. This clear shift in national preferences is a classic example of how internal economic and political crises in the region has severely affected the coordination efforts in the region, thus undermining the commitments made by the members (Machinea and Rozenwurcel, 2005; Carranza, 2003a).

During the period of automatic tariff reductions (1991-94), a variety of business groups in “*Argentina, Paraguay, and Uruguay were vocal in their opposition to the Treaty of Asuncion*” and demanded a slower pace of trade liberalization (Jenkins, 1999). “*Uruguay saw itself forced to join a regional integration scheme to avoid being shut out of accords between its neighbors*” (Alimonda and Steiger, 1994). During the same period, Argentina and Brazil had several trade disputes, including a conflict over the sugar industry, which was protected by Argentina and the capital and ICT goods protected by Brazil. Hence, the application of the CET in 1995 was faced with great difficulty owing to the exceptions sought by the members (Carranza, 2003, 2006; Gomez-Mera, 2009).

Nofal (1994) notes that during the same period, Brazil maintained a floating exchange rate with state support for the domestic industries, while Argentina followed a fixed Peso, pegged to the US dollar. Brazil also experienced rising inflation and Argentina, did not. This meant, that it was impossible for them to reconcile such divergent macroeconomic policies at that time, and that added to the difficulty in applying the CET. In the second half of the 1990s, divergent macroeconomic policies between Argentina and Brazil continued to be a serious political problem for Mercosur. Its troubles were exacerbated by unfavorable external conditions, such as the Tequila crisis of 1994-95, Asian crisis of 1998-99, the fall in commodities prices and the slowdown in world trade (Carranza, 2004). These shocks provoked a resurgence of protectionist tendencies in member states. “*It showed the vulnerability of the bloc's economies to external shocks*” and it became increasingly difficult to keep on managing the bloc's external and internal agendas on separate tracks. “*A bloc weakened by recurrent trade disputes between Brazil and Argentina would not be able to project itself internationally with a single voice*” (Carranza, 2003, 2006; Gomez-Mera, 2009;

Foxley, 2010). Intra-regional trade also stagnated along with overall trade in the late 1990s and early 2000s.

The Brazilian Real devalued in January 1999 by 40 percent and affected Argentina as a whole, given Argentina's export dependence on its neighbor. Both the countries went into recession, which significantly reduced the extent of bilateral trade. In the first eight months of 1999, Argentine exports to Brazil were lower by 28.4 percent from the comparable period of 1998; Brazilian exports to Argentina fell by 26.9 percent (LAWR 1999c). Additionally, the devaluation of the *real* left Argentine exports of automobiles, steel, rice, and fruit, less competitive on the Brazilian market, compelling Argentine producers to seek new markets elsewhere in Latin America. Carranza (2003a) notes that Argentine entrepreneurs feared that competition from the more advanced Brazilian industrial sector would exacerbate the traditional composition of bilateral trade: "Brazilian exports of manufactured commodities in exchange for Argentine agricultural products and agro-based manufactures".

Mercosur was opposed by the Argentine domestic industrial sector, represented by the Union Industrial Argentina (UIA), because SMEs in Argentina found it difficult to compete with the much larger Brazilian companies. The leading business group was the "*Group of Eight*" formed by the associations representing SMEs, industry, construction, the stock market, banking, and big farming (Carranza, 2003).

The Real devaluations in both, 1999 and 2001 stressed Mercosur to the point that Argentina felt compelled to consider temporary trade barriers to the unexpectedly highly cost-competitive Brazilian goods (Schwartz, 1996). As a result, the Argentina imposed several controls on imports as countermeasures against Brazilian protectionism and to protect the Argentine domestic market against a flood of cheap Brazilian imports; these controls included a surcharge of US\$410 per ton on imports of Brazilian iron; quotas for imports of five categories of Brazilian textile products, and prior licensing system for imports of paper (LAWR, 1999b). The Brazilian government responded with similar countermeasures, such as prior licenses for foodstuffs and border sanitary controls of Argentine products, including an import licensing system for industrial imports that affected majority of Argentine manufacturers as more than 50 percent of Argentine exports to Brazil were manufactured goods (Lorenzo, 2006).

In 2001, a crumbling Argentine economy questioned Mercosur's viability yet again. It was feared that the Argentine crisis would have a negative impact on Mercosur and damage the bloc's negotiating strategy with the rest of the world. A "*weak Argentina meant a weaker Mercosur*" (Carranza, 2004). The persistence of Argentina's economic slump that lasted till 2002 slowed down intra-group trade as well. These issues that created a gap between Argentina's fixed exchange rate and Brazil's periodic currency devaluations threatened Mercosur's survival. "*The anti-devaluation coalition ruling Argentina openly favored dollarization and striking a deal with the USA while reverting Mercosur to a free trade area, thus abandoning the common market project. This posture exacerbated trade disputes with Brazil, while the insistence on maintaining a fixed exchange rate with the dollar made macroeconomic harmonization with Brazil impossible to achieve*" (Carranza, 2004). Hence, the period from 1998-2002 was marked by a process of "*de-Mercosurization. The recurrent Argentine-Brazilian trade disputes are just a symptom of deeper internal problems*" (Gomez-Mera, 2005).

The bloc's weak institutional structure had encouraged member states to often flout the rules agreed to by the members. The repeated efforts to consolidate Mercosur have been jeopardized by Brazil and Argentina's tendency to unilaterally adopt protectionist measures that have weakened the incomplete customs union and made it very difficult to agree on a common trade policy. Carranza (2006) recalls that, in the first half of 2001 Argentina, Paraguay, and Uruguay "*unilaterally changed the common external tariff, weakening Mercosur's identity as a customs union*" and damaging the bloc's ability to maintain a strong and consistent negotiating position in the different initiatives of its external agenda.

However, Heymann and Ramos (2008) continue to hope that Mercosur has the potential to grow despite these challenges: "*Wide macroeconomic swings that have marked the experience of the Mercosur in the first decade have implied very large changes in economic behavior of the members. Trade flows showed very big oscillations in size and composition, which caused visible frictions among the partners. In this turmoil, it has been difficult to identify a sense of direction for Mercosur as an economic project. However, the belief that countries stand to gain from trying to grow together, rather than the losses it they break down is widespread. Moreover, the political decision to*

assume Mercosur as a permanent enterprise appears established, and has survived with governments of different orientations”.

Second, since Mercosur set out to become a customs union, it was imperative for the members to adhere to a strict common external tariff (CET) for all imports originating in third countries. However, the CET covers only 85 percent of the goods and a long list of exceptions to protect sensitive national industries like sugar, automobiles, Information Technology, telecommunication services, and capital goods, continue to exist in the bloc today. Over 800 exceptions to the bloc's CET still existed; therefore, the group could be characterized as *“a free trade area rather than as an imperfect customs union”* (Bouzas, 2002). Carranza (2003a) emphasizes that *“what is left of a customs union when member states can establish so many temporary exceptions to the common external tariff?”* Sugar and automobiles remained subject to special rules and were excluded from intra-regional free trade. Additionally, little progress had been made on NTMs (Bouzas, 2011). In October 2004 Argentina announced that it would not liberalize trade in motor vehicles with Brazil in 2006 as initially agreed due to a widening gap between the countries.

Moreover, the intra-regional agendas were determined, in many ways, by keeping in mind, each member state's domestic economics and agenda. The Competitive Adaptation Mechanism (MAC) was established on February 1, 2006 that approved the adoption of certain restrictions on trade between Brazil and Argentina, including application of anti-dumping, countervailing and safeguard measures when imports from the one country began to hurt local industry in the other country; this was a response to intense lobbying from Argentine footwear, clothing and textiles, and household manufacturers facing 'unfair' Brazilian competition during the devaluation of the real (IDB-INTAL, 2008; Carranza, 2006). Thus, the exceptions to the CET and various protectionist measures that target intra-bloc trade continue to hinder full harmonization of the bloc's trade policy.

Third, the bloc suffers from the lack of clear leadership. As mentioned, although the idea of Mercosur was adopted from the European Union's successful attempt at regionalism, the bloc has failed to form a supranational organization, which could coordinate and promote the intentions of the member states. Mercosur's survival largely depends on intergovernmental decisions made by the presidents of Argentina,

Brazil, Uruguay, and Paraguay. Unlike the 'European Union', the Southern Market does not possess a central-supranational entity like the European Commission (Carranza, 2003a; Fabbrini, 2007; Mukhametdinov, 2007). However, Mercosur has successfully established a strong institutional structure. But, these institutions like the Common Market Group, “*lack authority and relies on foreign ministries of the respective countries*”; additionally, “*the Mercosur administrative Secretariat is very small, lacks human and material resources*”, and is often bypassed by the national sections of the Mercosur Trade Commission and by the Common Market Group's and the Common Market Council's decisions based on *periodic rotations of meeting places and chairmanships* (Carranza 2006; IDB-INTAL, 2000). The absence of supranational institutions in Mercosur, predicts that “*disagreements among member states on the level of the common external tariff*” (Carranza, 2006), even after the establishment of an imperfect customs union, provokes relative gains conflicts, exacerbated by the asymmetry of power between Brazil and its junior partners (Manzetti, 1994; Kaltenthaler and Mora, 2002; Doctor 2013). On the contrary, the lack of supranationality ensures equal participation of each member in the negotiating and signing of every agreement and protocol (Baptista, 1998).

Kim, et al. (2011) summarizes the urgent need of an institutional structure, given the position of Mercosur. “*Mercosur started off very unstable due to negative political and economic developments, both internally and externally. A high dependency on foreign capital, recurring economic crisis and the emergence of neoliberal politics, led to a set of fragile political institutions. Thus, the development of institutions is scant and has been a deterrent in successful policy coordination. Following which, there is a need to homogenize the quality of institutions, including a common legal system in the bloc and harmonize custom practices and procedures, to ensure smooth logistics between the member states.*”

Fourth, significant asymmetries still remain within the bloc, in relation to the size of the countries, population, GDP, relative importance in regional trade, extend of trade liberalization and diversification of production structures. For instance, population in Brazil represents about three times the population in the rest of countries. By contrast, Uruguay is the country with the least population of only 3.5 million persons (2018); the rest of countries taken together constitute a combined GDP (2018), 40.5 times that of

Uruguay. These differences also generate some asymmetries in their external relationships. For example, the two smaller members, Paraguay, and Uruguay remain dependent on the international market due to the restrictions in the regional market. They have specialized structures, producing large quantities of only a few products and a population that consumes small quantities of many products. The exposure to the volatility of international prices have led to an external vulnerability that could be reduced if the regional market could be accessed under free trade conditions. This could help broaden the range of products and services in which a small country might specialize (Vaillant 2005).

Fifth, the lack of macroeconomic harmonization is very pronounced in Mercosur, which is a necessary condition to form a common market and to avoid conflicting trade and macroeconomic policies among the countries. For example, during the financial crisis in Brazil in the nineties, the unilateral measure of devaluation and imposition of general import restrictions adversely affected the members of the bloc (Machinea and Rozenwurcel, 2005); later the Argentine crises also witnessed the refusal to abandon the fixed-exchange rate system in favor of harmonization of policy with Brazil (Carranza, 2003a). This has led to *“poor reputation, lack of credibility and predictability in the members’ economic policies”*. Thus, the need to curb individualistic policymaking and ad hoc measures is dire, especially in financial systems, domestic capital markets, and tax treatment of investments (Machinea and Rozenwurcel, 2005). If Mercosur proceeds towards creation of an optimum currency unit, the members would have to give up exchange rate manipulation as a tool to gain comparative advantage within the region, for example, the Brazilian maxi-devaluation of 1999 (Kronberger, 2004).

Finally, the efforts to implement a number of protocols on investment, intellectual property and public procurement, have been stalled as the negotiations on these protocols are hampered by the varying degrees of trade liberalization in each member (Rozenberg, 2002; Vervaele, 2005). Further, there is a lack of social cohesion among the member states, without adequate labor protocols and laws. There also exists, considerable gap in policies on technology, infrastructure, innovation and energy. As mentioned earlier, the external agenda of the bloc had become a “glue” holding it together despite internal disturbances and failure to coordinate on their commitments.

However, there is evidence to suggest that the internal issues had a negative impact on the external negotiations (Carranza, 2006; Phillips, 2003, 2004). For example, the negotiations with the European Union were stalled through the 2000s due to the inability of the members to find a common position on trade in goods in their negotiations with the EU. Thus, the *perforated* CET, along with the persistence of intra-bloc restrictions and exceptions, ongoing trade wars and poor macroeconomic harmonization has exposed the external negotiations to the instability inside the bloc. Therefore, it is imperative that members overcome these economic and institutional bottlenecks to increase consolidation efforts. The external agenda cannot hold the bloc together for long if the key pending issues in the internal functioning of the bloc are not addressed.

Moreover, factors that may have played a role in the formation of Mercosur in 1991, such as “the need for government officials to 'lock in' reforms based on the Washington Consensus, or the promotion of democracy while reducing the likelihood of reversion to authoritarianism, have become less important with the passing of time”, and may no longer guarantee the bloc's survival (Carranza, 2006). He thus argues that, “*Mercosur runs a real danger of becoming irrelevant if it remains suspended in its present 'transition' phase, without taking significant steps to implement its internal agenda by completing the customs union and moving toward a common market.*” Over the years, they found themselves to be in the cobwebs of bilateral issues and failing national economies. One cannot disregard the role played by politics in shaping the present-day bloc. The political misalignments have hastened any economic progress in the bloc. The question however, remains, is what drives the success of Mercosur? Can they assume away the political costs and reconcile their internal contradictions?

V) Comparison of the EU and Mercosur

As discussed earlier, the motivation to form Mercosur was influenced by the closer economic integration in Europe. There have been various comparisons between the European Union and Mercosur. This section attempts to highlight the debate, while presenting the rationale for this comparison as well. Some questions like why are the two blocs compared so often, what are some of the similarities and differences will be answered in this section. But first, a brief history of the integration of the European Union is presented to assist in the comparison exercise.

Brief history of the EU

“Custom unions involve political connections between countries and strong political connections were the key for Europe in 1930s.”

- Gottfried Haberler

Europe in 1960s was ravaged by the atrocities of the two world wars, while its economic and social infrastructure was ruined in the period that followed. Regional integration was seen as a way of discouraging the cause of war by focusing on interstate reconciliations, creating economic interdependence, fostering political moderation, and opening diplomatic channels (Ginsberg 2007; McCornick, 1999).

The European Coal and Steel Community (ECSC) was formed in 1951 to create a single market for coal and steel producers and to quell the historically hostile Franco-German relation (Ginsberg, 2007). It was established with the Benelux (Belgium, Netherlands and Luxembourg) countries, Italy, Germany and France. The ECSC created economic interdependence and cooperation, which ended the possibility of future aggression between France and Germany (Ginsberg, 2007). Various spillover effects led it to its success and cooperative behavior was promoted through the possibility of lasting peace.

The Treaty of Rome finally transformed the ECSC into the European Economic Community (EEC) in March 1957; the goal of the treaty was to create a common market, with the inclusion of implicit and explicit supra-nationality. The idea of forming a Customs Union was revived in the 1980s through the EEC, resulting in the single European Act, which called for all members to complete negotiations by 1992 (Ginsberg, 2007). In 1992-93, the Treaty of Maastricht established the European Community. This was a lengthy-cumbersome process and Europe faced many hindrances to integration over the years. The process of unification was haphazard and fragmented. There were tendencies for a few countries to want greater integration, while others may have wanted to exclude existing members. The array of asymmetric national interests led to a long-painstaking negotiation process (Scharpf, 2009). Additionally, there were frictions in the debate of national sovereignty versus supranational law making. In some cases, national parliaments have opted-out of common legislations and policies in the EU, thus undermining the supranational

method. Hence, it can be said that the EU developed along “long variable geometric lines” (Blockmans, 2014).

The Comparison

It is undeniable that the formation of the project of the European common market had a profound impact on Latin American views on the need to develop a regional initiative (de Oliveira, 2005). There is extensive literature that compares the integration experiences in both the regional bloc and conclude that Mercosur is not as successful as the EU. It should however be noted that the integration is a multi-dimensional process involving security, policy and culture (Mukhametdinov, 2007) and requires time. While the members of the European Union spent years developing a closer economic relation and increasing interdependence, it took Mercosur members a few years to launch a full-customs union program. Notably, the European Coal and Steel Community that laid the basis or the present-day European Union was signed in 1951, but the full unification did not happen until 1992; on the contrary, the journey from the security arrangement, *Iguaçu Declaration* (1985) to the first economic agreement of *Programa de Integración y Cooperación Económica* (PICE, 1986) to the *Treaty of Asunción* (1991) that established a customs union, and finally to the Ouro Preto Protocol (1994) that established Mercosur’s legal status globally took less than ten years for completion (de Olivera, 2005). It may seem that South American countries hastened the process.

Mercosur had a very different approach to the European integration process. The European integration occurred at a rather slow pace as they tried to experiment with various approaches, moving from the idea of *functionalism* to *neo-functionalism*, and from *inter-governmental authority* to limited *supra-national authority*. European integration was a large collection of several small processes and efforts over a long period of time while that in Mercosur was the complete opposite. Mercosur disregarded this approach and jumped into it head first as it tried to accomplish too much in a short period of time (Hardt, 2008). Roett (1999) also notes that Mercosur members rushed through the negotiations and signed the treaty of Ouro Preto in 1994, which established the customs union, while the negotiation process was far from completion. Unlike in the European process, there was little participation of industrial sectors or special interest group and it is believed that the negotiations were purely driven by political

actors. Hardt (2008) termed this experience to be unrealistic for such a short period of time with high aims and colossal objectives.

If the EU and Mercosur are measures with the same yardstick, Mercosur is bound to fail the test. For example, the three pillars of the EU realized through the Maastricht Treaty of 1992 were defined as Community (economic, social and environmental), common foreign and security policy (foreign policy, defense), and police and judicial cooperation in criminal matters (judicial, criminal)³². When these pillars are applied to Mercosur, the discrepancies from the “plan” are stark. However, evidence points toward a rather successful customs union in Mercosur, although it may still host a plethora of exceptions. Hurrell (1995) also highlights that “*the difference in motivation behind the formation of similar regional integration areas influences the final outcome*”. The European motivation was based on security considerations, economic interdependence by pooling common natural resources, coordination of macroeconomic and monetary policies, and supranational policymaking; however, the South American motivation was founded on reduction of regional conflict including de-militarization in Argentina and Brazil, cultural affinity and the need to cooperate on external trade negotiations. Regional integration was seen as a facilitator to overcome backwardness, foster economic and social development, and increase the relevance of South America in the global trading system (de Oliveira, 2005). Thus, “*the character of integration depends on the existing motivations of cooperation*” (Mukhametdinov, 2007).

Another supporting theory was developed by Hardt (2008). He notes that there exist two preconditions for regional integration to take place: a threat to security and violence; and a market failure. The first condition was met in Europe due to post-war destruction while in Mercosur the Brazil-Argentina relationship was made up of border disputes and resource rights. The second condition highlights the non-existence of a market in the EU as the war had used up all infrastructure and resources, while Mercosur was characterized by hyperinflation and subsequent debt crises. Thus, Mercosur’s motivation towards regional integration was justified as per this argument.

³² More information at http://www.europarl.europa.eu/ftu/pdf/en/FTU_1.1.3.pdf

However, Malamud (2010) and Mutimer (1994) introduced an alternative theoretical tool to compare the two regional blocs. This tool called “*Communicative interactionism*” was developed by Karl Deutsch in the 1950s and aimed at explaining regional integration. It stated that among a number of similar countries in a region, the possibility of waging war against each other becomes entirely unthinkable, as an increasing pattern of communication and interchange between countries will give rise to a growing sense of community, regional awareness and supranational identification. Thus, the EU was born out of the abatement of regional conflict and the aim of restoring regional security. It is however assumed that these neighboring countries share common values, and stressed on the importance of intra-regional communications in the form of trade flows and tourism. This ideology can be applied to the formation of the European Union but not entirely to Mercosur. Although there was a threat to regional security, the motivation to form Mercosur was economic and guided by principles of neo-realism: “*integration as a measure by which to increase individual and collective powers vis-à-vis international hegemony* (Mukhametdinov, 2009).

Mukhametdinov (2009) emphasizes on the power asymmetry in Mercosur and its impact on the integration process. However, first, he notes that the size of Mercosur itself in comparison to the EU spells stark differences between the blocs. Mercosur only has four members, while the EU has twenty-eight members. It is easier for Mercosur members to adopt a policy changes based on consensus, wherein they can alter the policies based on their domestic preferences, as opposed to the majority voting procedure for decision making in the EU among 28 members. The other difference between the blocs is in the intra-regional balance of power. The power symmetry in Mercosur is sharply skewed in favor of the giant, Brazil, which accounts for about two-thirds of land and population. This can hinder policy harmonization in the bloc. It is easier for Brazil to negotiate unilaterally, rather than awaiting consensus in the bloc for a common commercial policy. Even in terms of the market availability, Brazil’s domestic market is bigger than the rest of the intra-bloc markets together, leading to low dependency on the internal market. Since the rest of countries are relatively small, their dependency on the bloc for trade is more pronounced than that of Brazil; particularly, the two smallest states (Paraguay and Uruguay) are highly vulnerable to economic volatility and political changes in their larger neighbors (Malamud and

Schmitter, 2006)³³. In contrast, EU's power structure is distributed equally between France, Germany, Italy and Spain along with many small countries that are willing to reconcile with a supranational authority, leading to a dynamic bloc. "*However, the asymmetrical relationship among the Mercosur countries and the hierarchical structure of Mercosur is seen as an obstacle to the creation of supranational authority*" (Fabbrini, 2008).

It is widely believed that the difference in the ages of the bloc is an important determinant of the regional institutional structure. As mentioned earlier, Mercosur was formed in 1991 but the EU members began their journey together back in 1951 and had more time on their hands to develop a deeper and stable institutional structure. However, like the EU, Mercosur does have a number of institutional agencies to assist the functioning of the bloc, but they do not possess the same level of competency. This young bloc along with weak institutions has also failed to fully internalize the common law adopted by the CMC in Mercosur (Mukhametdinov, 2007). Mercosur still maintains intergovernmental structure and does not have a corresponding structure to the supranational European Commission that regulates and promotes economic cohesion in the bloc. Hence, the question of limited intergovernmental institutions and their functionality persists in the case of Mercosur. De Oliveira (2005) offers an alternative view: Intergovernmentalism has been for centuries a viable mechanism for dealing with international issues and can be presented in different forms of periodical meetings of national leaders or policymakers to discuss common problems. The option taken by Mercosur *avoided the creation of a large and expensive set of supra-national organizations that would not have political power, that would conflict with national institutions* and special bodies dedicated to international issues.

In economic terms, the comparison continues. Economic interdependence is a product of *neo-functionalism*, which rests on the main assumption that increased levels in economic and social interaction leads to economic integration and policy harmonization through convergence of demands within and among the nations (Mutimer, 1994; Lindberg, 1963). In Mercosur, this level of interdependence is quite low as compared to the EU, which reflects the low dependence of Mercosur members on the common market than their EU counterparts (Mukhametdinov, 2007). This can

³³ This theory has also been examined in the following chapters of this thesis.

be further explained by the enormous territory and the deficit of cross-border infrastructure, which has restricted intra-bloc commercial trade among Brazilian and Argentine provinces. Moreover, EU has been facilitated by short distances and well-developed cross border infrastructure, scarcity of which, is prevalent in Mercosur. Thus, the efficiency of the common market can be explained by the infrastructural development, and thus the freight charges across the major cities and ports in the region (de Oliveira, 2005).

It is also apparent that Mercosur's success story was a consequence of its external liberalization and globalization, rather than intra-regional liberalization. Its regional market is less important to the countries than in the EU, leading to poor enforcement of legal protocols and dispute settlement. Further, since EU already has a common currency in place, unlike in Mercosur, the higher economic and financial interdependence is not shocking. Another glaring difference between the two blocs and their experience is their past. While Mercosur had an epoch of colonial pattern of production and trade in primary products that excluded them from accumulation and technological progress, EU industrialized fairly earlier. This experience in the south, and low economic interdependence forced the countries to liberalize and form a common market to develop a regional market for products produced by their newly industrialized manufacturing sectors (Mukhametdinov, 2007).

The last obvious difference between the blocs can be attributed to the concept of regional homogeneity and heterogeneity. According to several studies (de Lombaerde and Pineda, 2002; Hofstede, 2001), Mercosur has one of the highest levels of cultural homogeneity, in the world, which offers opportunities for the building of regional policies. On the other hand, in the European Union, there are significant cultural differences between the member states, with the highest level of bilateral cultural distances and also the highest level of heterogeneity. This heterogeneity alone justifies the existence of a supranational agency to coordinate different ideas of economic and political policymaking in the EU, and also defends the lack of in Mercosur.

Despite the myriad of differences that have been highlighted in the rationale for the formation of the European and South American regional blocs as well as in their respective integration processes, there are a few similarities between them. De Oliveira (2005) emphasizes that both the regional initiatives have *successfully* implemented the

model developed by them, based on the common motivations of improving regional security and using natural resources to enhance integration. Mercosur's trajectory has been stable and has succeeded in a steady transition to global insertion for all its members through intergovernmental coordination, despite the absence of a supranational institutional structure. They have "*taken a prudent and pragmatic approach given the historical and political limitations, rather than as ideological one*". "*Regional integration is an endogenous process*" (Malamud and Schmitter, 2006) that must be applied in a way consistent with the economic and political realities of the region. Moreover, the structural and geographical differences between EU and Mercosur are well documented and been presented in this chapter, hence it is not viable to make a comparison between them (Lawrence, 1996).

CHAPTER 3: EVOLUTION OF TRADE POLICY

INTRODUCTION

We had discussed in the previous chapter that Argentina and Brazil had signed the Treaty of Asuncion in 1991 to form a free trade area between four countries in the region including Paraguay and Uruguay that lay the foundation for the establishment of a customs union by 1995. Theory predicts that these four countries would be natural trading partners owing to low transportation and communication costs (Kose and Reizman, 1997), as well as a strong regional bias due to their geographic locations (Krugman, 1991). Shared historical relations, similar language and cultural affinity increase this bias to trade with regional neighbors. Perroni and Whalley (2003) have thus cited the reliance on trade as one of the enabling factors of the Mercosur agreement.

The literature review presented in the previous chapter highlighted the rationale for the formation of Mercosur in economic and political terms. The formation of Mercosur was not solely about bigger markets and economic growth; rather, the integration also promoted domestic political stability, democratic consolidation and promotion of regional economic interdependence (Kaltenthaler and Mora, 2002). At first, it was a strategic geopolitical project aimed at bringing Argentina and Brazil together, but it soon developed strong economic objectives (García, Pabsdorf and Herrera, 2013).

For Brazil and Argentina, the adoption of an open-door policy with its regional neighbors through the Treaty of Asuncion was a departure from the inward-looking import substitution policies that they both had followed in the past. It was an attempt to relaunch their economies in the global scene, reconcile differences with their traditional rival through political harmony and closer economic ties. Simultaneously, they began to realize that despite this integration effort they would continue to remain an unstable region due to severe external pressure, especially from the United States in terms of trade competition and came together to protect the region from this external pressure (Mecham, 2003).

For Paraguay and Uruguay, the eagerness to join Argentina and Brazil in a free trade agreement (FTA) was embedded in the need to secure a preferential market access in their biggest trade partners, Argentina and Brazil; it was also an insurance against any future trade wars that could be extremely destructive for these small economies. Another possible explanation could be related to the innocent bystander problem. Krugman (1991) has described this as the exclusion from a free trade agreement between big countries can lead to welfare losses; these losses are exacerbated if one is excluded from a customs union as opposed to a free trade agreement; it can lead to an increase in joint retaliatory power of the bloc vis-à-vis the rest of the world. On the contrary, entry into a customs union can also increase the bargaining power of small countries in multilateral negotiations (Whalley, 1996) and incentivize them to harmonize their trade policy with larger member countries.

In Mercosur, the Common External Tariff (CET) is harmonized and internalized by all the four countries. However, there exists a list of national exceptions in addition to complete exclusion of the automobile and sugar industries (Laird, 1997). The exceptions provide flexibility to the members states to follow an independent trade policy. Today, the countries are very different, and the trade integration efforts have been different as well (Leipziger, Frischtak, Kharas and Normand, 1997).

The first hypothesis of this thesis as stated in Chapter 1 was that the drive towards a common external trade policy amongst members of an RTA results in greater policy harmonization among the members states of the bloc. This can be achieved if an RTA is able to establish strong institutions for the implementation of the agreement. In the absence of such institutions, the trade policies pursued by the bloc members is determined by the interplay of policies formulated by national authorities. Further, small members of the bloc will display greater adherence to the rules of the agreement as compared to the larger members. This hypothesis is tested in this chapter. Argentina and Brazil are the larger members of the Mercosur bloc, while Paraguay and Uruguay are the smaller members of the bloc.

This chapter focuses on the evolution of trade policies, major historical reforms and macroeconomic developments in the four members of the bloc, namely, Argentina, Brazil, Paraguay and Uruguay. These countries have had different growth experiences that have influenced their dependency on trade with other bloc members and shaped

their overall trade policies. The two bigger countries historically followed an import-substituting industrialization policy to promote the diversification of domestic manufacturing sectors and protect them from international competition. Together with the focus on a large domestic market, this resulted in low reliance on trades. Today, vestiges of the policy-orientation of the past reverberate even after three decades as the two countries continue to protect their internal industrial base and promote high national content in production through implementation of high tariffs on raw materials and intermediate goods (Foxley, 2010, pp.20).

On the contrary, the two smaller members are heavily dependent for trade with their regional neighbors and the rest of the world; these export-led economies are competitive in the production of a few commodities and are focused on exploring trade opportunities beyond the regional markets. Thus, it is expected that they would display greater policy harmonization with the overall agenda of the bloc. The country analysis for these countries will thus test this hypothesis.

As mentioned in the previous chapters, the formation of Mercosur was based on the historical relations among the four members, given the need to enhance regional trade relations and cooperate on international issues. As a result, the countries agreed to coordinate their external policies and adopted the common external tariff as well. This chapter analyses the extent of policy alignment in the four countries with the overall agenda of Mercosur. It also comments on trade preferences beyond the scope of the bloc's commitments, including the exceptions to the CET, the move to promote multilateralism and the emphasis on greater South-South trade by the members. The trade policy of the bloc was also influenced by external pressures such as the United States' foreign policy towards the South American continent in the nineties in the form of the FTAA negotiations, and the rise of China in 2000s. These instances have also been highlighted in the following sections.

Finally, the nature of the tariff regimes in Argentina and Brazil have evolved in every peak-trough economic cycle through, alternating between periods of protectionism and trade liberalization; while those of Uruguay and Paraguay have remained fairly stable since the inception of the bloc. These dynamics have also been analyzed for each of the members in their respective country-analysis. The chapter is organized as follows: the first subsection presents the trade policy analysis for Argentina, followed by the

analysis for Brazil, Paraguay and Uruguay. All four of the country analysis share similarities albeit the differences that exist, exacerbated by asymmetries in size. This comparative analysis is highlighted in the concluding section that also comments on the extent of policy harmonization in the bloc.

ARGENTINA

Argentina is an agriculture-based economy and is naturally endowed with arable land and conducive weather conditions to maximize crop yield. Since 1961, Argentina has been a large exporter of wheat and maize; while production of soybean only began in early seventies. However, its position in global agricultural exports has been limited by periods of export restrictions in the form of export taxes and non-tariff barriers. Although there is evidence to suggest that Argentina has been applying export restrictions since 1955, with the exception of the trade liberalization efforts of the nineties, it was only recently in the period 2002-2012 that the government imposed very high export taxes, ostensibly to generate fiscal revenue, promote domestic industry using tariff escalation and to ensure a stable internal supply of food through price control mechanisms³⁴. Here the agricultural dichotomy is obvious: while the agro-food industry comprised the largest share in the exports of the country, it also contributed significantly to tax revenue collection (Regúnaga and Rodriguez, 2015, pp.1).

Argentina is characterized as a “closed economy” in the post-war era and remained this a situation close to “autarky” till the mid-1970s. It was only after a decade of economic decline and devastating bout of hyperinflation that a holistic program of reform in the form of trade liberalization was adopted to reintegrate Argentina in the world economy. Mercosur’s formation in 1991 coincided with these reforms, backed by the urgent need to reconcile differences with its closet neighbor Brazil (Galiani and Somaini, 2018). Thus, Argentina’s economic performance has been very uneven, marked with

³⁴ In particular, export taxes rose from 2002-2012 in line with international food prices due to the increase in a demand from China and India. In 2008, the peak tax was on soybean at 35 percent, 23 percent on wheat and 20 percent on maize (Regúnaga and Rodriguez, 2015, pp.7-10). To some extent, given the position of Argentina in the global exports of these products, these domestic taxes restricted global supply and pushed up prices even higher.

alternating periods of high growth and severe recession. The economy has oscillated between vicious and virtuous cycles; the hyperinflation and growing external debt crisis of 1989 and the accumulation of a large public debt that led to a banking crisis in 1999-2002 led to downturns in the economy, while, the pro-market reforms in 1991 and the post-2002 favorable international conditions set in motion two virtuous cycles (Braun, 2006). This *stop-go pattern* of economic growth increased income disparities in the country as policymakers were unable to harness the ‘fruits of growth’ in the prosperous period to protect the economy from periods of deceleration and external shocks. The Argentine export-led agricultural sector has also remained exposed to weather-related phenomena and international price fluctuations that have had severe economic impact on the country’s growth.

This country-analysis of Argentina narrates the path of its trade policy since the postwar era, marked by persistent macroeconomic disturbances and efforts to increase participation in global trade. It also delves deeper into some of the key policy changes at the time of the country’s worst crises that occurred in 1989 and 2002 and comments on their impact on the trade policy of the country. It is important to highlight that in the beginning of the twentieth century, Argentina was a rich economy with a lot of potential but it “snowballed” into a macroeconomic mess due to its restrictive domestic policies. In retrospect, the stop-go path of its economy was clearly dictated by the “confused” state of its policymaking, swinging between populist and elitist ideologies.

This subsection on Argentina is divided into four distinct phases in the evolution of the trade policy in Argentina. The first phase is the post-war era characterized by an import substituting industrialization (ISI) policy supplemented by exports of agricultural goods despite restrictions on exports. The next phase begins at the end of the ISI policy in the eighties, marked by macroeconomic failures that ended in an external debt and the worst rate of hyperinflation in the world. It describes the IMF-led restructuring policies and trade liberalization efforts in the nineties to increase the external orientation of the economy that coincided with the inception of Mercosur, a step towards closer ties with regional partners. The third phase highlights the subsequent debt crisis of 2002. Finally, the last phase began in early 2000s and was characterized by large agricultural exports, thus, completing a policy reversal to export-led growth after three decades of persistent

crises. In the end, the present-day tariff policy under the CET regime is presented to complete the analysis of trade policy.

IMPORT SUBSTITUTION POLICY (1950-80s)

At the beginning of the twentieth century, Argentina was considered a rich country, with GDP comparable to that of Canada and Australia. It is hypothesized that Argentina had natural resources that *temporarily* made it rich in periods of high international demand. However, towards the postwar era, Argentine economy began to decline as it did not share the strong structural and institutional framework with other advanced countries of the time and lacked in human capital, physical capital and access to the latest technology. Argentina was reliant on imports of capital goods and consumed technology from abroad rather than developing it at home (Glaeser, Tella and Llach, 2017; The Economist 2014). After the Second World War, Argentine policymakers realized that this dependency on capital imports could potentially hurt the economy and took protective measures that reduced imports of heavy machinery and intermediate capital inputs. The new domestic policy was focused on *import-substituting production of industrial goods* to reduce the import bill, especially in periods of low export earnings. This protectionist stance also promoted industrialization in the economy during the fifties and the sixties (Hirschman, 1968)³⁵.

Argentina pursued an import substitution policy from the early fifties, but it also remained largely dependent on imports of heavy machinery, intermediate inputs and other capital goods. The objective of the ISI policy was to reorient the economy from just a commodity exporter to one that had a more resilient manufacturing sector. This was a direct application of the Prebisch-Singer hypothesis³⁶, according to which, the terms of trade between primary goods and manufactured goods tend to decline over time. Hence, countries that are dependent on exports of primary goods such as agricultural goods or natural resources must use the foreign currency thus earned to import capital goods for one, greater mechanization of agriculture and two, to transform their industrial sectors (Singer, 1948, pp.4; Prebisch, 1950, pp.6). The policy inference

³⁵ Accessed at: https://www.jstor.org/stable/1882243?seq=1#metadata_info_tab_contents

³⁶ Raúl Prebisch was the most well-known and famous Argentine economist. He developed his ideas in his seminal study in 1950. Shortly earlier, Hans Singer published an article on similar lines in 1948.

of this would be a move favoring production of manufactured products through policies directed at industrialization and tariff protection (Toye and Toye, 2003). Argentine policymakers borrowed this argument from Prebisch-Singer hypothesis and shifted the focus to import substituting industrialization policies in the early fifties, through reduction of the import-dependency by offering protection to the domestic manufacturing sector (Taylor, 1994).

This policy involved a high degree of central planning, combined with protection of trade through tariffs, duties, exchange rate manipulations, quotas and exchange controls. However, this inward-looking policy has an adverse effect on the agricultural sector as it was subject to pervasive policy intervention that ultimately promoted other sectors at the expense of agriculture (Schnepf, Dohlman and Bolling, 2001). Paolera, Amorocho and Musacchio (2018) highlight that “*the golden years of the ISI for Argentina were the 1950s up to the early 1970s. The Peron administration (1946-1955) opted—by default—for an inward-looking industrialization model*”. They also note that such policies intended to promote industrialization in several stages. The government followed a series of policies to sequentially promote new industries with higher value added and more technological complexity.

Paolera, Amorocho and Musacchio (2018) note that initially, the government promoted “consumer goods and basic building materials industries because of their simple technology and their low capital requirements”. Then, governments supported “more complex consumer goods industries, which required more sophisticated technologies and higher capital requirements”. In 1960s, the state-owned enterprises already controlled the basic sectors of the economy such as iron, steel and petroleum, energy generation, telecommunications and transport. However, production of vehicles, pharmaceuticals, petrochemicals, tobacco, agricultural equipment and food processing was carried out by private firms, both domestic and multinational corporations (Paolera, Amorocho and Musacchio, 2018).

In this stage, the focus was on production of consumer durables, such as household appliances, means of transport like scooters, motorcycles, motor vehicles and trucks, that were first assembled and then began to be manufactured with up to almost 100 percent local content in Argentine territory (Teitel and Thoumi, 1986). Moreover, domestic production of machinery and industrial equipment was also boosted in this

period. This exerted pressure on the iron and steel industries and called for their immediate expansion, along with deepening of aluminum, basic chemicals and petrochemical industries through government promotion. This was the final stage of the import-substituting industrialization (ISI) policy in Argentina. Teitel and Thoumi (1986) note that the economy had already shifted towards domestic production of metallurgical and chemical based intermediate products and more complex capital goods by the mid 1970s.

“Argentina was the front-runner in the process of industrialization in the first part of the twentieth century, despite the fact it was experiencing a sustained export-boom based on primary products” (Paolera, Amorocho and Musacchio, 2018). However, it is believed the policy diverted resources and investment from the export-oriented agricultural sector that in turn, reduced the capacity to export. One would expect that as the policy ran its course from the fifties to the eighties, Argentina would have begun to export manufactured goods with high value addition and replaced agricultural exports. However, as the focus was on *‘import substituting production* for the domestic market, little effort was actually made to export manufactured products in the period (Narula, 2002). Even as late as 1985, manufacturing exports from Argentina were just 21.4 percent of total exports, and primary sector exports still made up the chunk of 78.6 percent of total exports (World Development Indicators, World Bank). This clearly meant that Argentina continued to export agriculture-based commodities in line with its historical economic structure. While the government implemented the import-substituting industrialization policy for a few decades, the economy returned to its historic agricultural roots towards the end of the twentieth century and re-focused its industrial policy to expand exports of agro-based products. This coincided with the creation of the *Cairns Group* in 1986, a coalition of 19 agricultural exporting countries committed to achieving free trade in agriculture.

During the eighties, on one hand, Argentina was advocating greater market access for its agricultural exports and elimination of export subsidies by developed countries; on the other, approximately half of its domestic products, including agricultural goods were still protected by quantitative import restrictions; more than 7,000 tariff lines were subject to import licensing and imports of consumer and capital goods were prohibited altogether. Average tariffs were in the range of 43 percent, in addition to import taxes.

Once the ISI policy ended in late seventies and the government lifted some of the import barriers, the economy witnessed a massive surge in imports, that led to an external debt situation in the eighties. This debt along with bloated the government expenditure and the largely inefficient production schemes combined to cause chronic inflation, which continued to rise throughout the 1980s. The declining international commodity prices for Argentine exports further hindered the government's ability to pay the external debt that led to a situation of hyperinflation in the late eighties. "During that period, Argentina's yearly inflation rate averaged a remarkable 300%, but worse even, for a brief period in 1989, the government completely lost control of the economy, and the inflation rate surpassed 1000%" (Manzoni, 2018).

MACROECONOMIC FAILURES AND THE PERONIST REFORMS (1980-1991)

Argentina followed a comprehensive policy of import-substituting industrialization for almost three decades. However, instead of delivering a steady path of inward oriented path, the strategy resulted in bumpy cycles of economic expansion, followed by sharp recession in Argentina in the nineties (Galiani and Somaini, 2018). As mentioned in the previous section, Argentina continued to be dependent on commodity exports and was vulnerable to changes in global commodity prices. These prices fell sharply in the early 1980s, leading to a huge trade loss and a large rise in its external debt in the late eighties.

The ratio of domestic public debt to GDP rose from 10 percent in 1981-82 to 16 percent by 1987-88. External debt also grew rapidly, relative to GDP, over the same period from 23 percent to 38 percent. Consequently, there was a sharp increase in total public debt, from 36 percent of GDP in 1981-82 to 52 percent of GDP in 1987-88 (IMF, 1991).³⁷ These developments in the eighties primarily reflected the combination of severe recession and extraordinarily high inflation not only in Argentina, but in Brazil, Mexico and Uruguay as well. It was a classic case of fiscal and monetary excess as the recently elected government that ended military dictatorship after six years tried to consolidate its political power before regaining control of the economy that was suffering from a widening debt. The government tried print more money to tackle this debt, but that led to surplus liquidity in the economy and contributed to the rising inflation. Notably, in the period 1989-90, hyperinflation in Argentina and Brazil

³⁷ Accessed at: <https://www.imf.org/external/pubs/ft/ar/archive/pdf/ar1991.pdf>

reached an average of 770 percent, with a peak in Argentina at 5000 percent.

Argentina had been trying to secure a financial package from the Fund since the beginning of the debt crisis in 1983. However, during early eighties, IMF's role was limited to providing short-term solutions in the form of fiscal, monetary and wage policy tightening along with maintaining a competitive exchange rate from devaluation. This involvement of the IMF was aimed at only restoring the relationship between Argentina (debtor) and commercial creditors and ensure stability of the international banking system (IMF, 2001). It failed to correct the long-standing issues of fiscal indiscipline, weak institutions and actions of political agents with short horizons (Braun, 2006).

Galiani and Somaini (2018) note that it was only after a long period of absolute economic decline and a devastating bout of hyperinflation that a comprehensive program of reform and integration into the world economy was adopted by Argentina in 1989. This long-term structural adjustment program was based on the new recommendations by the IMF that were aimed at restructuring the public debt through privatization of state enterprises, liberalization of prices and simplification of regulations. The newly elected government under the Peronist President Menem introduced "neoliberal reforms based on the Washington Consensus"³⁸ (Salvia, 2015)³⁹. As the first step, the Economic Emergency Law (*Ley 23.696 de Emergencia Económica*) and State Reform Law (*Ley 23.697 de Reforma del Estado*) were enacted by the Congress, granting extensive legislative powers to the new government (Bambaci et al, 2002). "The first of these laws dismantled most of the institutions related to the state-centered, inward-looking development model: subsidies, industrial subsidy regimes, etc. The second one conferred vast power to define the details of the reform policies, including the privatization of state-owned enterprises."

Nicknamed the 'Bunge y Born Plan' (Beckerman, 1995)⁴⁰, the reforms were characterized by three central measures: firstly, the *Convertibility Law* was introduced

³⁸ The term was coined in 1989 and the first usage was to examine the extent to which the old ideas of development economics that had governed Latin American economic policy since the 1950s were being swept aside by the set of ideas that had long been accepted as appropriate within the OECD (Williamson, 2004). Accessible at: <https://piie.com/publications/papers/williamson0904-2.pdf>

³⁹ Accessed at: http://www.scielo.br/scielo.php?script=sci_arttext&pid=S0101-31572015000200325

⁴⁰ Accessed at: <http://www.jstor.org/stable/158487>

by the Minister of Economy Domingo Cavallo in June 1991 that pegged the peso to the US dollar at the parity rate of one-to-one (ARS\$1 = US\$1). Under the new arrangement, which was referred to as the 'Currency Board', the Central Bank was no longer able to print money to finance fiscal expenditure, i.e. it prevented the executive from canceling debts by simply issuing more currency. The law stated that money supply would be fully backed by liquid international resources in the form of either gold or foreign exchange. This law excluded the possibility of devaluation by the government, that used to make Argentine exports seem more competitive in the international market. The companies that once relied on *peso devaluation* were now forced to face international competition and compelled to increase productivity and quality of their goods.

Secondly, *trade liberalization efforts* were made involving the simplification and reduction of import tariffs, non-tariff barriers, and elimination of export taxes (Viguera, 2000). This made imports of capital goods and finished goods cheaper that generated a pressure on domestic industries to increase labor productivity to survive increased competition from imports. The trade liberalization policy was aimed at re-launching Argentina in the international multilateral trading system and was also met with the formation of the regional bloc Mercosur (*Mercado de Sur* or the Southern Market) in 1991. Lastly, to supplement this new regime, President Menem also undertook market oriented structural reforms in the form of a widespread privatization of state enterprises (for example, airline and telecommunication), an effort to promote efficiency and productivity in the economy; he also introduced fiscal reforms through simplification of the tax system and strengthening of the tax collection agency (Bambaci et al., 2002).

Subsequently, by the end of April 1991, financial support (in the form of standby credit) for debt and debt service-reduction operations had been approved by the IMF for various Latin American countries including, Argentina, Mexico, Uruguay, and Venezuela. Overtime, however, its role broadened to include crucial steps to restructure the debt and restore growth in Argentina in 1991. This was carried out in the form of 'IMF conditionalities' that accompanied the final financial package in 1991 to tackle the situation of hyperinflation and burgeoning public debt. Argentina used this IMF package to implement financial policies aimed at macroeconomic stability and to gain access to international financial markets. The authorities introduced the new system to guarantee that there would be no more discretion in monetary matters and that the

Central Bank would definitely stop offering credit to the government (Galiani, et al, 2003). This also opened up access to the international financial markets.

As a result of the new policy, Argentina grew at 6 percent per annum in the period 1991-1998 (IMF, 2004), and led to a stable investment climate that supported an increase in international financial inflows, including portfolio investment and direct investment. There were a few pullbacks from external events unfolding in the world. For example, the Mexican depreciation “*Tequila Crisis*” in 1995 created financial disturbance in the region, but gave an impetus to the privatization of banks in Argentina by the Menem government.

However, overall, the nineties decade witnessed a sharp increase in foreign trade volumes and the growing significance of trade in the GDP as well. Exports grew by an annual average rate of 10 percent from US\$ 12.353 billion in 1990 to more than double its value of US\$ 26.441 in 1998. Similarly, imports grew at an annual average rate of 29 percent in the same period from US\$ 4.1 billion to US\$ 31.4 in 1998 (Fig 1). In addition, strong international commodity prices of the mid-1990s provided a powerful incentive to invest in agriculture and expand production. This increased competitiveness and efficiency in the agricultural sector. A period of high crop prices shortly after the initiation of economic and policy reforms enabled Argentine farmers to take advantage of the increased market orientation. With liberalized trade and strengthened market signals, imports and use of agricultural inputs and technology also increased markedly throughout the 1990s (Schnepf, Dohlman and Bolling (2011)⁴¹.

Argentina along with the other Mercosur members, pursued growth in the nineties; marked by a shift from a model founded on import substitution to one based on opening up their domestic and external markets. The formation of the Mercosur bloc came at a time when Argentina’s new government under President Menem had launched a comprehensive trade liberalization policy, with the aim of re-integrating Argentina into the *community of nations*. “Mercosur was the crucial victory of neoliberal right-wing governments in the four countries of the bloc in the early 1990s, namely: Menem (in Argentina), Collor (in Brazil), Lacalle (in Uruguay) and Andres Rodriguez (in Paraguay).” Such openness, although sudden, was the only solution in the time to solve

⁴¹ Accessed at: https://www.ers.usda.gov/webdocs/publications/40339/15081_wrs013_1_.pdf?v=

the economic stagnation that has embraced these countries in the 1980s. Mercosur appeared to achieve a rapid recovery from the crisis that rocked the member countries in the eighties, also regarded as a *lost decade*. (Bastos, 2004)⁴².

Starting from 1985, there was an attempt to increase bilateral integration between Argentina and Brazil. In July 1986, following the Iguazu Act of 1985, the presidents signed the *Act for the Integration of Argentina and Brazil* consisting of 12 protocols including capital goods, land transport, binational enterprises, food complementarity, iron and steel industry, energy, among other. Till 1989, twenty-four such protocols were already signed. Finally, a *Treaty of Integration and Cooperation* was signed in 1989 to create *free trade zones* in the next five years, followed by the creation of the *Common Market Group* in December 1990. The Partial Scope ECA No. 14 that included all previous agreements and the *Treaty of Asunción* that created the *Mercado de Sur* or the Southern Common Market (Mercosur) was signed in March 1991. It was then broadened to include Paraguay and Uruguay was signed in March 1991 (GATT, 1992). The *Ouro Preto* protocol was signed in 1994 that gave Mercosur a legal personality.

The regional agreement was created as an instrument to facilitate, jointly determine and drive the integration of these four economies as the international economy entered a new stage of globalization (Valliant, 2005). Countries around the world began to engage extensively in multilateral trade and laid the foundation for the formation of the WTO through the Uruguay Round in 1995. At the same time, countries in the Americas and Europe took steps to foster deeper regional integration through free trade initiatives, for example, NAFTA as created in 1994 and the EU was formed in 1993 through a series of regional efforts. Mercosur was formed at this time when globalization was at its peak and countries were widely adopting the Washington Consensus's trade liberalization package that extended domestic factors beyond the national borders (Brainard, 2001)⁴³.

Mercosur was a platform for connecting to the rest of the world as well as creating a larger domestic market, through promotion of free trade and fluid movement of goods, peoples and factors of production. As indicated earlier, Mercosur free trade zone finally

⁴² Accessed at: <http://www.tnc-online.net/pic/20130711080705779.pdf>

⁴³ Accessed at: <https://www.brookings.edu/research/trade-policy-in-the-1990s/>

came into effect in 1995, with the application of a common tariff policy regarding third countries, through a Common External Tariff (CET), subject to few national exceptions granted to each member. The creation of Mercosur could not have come at a better time for Argentina and is said to have marked a drastic change in the trade policies of all the members, especially Argentina: “*What had once been a classic case study of inward-looking import-substitution policies, protectionism and economic mismanagement was now one of the most open economies in the world*” (GATT, 1992)⁴⁴.

DEBT CRISIS AND THE END OF THE CONVERTIBILITY REGIME (1998-2002)

An UNCTAD Report (2013)⁴⁵ notes that while trade integration can help promote economic growth and industrial development, it also exposes the domestic economy to external financial shocks. Despite the reforms undertaken by the Menem government to gradually open up the Argentine economy to international trade, ease inflation and reduce external debt, Argentina was once again faced with a rising public debt in the late nineties caused by several international factors. For example, in 1998, Argentina was faced with multiple external shocks, starting with the appreciation of the US dollar against other countries, the contagion from the Asian crisis in 1997 and the Russian default in 1998. These breaks in developing countries increased the country-risk premium that drove up the interest rates in Argentina as well.

Simultaneously, Argentine exports lost its competitiveness in the region due to the Brazilian devaluation (relative revaluation of the peso) and declining global prices for argentine exports added to the distress. As a result, Argentina’s export earnings fell by 10 percent in the second half of 1998 (relative to the first half), while growth in volume terms was reduced to less than 2 percent from 15 percent in 1997 (IMF, 2003).⁴⁶ This affected the overall domestic demand and increased the external indebtedness of the economy. Consequently, public debt increased from 10 percent to almost 50 percent of the GDP in 1999-2000. The privatization carried out under President Menem in 1991 had already increased the number of pensioners, and the rising unemployment in 1998-

⁴⁴ GATT, Trade Policy Review Mechanism, Argentina, Report by the Secretariat, documents C/RM/S/18A, C/RM/S/18B and C/RM/G/18, dated Nov. 8th, 1991; C/RM/M/18 dated May 14th, 1992

⁴⁵ Accessed at: https://unctad.org/meetings/en/SessionalDocuments/cimem5d2_en.pdf

⁴⁶ Accessed at: <https://www.imf.org/external/np/pdr/lessons/100803.pdf>

2000 from 12.5 percent to 15 percent added to the stress in the economy (IMF, 2003; Motamen-Samadian, 2006).

This situation finally led to a severe economic crisis that was a result of mismanagement of not just the fiscal policy, but the monetary and external policy as well. The growing public debt (*fiscal crisis*) was exacerbated due to an overall reduction in fiscal discipline in the economy that led to banking weakness as well. The banking system repeatedly made efforts to bail out the government by helping it repay its large outstanding debt that led to draining of bank reserves and controls on public withdraws (*monetary crisis*). Subsequently, the financial system collapsed due to a bank run. Finally, in 2002, the government defaulted on the sovereign debt given that devaluation was not an option as the peso was pegged directly one-to-one to the US dollar (*external crisis*). Consequently, Argentina was forced to abandon the convertibility regime that meant the peso was no longer pegged directly to the dollar. The peso was allowed to depreciate to half and then one fourth to a dollar and as a result inflation also stabilized at 14 percent by late 2002. Overall, between 1998 and 2002, the economy shrank by 28 percent (Saxton, 2003).

The role of the IMF in Argentine crises in 1989-2002 is undisputable. The IMF continued to support the failing Argentine policies despite repeated inadequacies, for example, IMF supported Argentina's effort to preserve the exchange rate regime in the period 1999-2001 with a commitment to supply of monetary resources. However, IMF could have exercised surveillance to ensure the choice of exchange rate regime chosen in 1991 was suited to Argentine political and economic situation; and could have shown restraint in providing excess financial support at the time of the policy failure in 1998. Had these resources been used to mitigate the crisis situation by helping the economy abandon the convertibility regime, Argentina's growth would not have plummeted so far (IMF, 2004).

THE COMMODITY PRICE SUPERCYCLE (2002-2011)

Argentina's emergence from a four-year long depression in the economy coincided with a momentous rise in global commodity prices (termed as the *supercycle*) in 2002. The prices of food crops, meat, minerals, metals and fuels rose between 2002 and 2008. A World Bank report (2016) notes that South American countries like Argentina were

uniquely exposed to the international price turbulence, given the commodity-dependence of their export structures. The robust growth observed in the region over the decade of the 2000s is also an important reflection of the connection with China, both directly (trade and inward FDI) and indirectly (China's role in raising commodity prices) (World Bank-LAC, 2011). Following China's accession to the WTO in 2001, the period from 2001-2008 witnessed unprecedented growth in its economy, with an annual average rate of 10.4 percent. This also marked a significant change in how China engaged with the rest of the world as total trade expanded at an annual average of more than 35 percent between 2001 and 2008. China's accession further promoted market access by reducing tariff rates and removing non-tariff barriers, and created a predictable investment climate for foreign investors that promoted China's trade expansion (Zhao and Wang, 2009).

As a result, global demand of commodities, including food, agricultural and animal-based products thus increased backed by the Chinese growth, leading to a rise in international prices of these goods. This dramatic increase in prices led to an improvement of terms of trade for commodity exporters in the Latin American region, including in Argentina (World Bank, 2014). Given, Argentina has been one of the largest exporters of such commodities; and as in 2002, these commodities occupied a 50 percent share in Argentina's export basket (World Development Index, World Bank), Argentina exporters benefited from this price supercycle that lasted till 2011-12. Thus, high export revenue relied on buoyant prices of high-rent commodities and its volume response (World Bank, 2016).

Increased export earnings benefited the small and medium farmers in the economy and also contributed to reduction in poverty levels in Argentina. However, it is believed, the commodity boom caused de-industrialization in the economy: "Because a pure terms of trade price windfall has no output counterpart, *any spending* out of the windfall creates excess demand on impact. In the absence of a local supply response, the increase in demand must be fulfilled through imports. It therefore triggers a *Dutch disease-type problem*. With a fixed supply of non-tradables, the increase in demand raises their price relative to that of tradables, thereby appreciating the real exchange rate, which discourages the production of non-commodity tradables." (World Bank, 2016).

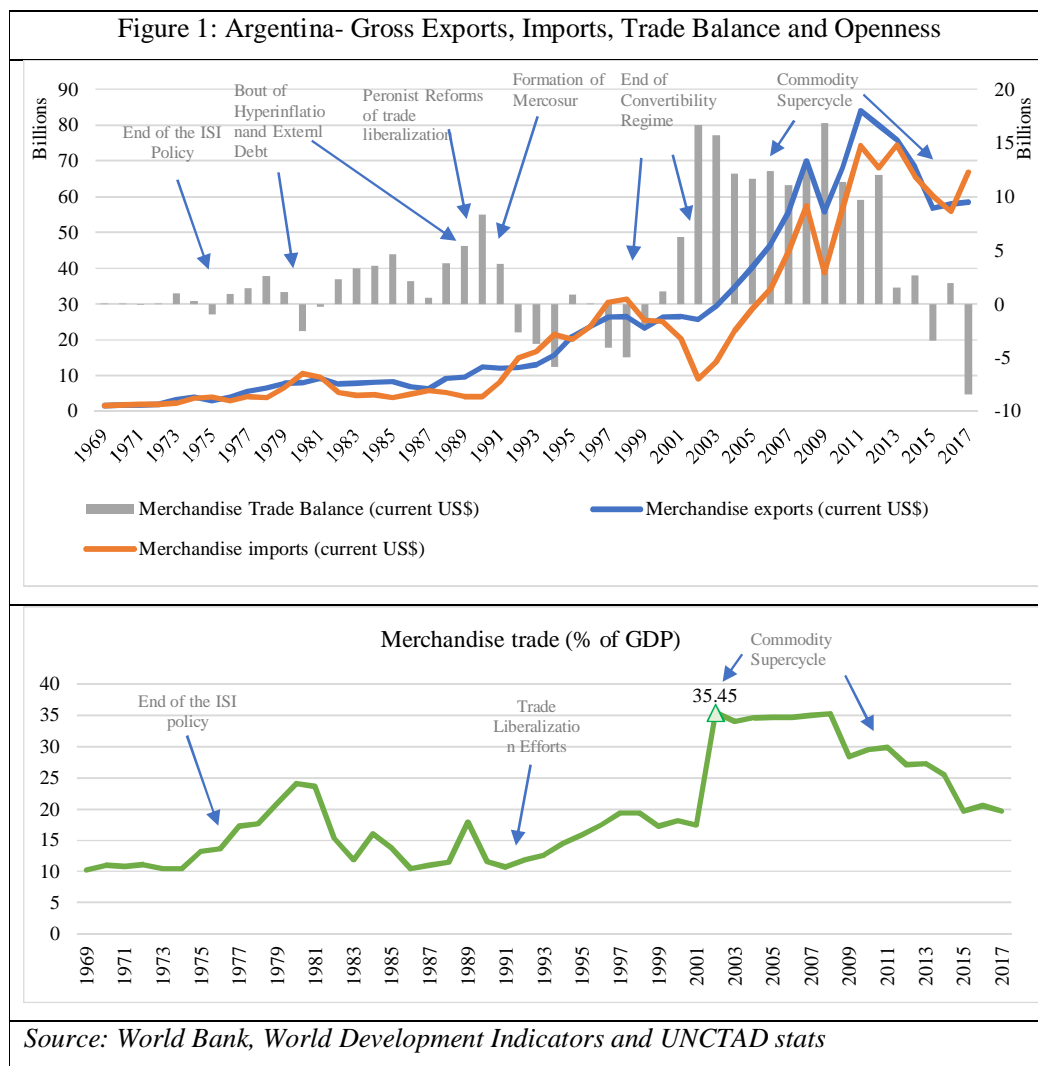
Overall, total exports grew from US\$ 25.7 billion in 2002 to US\$ 70 billion in 2008. However, in the wake of the global financial crisis in 2008-09, total exports fell in 2009 to 80 percent of their value in 2008 (Fig 1). This downturn in exports coincided with a severe drought in Argentina that destroyed crop and cattle alike, thus, affecting their exports of soybean, corn, wheat and beef to the world in the period that followed. According to data reported by United States Department of Agriculture (USDA)⁴⁷, crops took a beating in 2009 as the severe drought had affected corn, cotton and soybean crops such that 2009 crop production was only 30-60 percent of 2008 quantities, depending on the crop. The drought made the cotton crop susceptible to insect pests and the heat wave that followed struck the soybean crops right in the middle of its flowering season. Following this downfall, Argentina imposed a tariff hike on exports of grain in 2008 to protect domestic supply of grain and meat. Moreover, owing to reduced export revenues, the capacity to import declined and total imports by Argentina decreased from US\$ 57.46 billion in 2008 to US\$ 38.78 billion in 2009.

After the slowdown caused by the international economic and financial crisis in 2009, high growth rates of trade were again recorded in 2010 and 2011 (Fig 1). Exports peaked in 2011 at US\$ 82.98 billion, possibly due to better international outlook, conducive weather conditions in Argentina and the ongoing effects of the commodity supercycle (WTO, 2013). Overall goods exports grew at 12.3 percent per year from 2006 to 2011. Imports grew faster at an annual average of 16.7 percent in the same period, and as a result, Argentina managed to record a trade surplus in its total trade with the world. Though both exports and imports expanded in the period 2002-2011, the share of total goods trade in GDP declined from 41.75 percent to 35.2 percent in 2011 (Fig 1). This reflects the growing importance of the domestic component of GDP in Argentina.

International prices that had peaked in mid-2011 began to fall, as the supercycle had run its course by late 2011 due to the end of the upswing in the commodity prices (IMF, 2014). By 2011-12, the economy had decelerated as they met with capacity constraints after a ten-year demand boom (World Bank-LAC, 2011). The end of the boom in 2011 was marked by a slight downturn in export value in 2012 to US\$ 80 billion from their

⁴⁷ <https://earthobservatory.nasa.gov/images/37105/drought-in-argentina>

2011 peak of US\$ 83 billion. This decline in exports and imports continued till 2016, driven by the downward pull of the Brazilian economy, the bursting of the price bubble and the sharp growth deceleration of China (World Bank, 2016). To counter this downturn in growth and trade, the Macri government took a pro-trade liberalization stand in late-2015 and implemented policies that reduced import and export restrictions to open up the economy to the rest of the world. This policy stance was reflected in the upswing of both exports and imports in early 2017. While only exports grew marginally from US\$ 57.7 billion in 2016 to US\$ 58.4 billion in 2017, imports grew by an impressive 20 percent in 2016-2017, from US\$ 55.6 billion to US\$ 67 billion in 2017. Consequently, between 2015-2017, the share of total trade in GDP also rose from 22 percent to 25 percent.



TRADE POLICY IN THE NEW MILLENIUM

The upward growth pattern highlighted in the previous section was possible due to the fairly liberalized trade policy followed by Argentina since the turn of the century. Argentina began to engage in multilateral negotiations, starting with the participation in the G20 to promote development through financial management and coordination between the members; followed by the Doha round in 2001 that called for removal of trade barriers and revision of trade rules, with the overall aim to achieve major reform in the international trading system; and the creating of the NAMA-11 group to advocate for greater market access for non-agricultural products. As mentioned earlier, Argentina was already a founding member of the Cairns group to negotiate for market access and reduction of trade barriers for agricultural goods. The trade policy in the decade of 2000s was highlighted by these multilateral efforts to improve global trade along with unilateral measures to enhance efficiency of trade. The devaluation following the recession of 1998-2002 worked to promote competitiveness of Argentine exports in the market as well. Two of the main multilateral initiatives have been highlighted below:

Cairns group: Through active participation in the Cairns Group, Argentina has been a strong advocate for increased market access for agricultural goods and continues to believe that countries must concentrate to fulfil the Doha agricultural negotiating mandate for achieving overall food security in the world. Developed countries have continued to protect their **agriculture sectors** through series of traditional distortive measures (high tariffs, quotas, export subsidies), aided by the proliferation of scientifically unjustified sanitary, phytosanitary and technical barriers that restrict the development of many developing countries that are primarily agricultural exporters. In 2013, at the Bali ministerial conference, the Cairns Group released a communiqué⁴⁸ calling for elimination of export subsidies on all agricultural goods that are trade distorting; unwavering support for the work done by FAO on establishing food security, limit import restrictions, simplify SPS and technical regulations, improve operations of tariff quotas; and level the playing field for developed and developing countries by

⁴⁸ Accessed at: <https://cairnsgroup.org/pages/131202-communication.aspx#moving-forward>

increasing market access for agricultural exports and ensuring greater discipline of agricultural domestic support (Cairns Group, 2017)⁴⁹.

Nama-11 group: Argentina has also attached vital importance to negotiations on market access for **non-agricultural products** (NAMA) (WTO, 2013). As a result of the Doha Ministerial Conference in 2001, NAMA-11 was created in early 2002 to promote tariff-cutting negotiations on all non-agricultural products. Argentina was one of the founding members, with the aim of elimination of tariff peaks, tariff escalation, non-tariff barriers on all non-agricultural goods, with no a priori exclusions to any of the members. The focus was on exports of particular importance to developing countries, with special provisions for developing, LDCs and newly accessed members. In 2006, at the Hong Kong Ministerial Conference, they adopted the *Swiss formula* for tariff reduction. Countries bound all tariffs in *ad valorem* terms and established the mandate to increase tariff bindings to 100 percent. Argentina has thus insisted on comparable market access for agricultural and non-agricultural goods through the NAMA-11, while maintaining special treatment for developing countries like itself to continue to apply moderate tariffs and formulate policies aimed at increasing employment, widening the production base and increasing social security. Argentina continues to argue that given developed countries still manage agricultural trade through government support, developing countries could also use the same instruments to regulate trade in non-agricultural goods (WTO, 2008)⁵⁰.

Although Argentina has been a strong advocate of greater market access for agricultural goods (Cairns Group) and non-agricultural goods (NAMA-11), it continues to control and regulate its overall trade. One way to explain this paradox is that Argentine multilateral advocacy for increased market access is aimed at reducing *trade-distorting measures* that are used by developed countries to protect their local producers from international competition. On the contrary, it applies export duties and import tariffs to ensure inflow of revenues from these measures; possibly to safeguard the domestic

⁴⁹ Accessed at: <https://cairnsgroup.org/Pages/171211-statement-of-the-40th-cairns-group-ministerial-meeting.aspx>

⁵⁰ WTO, Communication from Argentina, Market Access for non-agricultural products, document TN/MA/W/109, dated Nov. 25th, 2008

supply of food and industrial goods as well as to maintain price stability in its large internal market.

Though the decade of 2000s, Argentina imposed mechanisms to control exports as means of ensuring domestic supply and price stability in the internal market. This unilateral trade measure comes as a stark contrast to the multilateral efforts made by Argentina to liberalize global trade. Under this system, certain agricultural products are subject to official export prices. Moreover, export duties are used to cushion the adverse effect of exchange rate fluctuations that may harm domestic prices, particularly of household items and as a way of ensuring a steady revenue stream to fulfill fiscal needs. With a few exceptions, all goods are subject to such export duties currently ranging from 5 to 100 percent. Historically, Argentina maintained a *value control system* to guarantee the revenue obtained through export duties. For example, products of the mining and forestry origin were subject to one of the lowest export duties ranging from 5 to 10 percent only, and attracted special export subsidies as well. However, in late 2015, under the Macri government, Argentina eased its trade policy by removing some barriers to trade. According to *Decreets 133/2015 and 160/2015 of December 2015*, all export taxes were revised and all export tariffs were reduced or eliminated on agricultural and industrial products. This policy change is a positive step towards a more liberalized Argentine economy. The main exceptions were soybean (30 percent tax) and soy byproducts (27 percent tax) (European Commission, 2016)⁵¹.

Over time, Argentina's use of non-tariff restrictions has increased in the form of registration requirements by exporters and importers, other extensive import procedures and import licensing. All exporters must be registered with the Register of Export Operations (ROEs). In addition to general registration requirements, some exports of cereal, meat and dairy have to be entered in a special register. For example, cereal export operations must be listed in *ROE Green*, exporters of bovine meat in *ROE Red*, and exporters of dairy products in *ROE White*. Moreover, Argentine legislation allows prohibitions to be imposed on exports and imports for economic and non-economic reasons, including reducing unemployment, stabilizing domestic prices and

⁵¹ More information at http://trade.ec.europa.eu/doclib/docs/2016/january/tradoc_154188.pdf

supply, implementing trade policy, protecting domestic production and intellectual property, and safeguarding public health and environment (WTO, 2013).

In general, Argentina applies Mercosur's CET with a few exceptions. However, special industries of national importance like the sugar and automobile industries are excluded from the CET. Up till 2010, Argentina applied minimum specific import duties (DIEMs) that affected 8 percent of all tariff lines, but were abolished in 2010. Thereafter, Argentina only applied ad valorem tariffs on imports. There were ad valorem tariffs on 100 percent of tariff lines and varied between 0-35 percent. In 2017, the simple MFN applied tariff was 13.7 percent, while it was slightly lower at 11.4 percent in 2012 and 10.4 percent in 2006. Notably, in 2017, the MFN applied rate was lower than average for agricultural imports at 10.3 percent, while non-agricultural imports attracted an average of 14.3 percent in 2017 (Table 1). Of the total groups, Petroleum imports had 97.2 percent duty-free lines, the highest in Argentina's tariff schedule. On the contrary, Clothing, textiles attracted the highest average applied duties of 35 percent and 23.2 percent respectively. Other lines attracting high duties were transport equipment (18.4 percent), Dairy products (18.3 percent with zero duty free lines), beverages & tobacco (17.8 percent), sugar (17.6 percent), leather and footwear (16 percent), and coffee & tea (14.3 percent).

However, Argentina's tariff policy remains highly unpredictable as there is a large difference between the final bound tariff rates and the MFN applied rates (binding overhang) for majority of the product groups. This leaves ample room for maneuver with changes in trade policy of the country, for example, the maximum final bound duty for Petroleum products was 35 percent but the MFN applied rate was only 6 percent. On the contrary, products groups like fruits and vegetables, coffee and tea, oilseeds and beverages have a binding overhang of zero percent as the maximum applied rate was equal to the maximum bound rate in 2017. Argentina grants tariff preferences to goods originating in Mercosur members, Colombia, Ecuador, Venezuela, Bolivia, Chile, Cuba, Mexico, Peru, India and Israel.

Table 1: Bound and MFN tariff rates in Argentina

Summary	Year	Total	Ag	Non-Ag		
Simple average final bound	2017	31.8	32.4	31.7		
Simple average MFN applied	2017	13.7	10.3	14.3		
	2012	11.4				
	2006	10.4				
	Final bound duties			MFN applied duties		
Product groups	AVG	Duty-free in %	Max	AVG	Duty-free in %	Max
Animal products	26.5	0	35	8.3	6.5	16
Dairy products	35.0	0	35	18.3	0	28
Fruit, vegetables, plants	33.8	0	35	10.0	5.6	35
Coffee, tea	34.2	0	35	14.3	0	35
Cereals & preparations	33.0	0	35	10.9	14.7	31
Oilseeds, fats & oils	34.6	0	35	8.5	10.8	35
Sugars and confectionery	33.3	0	35	17.6	0	20
Beverages & tobacco	34.7	0	35	17.8	0	35
Cotton	35.0	0	35	6.4	0	8
Other agricultural products	31.0	0.7	35	7.7	10.4	20
Fish & fish products	34.5	0	35	10.4	3.9	16
Minerals & metals	33.8	0	35	10.1	7.2	35
Petroleum	33.6	0	35	0.1	97.2	6
Chemicals	21.4	0	35	8.2	1.4	35
Wood, paper, etc.	30.2	0	35	11.2	3.3	35
Textiles	34.9	0	35	23.2	0	35
Clothing	35.0	0	35	35.0	0	35
Leather, footwear, etc.	35.0	0	35	16.0	2.8	35
Non-electrical machinery	34.9	0	35	13.2	12.8	35
Electrical machinery	34.9	0	35	14.7	11.0	35
Transport equipment	34.5	0	35	18.4	12.0	35
Manufactures, n.e.s.	33.5	0	35	15.7	8.9	35
<p><i>Note: Only duties and imports recorded under HS Chapters 01-97 are considered. National tariff lines that do not follow the corresponding standard HS nomenclature at the level of HS six-digit subheadings used by the country for the reference year were discarded and not considered.</i></p> <p><i>Source: World Trade Organization, Country Profile of Argentina, accessed at: https://www.wto.org/english/res_e/statis_e/daily_update_e/tariff_profiles/AR_E.pdf</i></p>						

With the broader aim of promoting trade in the country, Argentina has introduced special schemes such as *free zones*, special customs zones, temporary admissions regime, subsidies for mining and forestry industries, and special tariffs for capital and ICT goods. In addition, the Investment and Foreign Trade Bank (BICE) also maintains credit lines and post-financing of exports of goods from large enterprises and SMEs alike.

Similar to its neighbor Uruguay, Argentina does not apply tariff quotas except for preferential access given to countries that have signed preferential trade agreements with Mercosur or Argentina on a bilateral footing. These include, preferences granted to the automobile imports from Brazil (as per the Argentina-Brazil automotive agreement), to Mexico, and to the Andean Community.

Most imports in Argentina are subject to a statistical tax of 0.5 percent of customs value up to a maximum value of US\$ 500 or a verification of destination charge up to maximum of 2 percent of customs value. Further, VAT is also payable on imports and the average VAT is 21 percent with a few exceptions. Most goods are taxed at 10.5 percent, while books, aircrafts are exempt from the VAT among a few other goods. Similarly, exports are also exempt from the VAT. Some imports are also subject to excise duties, including tobacco, beverages, motor vehicles, aircrafts, luxury goods, electrical appliances, and mobile phones. Argentina also imposes *other charges* on importation of liquid fuels, natural gas, cigarettes and electric power. However, since 2010, under the *Promotion Scheme for Sustainable Production and Use of Biofuels*, biofuels are exempt from these taxes. Importers must also pay income/profit tax on goods imported, with an exception of bovine animal imports. Following the new trade policy in late 2015, luxury tax for vehicles was terminated.

Imports are also subject to *automatic or non-automatic licensing*. Importers are required to file an application with the relevant authority as a prior condition for importation of goods. Authorities may use the non-automatic licensing regime to administer trade restrictions and adherence to technical regulations on certain products, which are justified within the WTO legal framework. In September 2012, Argentina eliminated the Prior Automatic Import License regime (LAPI: *Licencias Automáticas*

Previas de Importación), thereby reducing the number of tariff lines subject to automatic licensing. Thus, non-automatic import licenses apply to textiles, clothing, motor vehicles and mechanical appliances. Importers are also required to obtain mandatory certification for certain products. Goods destined for final consumption in Argentina must pay special taxes, but imports under the temporary admissions regime are exempt from this tax (WTO, 2013).

BRAZIL

Brazil is the largest economies in the Latin American region and its trade policy has influenced the overall policy in the region. From Brazil's trade agenda towards regional integration that has evolved over time, and led to the creation of Mercosur in 1991, to its great commitment to international integration through continuous efforts in the multilateral forum, Brazil's trade policy has reflected its domestic needs, while maintaining strong advocacy for equitable rights of the developing countries in the global trading regime. Historically, Brazil has been a major exporter of farm-based products, mainly agricultural commodities and livestock. It has used this position of power to call for more stable commodity prices and has spearheaded the establishment of various agricultural coalitions with other commodity-export-dependent countries.

Nevertheless, its external trade policy has been inclined to safeguard its internal market and Brazil has increasingly focused on the development of its domestic industrial and agricultural sectors. Thus, it can be said that Brazil is an inward-looking country; at a time when developing countries were liberalizing to join global value chains, Brazil chose to implement policies directed at minimum local content requirement and promotion of domestic industries, shielding them from international competition. Brazil focused on its large domestic market due to which, its trade to GDP ratio has been one of the lowest in the world. It was one of the strongest advocates of the import-substituting industrialization policy that many Latin American countries followed at the time, particularly from the forties to the late eighties. However, it was forced to abandon the ISI trade policy as it faced a massive inflationary period in the late eighties due to a restrictive external policy at home.

Subsequently, the nineties were a decade of reforms in Brazil, starting from trade policy reforms in late eighties, to privatization of state-owned assets in early nineties, followed by stabilizing efforts in the financial sector in the latter half of the decade through adoption of the new currency under the Plano Real that helped stabilize the economy. Trade liberalization started in late eighties with a prominent change in the nominal tariff structure and reduction of tariff rates. The policy was broadened to comprise the elimination of NTBs and increased incentives to promote exports. These reforms contributed to the tremendous trade growth in the decades that followed and came at a time when Brazil was starting to re-launch itself in the global trade scene. This coincided with the establishment of the Southern Market or Mercosur in 1991, followed by the adoption of the *Common External Tariff* regime of Mercosur in 1995; the trade liberalization efforts in the nineties were indeed responsible for later success of the Mercosur bloc.

Despite various crises, Brazil's exports grew at an unprecedented pace in the new millennium, sustained by the commodity price boom and the rise of China in 2002-03. The emergence of the middle class around the world boosted the demand for many of Brazil's key agricultural and commodity exports. In parallel, the widespread dialogue to combat climate change encouraged actions and investments towards a sustainable low carbon future, that has increasingly favored Brazil's biofuel sector. Thus, overtime, Brazil has benefited from wealth of natural resources and legacies of the policies on energy self-sufficiency that were implemented in the sixties through the Proálcool program and reduced the reliance on imported petroleum oils. Today, Brazil has one of the cleanest energy mixes in the world, relying on biofuels such as sugarcane-based ethanol, biodiesel, biomass, wind energy, hydroelectricity, natural gas and petroleum oils.

This country-analysis of Brazil narrates the evolution of its trade policy since the postwar era. This subsection is divided into four distinct phases: the first phase is the post-war era characterized by an import substituting industrialization (ISI) policy. The next phase is marked by the currency reforms and trade liberalization policies in the nineties, aimed at relaunching Brazil in the global trade scene. This phase coincided with the inception of Mercosur, a step towards closer ties with regional partners. The third phase describes the response to the increasing external pressures from the United

States to negotiate the FTAA. It also highlights the export-led growth experienced by Brazil under the Chinese influence. Finally, the last and fourth phase analyzes the impact of the political crisis of 2014 on its trade policy. In the end, Brazil's role in multilateral negotiations is presented, followed by the analysis of the targeted agricultural and energy policies implemented by Brazil that have impacted its trade policy over the decades. This subsection ends with Brazil's present-day tariff policy under the CET regime.

EVOLUTION OF THE ISI POLICY

The period starting from the thirties to the eighties was characterized by import substituting industrialization that involved import licensing (to keep demand in check), high tariff quotas, import prohibitions, an overvalued exchange rate and government investment in key industries of the economy that stimulated industrialization in Brazil, especially in automobile and iron & steel industries. Thus, trade policy was primarily state-led and inward looking that promoted domestic manufacturing, state-owned enterprises and provided large subsidies to enable national production to compete with imports. This involved relaxation of tariff barriers such as tariff reductions and tax exemptions for inputs that were used in domestic manufacturing. Most industries were protected from international competition through import barriers such as high tariffs and stringent import licensing procedures. The most highly protected sectors were consumer goods such as Tobacco, Real Estate, Footwear, Perfumes, Soaps and Candles, Transport Material, Plastic products and Textiles & Clothing. The over-valued exchange rate of the *cruzeiro* was used as a tool to promote imports of inputs for these industries and foreign exchange control was one of the principal tools used for the promotion of the country's industrialization in the fifties. This period was also marked by mounting pressures of excess demand for foreign exchange and long-delays in the licensing system.

In January 1953, a new policy was adopted under Law 1807 that led to a more flexible exchange rate system. It created a limited free exchange rate market that allowed inflow and outflow of capital and its earnings, and the buying and selling of foreign exchange for tourism. Imports and exports continued to be controlled by CEXIM but the Law 1807 was used to stimulate certain types of exports such as coffee, cotton and cocoa. Later in October 1953, Law 2145 established a multiple exchange rate system that

created an auction for obtaining foreign exchange. Some imports were exempted from this auction as they were considered too essential and included petroleum and derivatives, printing paper, wheat and capital goods considered essential for development of the domestic industries (Baer, 2001).⁵² The character of the exchange rate system was such that it was no longer regarded as an instrument to cope with balance-of-payment difficulties but more as a tool for the promotion of industrialization.

Brazil and Argentina were focused on ISI and were trying to increase domestic content in the manufactured for the domestic market. This emphasis on substituting imported inputs with domestic content led to a sharp rise in production costs of manufactures, and drove the domestic price far away from the international prices. Hence, exports were not an option at the time. Forward and backward linkages began to work in the industrial sector that lowered prices and most exports came to be concentrated in natural resources like the food industry and wood products, among others such as meat processing. Around 1964, the military government took measures to increase diversification of exports by abolishing state export taxes, simplifying administrative procedures, tax incentives and subsidized credit for exporters, for example, exemption of income tax on profits from exports in 1965 and exemption of VAT on exports of manufacturing goods in 1967.

The capital-intensive production was still dependent on imported inputs despite efforts to reduce the import coefficient of domestic production. One of the earliest capital-intensive exports were automobiles within the regional market. Apart from a price differential that prevented exports of non-resource-based manufactures, the other problem was the lack of medium term and long-term financing for exports, and the absence of a concrete export promotion policy in both Brazil and Argentina; on the contrary, the export policy permitted exports of goods after they had fulfilled domestic demand, that is those on excess of domestic demand could actually be exported. Overall, there exists a time lag between import substituting industrialization and export-led domestic industrialization in both the countries. For example, ISI-led product began

⁵² Accessed at:
https://books.google.co.in/books?id=qdBaM4nEefwC&dq=law+1807+1953+brazil&source=gbs_navlinks_s

in the post-second world war period, but exports of these manufactured goods really took off only by 1970s.

What the Brazilian policymakers failed to understand was that export could lead to domestic growth and prosperity in two distinct ways: one, an increase in exports would ease the pressure on the BOP and enable them to import essentials that could lower input costs and facilitate domestic growth, and; second, increase in exports would lead to increased production that could lead to economies of scale and lower costs for goods meant for the domestic market as well (Teitel and Thoumi, 1986). The evolution of the IS process led to the development of the metallurgical and metal-based works, and other sophisticated industrial exports that replaced the earlier natural resource-based exports from the sixties. These industries, which had overwhelming importance in 1961, approximately accounting for 96% of total manufactured exports had reduced their proportion in the total to only 54.1% by 1978. During the seventies, in Brazil's case, manufactured industrial goods that experienced the highest output and export growth were basic chemicals, nonmetallic minerals, iron and steel⁵³ and nonferrous metals, nonelectric machinery and transport equipment (Teitel and Thoumi, 1986).

“The development of manufactured exports seems to have followed a similar path in both Argentina and Brazil, and the IS policies followed by these countries do not seem to have resulted in permanent inefficiencies in many manufacturing industries. Rather, protection provided during the 1950s and 1960s to metalworking and metallurgical industries producing consumer durables, capital goods, and transportation equipment has been later reduced, and efficiency has evolved leading-sometimes in spite of significant antiexport policy biases-to a substantial volume of exports in the 1970s. The processes of absorbing and adapting technology and developing labor skills-fostered by the protectionist policies followed- seem to have been aided by the relatively large markets for industrial products of both countries, which eventually allowed the achievement of economies of scale. Thus, in the context of both countries’

⁵³ High quality Iron was available in abundance in Brazil for the steel industry. Starting in the mid- to late 1960s and continuing until the late 1970s, Brazil saw a deepening in the import substitution of metallurgical and chemical basic and intermediate products as well as that of large and more complex capital goods. The production of iron and steel, aluminum, and basic chemical and petrochemical industries was substantially expanded through governmental promotion and direct participation in production.

industrialization process, IS has been a preamble to the export stage, providing the learning required before reaching out for markets abroad. The new manufactured exports of the 1970s were not really the exclusive results of export incentives but rather the natural consequence of a maturing industrial growth process, aided by the substantial expansion in international trade that took place during this period. The natural resource base, skilled labor forces, and domestic market size of Argentina and Brazil were significant determinants of this process” (Teitel and Thoumi, 1986).

Another important determinant of the export promotion policy was the adoption of a crawling peg exchange rate in 1968 that indexed nominal exchange rate to the difference between Brazilian inflation rate and the global inflation rate. This led to a period of a stable exchange rate. As a result, the share of manufactured goods increased from 30 percent of total exports in 1974 to 50 percent in 1981 (Nogues, 1990). Later in 1979, a sharp devaluation of 32 percent of the cruzeiro led to an increase in inflation to 100 percent per annum in 1980 and to 200 percent per annum in 1983. These high inflation rates called for the implementation of the Cruzado Plan in 1986 that introduced a partial price freeze and the fixed the nominal exchange rate as well. It however, failed to stabilize the soaring inflation rates in the eighties that climbed to 600 percent in 1987 (Bresser-Pereira, 1990). Overall throughout the eighties, the inflation rate grew at 20 percent per month that comprised primarily of inertial inflation but the real exchange rate began to appreciate following the Cruzado plan. This stop and go pattern of policy intervention failed to manage the real issue, i.e.; inflation and it continued to rise till the implementation of the Plano Real in 1994.

PLANO REAL, AND OTHER POLICIES OF THE NINETIES

From the beginning of the nineties, the Brazilian economy was suffering from high bouts of inflation and a subsequent recession. By the first half of 1994, the inflation had reached an average of 42 percent per month, with its peak in June 1994 of 50 percent inflation rate per month. Consequently, the government implemented the Plano Real in 1994 that was used to stabilize the inflation and the economy. It was also supplemented by the deregulation of the exchange rate, privatization of state-owned-enterprises, trade liberalization through tariff-cutting, and an overall plan for stabilization and economic reconstruction of the Brazilian economy. Through Plano Real, the government implemented strict fiscal and monetary policies to reform the public finances, and

introduced the new currency REAL in the economy through three distinct stages. These three stages were aimed at tackling two components of inflation: the inertial inflation rising out of indexation mismatch of wages and prices; and the structural inflation that resulted from an ex-ante operational federal budget deficit (Taylor, 2003).

Stage One of the plan was aimed to display the ability of the government to manage public debt without depending on the future inflation to meet revenues (inflation tax) and balance operational budget through deep cuts in the budget proposal for 1994. They even set up a special Emergency Fund to manage the budget deficit at the time. *Stage Two* of the plan introduced a non-monetary reference currency called Real Value Unit (URV) such that 1 URV= 1 USD. All indexed contracts (wages and prices) were fixed in URV terms with daily indexation based on past inflation. This step was undertaken such that all wages and prices in the economy were directly comparable. The common problem in the Brazilian economy in the eighties and the nineties was that contracts were indexed differently, based on different timelines and rates. The URV unified these contracts under a single indexation scheme and helped align relative prices in the economy. The final stage (*Stage Three*) of Plano Real introduced the new currency such that 1 Reais was equivalent to 1 URV. This way, the nominal and the real currency were equalized. Additionally, the 1 URV was set to 2,750 cruzeiros reais (the old currency unit) for all future contracts that could not be converted in the first cycle.

Plano Real as successful in bringing down inflation in the economy from 50 percent inflation per month (translated to 600 percent per annum) in June 1994 to 5.5 percent in July 1994, 0.66 percent in September 1994 and it stabilized at just 15 percent inflation rate per annum by 1995. It was clear that the plan worked as inflation fell by 97.5 percent in just one year while Plan Real was being implemented. The plan however did not involve any wage or price freeze and did not fix monetary or exchange rate policy. The government seamlessly carried out full indexation and de-indexation of the economy in less than a year and ensured price stabilization without compromising on growth.

PRIVATIZATION AND DEREGULATION IN THE NINETIES

According to Gerschenkron (1962), it is necessary for the state to partially replace the market in allocation of resources for countries that were late-comers to the development process. In Brazil, this view was adopted and led to the creation of State-owned enterprises (SOEs) in sectors where private initiative was lacking due to technological and capital requirements or where the market favored monopolies. This process was consistent with the view of 'industrialization through import substitution' as a development strategy and allowed the state to encourage domestic production and regulate it (Pinheiro and Giambiagi, 1994). The first time the state intervention was questioned was at the time of the first oil shock in the seventies that led to macro deterioration and slowdown in the economy of Brazil as it was heavily dependent on oil imports. Consequently, a conflict arose between the state and the private entrepreneurs on allocation of the scarce resources available in the economy. As a response to this conflict, the government created the Special Privatization Commission in 1981 to curtail the expansion of the state-led productive activity throughout the eighties.

As a contrast to this policy, the privatization efforts in the nineties were part of a larger market-oriented reform package that induced deregulation and trade liberalization as well. This time around, however, foreign participation was permitted in the sale of SOEs. Later in the nineties, SOEs dominated the industrial sector, especially the mining sector, petroleum sector, metallurgical sector, chemicals and public utilities such as transportation and communication services. The autonomy granted to Petrobás in producing, transporting and refining oil was unparalleled. The privatization drive involved the sale of some of these SOEs and posed concerns over regulation of the sector as it granted excessive market power to the private sector in the essential sectors. Subsequently, this called for the development of a stable and mature apparatus.

The sale of the SOEs permitted through cruzeiros, government bonds, debts and foreign help securities and credit pertaining to the federal state. Law 8031 regulated the participation of foreign capital and limited holding to 40 percent for the minimum production of 2-3 years. Moreover, the SOEs were permitted to hold onto up to 15 percent of capital in the newly privatized companies to fulfill the objectives of the industrial policy of the time. By July 1993, 21 out of the 64 companies listed as SOE s

were sold, generating a revenue of US \$ 5.4 billion only and were concentrated in the metallurgy, petro-chemicals and fertilizer sectors. Critics have argued that the Brazilian state sold the SOEs at bargain prices that severely affected the fiscal impact of privatization. However, the reduction of public debt was the overarching of the state, along with highlighting its commitment to more market-oriented reforms to showcase its credibility. This particular policy worked in two ways: the sale of assets generated a revenue that can offset the present debt and can help restructure public assets to ensure the future reduction in debt. This process also helps reduce the public sector borrowing in the subsequent periods by foregoing investment in the newly privatized company.

The privatization drive helped raise the efficiency of the SOEs by enabling it to have clear views of the objectives and instilled greater market discipline as it could no longer rely on treasury funds to remain open despite prolonged losses. Historically, in Brazil, SOEs have had larger number of employees in the administration than required and have had lower returns on equity than private companies and worked with large capital to output ratios. For example, in 1989, the return on equity for the largest SOE was only 3.1 percent, whereas, the average return on equity for private companies was 11.4 percent. The trade liberalization process that was implemented alongside as part of the market-oriented reforms also helped increase the competitiveness of the private sector. Although partly successful in reducing public debt, the government should have established a stringent regulatory structure and a competition policy for the private sector.

TRADE LIBERALIZATION IN THE NINETIES

According to an ILO study of 2004 under Christoph Ernst, the Brazilian government adopted a liberal trading system that marked a gradual shift from an import substitution policy involving trade barriers and capital controls towards an export-oriented growth model that comprised of elimination of tariffs and increased access to international capital markets. This process of trade liberalization can essentially be broken down into three steps: unilateral lowering of trade barriers, multilateral reduction of tariffs that increases imports from partner countries, and regional efforts to raise integration with neighbors.

Notably in 1991-92 Brazil launched a trade liberalization program, where import licensing requirements as well as non-tariff barriers were removed, average applied tariff was reduced to 21.2 percent in 1991 from 51 percent in 1987, with an exception of the automobile and domestic electrical appliances industries. By 1995, Brazil had adopted the Common External Tariff under the Mercosur trade regime such that the average applied MFN tariff was reduced to just 12.5 *percent* and all tariffs were bound to the range 0-35 percent under WTO's Uruguay Round. They however, listed a few exemptions to the CET such as informatic goods, capital goods and a national list including petro-chemicals, foods, textiles, chemicals, leather and wooden products. Other than that, imports were also subject to IPI and ICMS taxes and tariff escalation applied by stages of processing (WTO, 1996). The late nineties witnessed some setbacks due to the economic crisis in 1999, but the overall trend of trade liberalization continued. In general, for all Mercosur members, primary products faced low protection and industrial products faced high protection. A major impact of the trade liberalization was an increase in trade throughout the nineties, especially as imports rose faster than exports and an increase in trade openness from 15 percent of the GDP in 1990 to 22 percent in 2000. This trade liberalization policy coincided with the Plano Real in 1994 and was supplemented by privatization and deregulation efforts by the government in the nineties as well.

EXCHANGE RATE CRISIS OF 1999

The trade liberalization efforts of the nineties, along with the degree of industrialization achieved through the ISI policy helped diversify Brazil's export basket in the period that followed. However, this growth was debt-led and dependent on the capital account through foreign borrowings. As a result of the overall economic reforms in 1994, Brazil adopted a crawling exchange rate system. The external crises in Asia and Russia in mid-nineties exerted tremendous pressure on Brazil's exchange rate regime and forced them to raise interest rate to maintain the stability of the regime, from 3.11 percent in 1996 to 24.26 percent in 1998. The rise in interest rate was accompanied by almost zero levels of inflation, and led to an increase in the *fiscal deficit* held by the government in the form of increased interest payments. Fiscal debt rose from 26 percent of GDP to 38 percent of GDP between 1994 and 1998 (Mántey, ed. Motamen-Samadian, 2006).

Another feature of the Brazilian economy in the nineties was liberalized trade and increased amounts of inward-FDI flows. The structural reforms of the early nineties helped reduce the perceived country risks and strengthened investor confidence in Brazil's market, such that, it attracted FDI worth US\$ 124 billion in the period from 1994 to 1999. The rise in interest rate however, caused a *current account deficit* as well due to increased interest and dividend payments that totaled 4.5 percent of GDP in early 1999. The pegged exchange rate leaned towards overvaluation and hurt competitiveness of exporters throughout the decade. Consequently, wages of those engaged in export-oriented sectors declined, unemployment rose and the deterioration of the trade account led to a current account deficit in the same period. Thus, Brazil faced a triple-deficit in the late nineties, primarily due to its internal policies and to some extent, simultaneous external crises.

The third feature of the crisis of 1999 was the immediate outflow of short-term capital held by foreign investors in Brazil following the Russian debt crisis of 1997. International capital froze and Brazil lost US\$ 30 billion in just 50 days, infamously referred to as the Black September. This massive outflow led to an exchange rate crisis in addition to the triple deficit situation in 1999. The monetary policy at the time was controlled by the flow of international speculative capital as the economy continued to be heavily dependent on foreign technology and imported capital goods to support the industrial sector. The erosion of export competitiveness due to overvaluation of the *Real* led to inflationary tendencies and the Brazilian authorities, with the fear of the eighties hyperinflation, tried to maintain the inflation through tightening of fiscal and monetary policies.

The triple deficit condition along with the exchange rate crisis forced Brazil to seek an aid package from the international monetary fund in 1999 in exchange for stronger fiscal adjustment, tighter monetary policy and exchange rate management. Finally, Brazil abandoned the crawling exchange rate regime, and first adopted a band system that let the exchange rate to move freely within set bands and later the floating exchange rate in January 1999. Devaluation was inevitable due to the pressure on the economy from all sides and the Real fell from R\$ 1.20 /US\$ to R\$ 2.16/US\$ almost instantaneously. Consequently, there was a temporary rise in inflation but under the auspices of President Cardoso, Brazil adopted a regime of inflation targeting by Decree

3088 of July 1999 as part of the IMF's fiscal adjustment program. This new regime aimed at raising interest rate to counter inflationary tendencies and preventing inflation inertia resulting from price indexation. As a result, the economy recovered as the exchange rate stabilized at R\$1.66/US\$ in July 1999, and authorities managed to bring inflation down to international levels (Averburg, 2002).

EXTERNAL INFLUENCE ON BRAZIL'S TRADE POLICY:

THE AMERICAN INFLUENCE

Regional integration has played a major role in Brazil's insertion into the global market. In the 1990s, after the success of the European union, a similar plan was initiated to unite the Americas under the Free Trade Agreement of the Americas (FTAA). It was born as a sum of bilateral agreements between the USA and Latin American democracies. The United States was however not keen on a single currency unit nor coordination of macroeconomic policies or political system under a supranational agency, a clear contrast to the EU integration process. From the Latin American side, Brazil was determined to shape the negotiations, while keeping US hegemonic tendencies at bay, and its opposition to the FTAA was "framed in an ideology of national sovereignty" (Nelson, 2015) to transform the power relationship with the United States. Brazil relationship with USA dates back to the second World War as Brazil was an ally. However, its close ties hit troubled waters in the next twenty years as Brazil sought a more autonomous foreign policy to be able to pursue the import-substituting industrialization framework in the fifties. Subsequently, Brazil's relationship with USA followed a stop-go pattern and was greatly influenced by the Brazilian presidency at the time.

For example, from 1951-54, President Vargas followed a nationalist and statist policy that included focus on industrialization rather than on foreign policy of the US. To supplement this inward-looking policy, Petrobás, the largest single public organization representing the energy industry and solely responsible for buying, selling, exporting, importing and transporting petroleum products; and the BNDES, the Brazilian Development Bank were established. Following this, President Kubitschek (1956-61) focused on national development through the ISI policy and signed the Latin American Free Trade Agreement (LAFTA) in 1960 that later set the basis for the creation of

ALADI. In an attempt to reject the US foreign policy in favor of a more autonomous Brazilian policy, President Goulart (1961-1964) established diplomatic links with the communist Soviet Union and trade relationship with the China. This defiance was however reversed with the arrival of the President Castelo Branco until 1967 as he was instrumental in renewal of Brazil's relations with the United States in fight against communism in Latin America. This Brazilian support was rewarded in the form of military aid from the World Bank and the IMF.

In the next few years, Brazil established trade relationships with countries in the east, especially with European countries and Japan to sell agricultural and industrial products, in order to reduce the dependency on a single US market. Once again, Brazil's foreign policy evolved beyond the stronghold of the US in the region under President Silva (1967-69), Medici (1969-73), and President Geisel (1974-79). A robust industrial policy was needed to support this foreign policy; however, the 1973 oil shock left the country unable to uphold its import substituting industrialization policy and a subsequent increase in the oil import bill led to an increase in external debt. As a counter measure, there was an increased alignment between the Washington consensus and Brazil's domestic, as well as external policy. Before the economy could full recover from this external shock, the second oil shock exacerbated the external debt situation as export fell as quickly as foreign direct investment in Brazil, and the domestic economy fell into a trap of high inflation, a situation that would only worsen through the eighties, until it would be fully resolved in the early nineties with implementation of Plano Real. Brazil's president at the time, President Figueiredo requested the IMF's assistance in tackling its internal crisis but was pressured to abandon the military rule. As a result, in 1984, the military rule came to an end and the first democratic president was elected. Meanwhile, the Washington consensus forced Brazil to reconsider its development strategy; consequently, Brazil began to increasingly engage with its neighbors in the region and with global governance structures.

One of the initial efforts to pursue a regional policy was marked by the signing of a cooperative agreement between Brazil and Argentina in 1985 that later led to the establishment of the regional bloc *Mercado de Sur* or Mercosur⁵⁴. Simultaneously, the United States launched the 'Enterprise for the Americas initiative' in 1990 to

⁵⁴ The creation of Mercosur has been discussed at length in the study on Argentina.

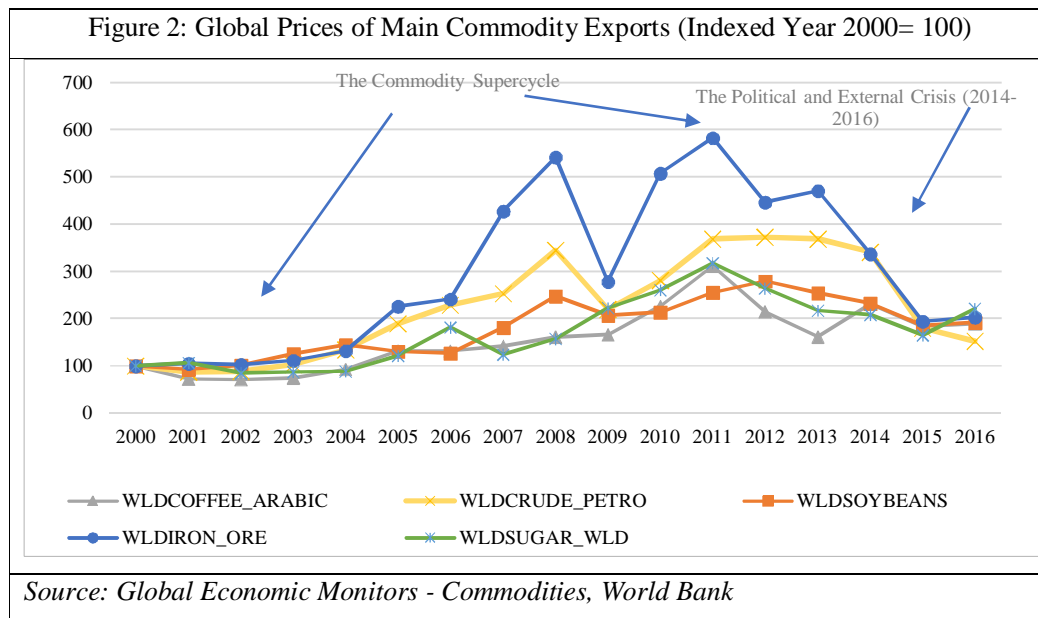
rearticulate American hegemony in Latin America and among pressures from the IMF and World Bank, Brazil, under President Collor de Melo finally accepted the American advances. FTAA negotiations formally began in 1994 at the Miami Summit and the American proposition included NAFTA-plus framework and the Itamaraty believed such a proposal could potentially hurt the Brazilian economy. The export- focused industrial sectors were receptive of the FTAA proposition, with the hope of securing greater market access in the American market. Conversely, the FTAA received backlash from the national civil organizations in Brazil as they viewed it as an extension of the US hegemony in Latin America. However, President Cardoso (1995-200) believed that if Brazil opted out of the FTAA negotiations, USA would retaliate by increasing its market share in other Latin America countries and vice-versa, posing as an unfavorable hurdle for Brazil's ambitions in the region.

Over the next few years, this fear dissipated and Brazil foreign policy came to be aligned with other developing countries to further south-south cooperation, notably on increased market access for agricultural goods through plurilateral initiatives such as IBSA, BRICS and the G-20 group. These initiatives ensured Brazil's commitment to multilateralism while maintaining a divergent institutional structure from the rest of the members. As a result, Brazilian negotiators of FTAA were more confident in projecting a unified South American front. In the final stages of the negotiations, they highlighted their belief that if south American countries were willing to give concessions on issues such as government procurement and intellectual property, the United States should also make concessions on agricultural market access through reduction of trade barriers and subsidies, simply on the principle of equity and fairness. However, these requests were not received well and finally in 2005, countries decided unanimously that America was not ready for such a commitment that lacks balance and prevents effective access to markets. Brazil's structural strength and its sheer size positioned it in the forefront of the FTAA negotiations; from the beginning, it remained cautious towards the United States, questioning its hegemonic tendencies and advocating equitable concessions.

THE CHINESE INFLUENCE (2003-2015)

The industrial policy followed by Brazil after the 1999 crisis focused on expanding commodity exports due to the increase in their prices in the international market since the turn of the century. China's growth since 2002 played a vital role in this export-led

growth. As the Chinese economy expanded, its appetite for food and natural resources grew at a momentous pace. This rise in demand from the growing middle class of China contributed to the exponential rise in commodity prices, such that this period was called the *commodity supercycle* (Fig 1). The greatest price rise was witnessed by exporters of iron ore, soybean, sugar, coffee and crude oil, all of which were exported by Brazil to China during the period 2002-2015.



Between 1999 and 2004, its exports to China grew by 800 percent in value terms while the value of its imports from China more than tripled. Total trade with China grew from under US\$ 3 billion in 2001 to over US\$ 75 billion in 2014. In just a few years, China came to be Brazil’s largest export destination and the second most important import source. China bought Brazilian iron and steel, beef, soybean and factions; and supplied electronics, especially mobile phones and machinery to the Brazilian market. The true extent of the Chinese influence on Brazil’s trade patterns is discussed in the following section.

Naturally, there was been a growing concern that the intensifying bilateral trade links with China adversely affect the sectoral production and employment structure in Brazil, given that Brazilian exports to China consist primarily of food and minerals, while imports from China increasingly compete with domestic manufacturing industries at home. Thus, there is a notable shift toward low value-added production that increasingly employs low-tech and semi-skilled human capital that may severely affect

Brazil's long-term growth trajectory⁵⁵. This phase has been compared to the process of de-industrialization in Brazil. It seemed that the Brazilian industries were feeling the effects of competition from cheaper Chinese imports, and the export pattern to China had led the export-oriented commodity exporters to benefit at the expense of the other industries, that caused job losses in various industrial sectors. Thus, in its relations with China, the Brazilian economy entered a phase of *commodification* (Jenkins, 2015 and Kessler, 2018). However, no concrete evidence was found that pointed towards a change in resource allocation in favor of commodity exporters (Nassif, 2008).

THE POLITICAL AND EXTERNAL CRISIS (2014-2016)

Brazil's trade experienced a slowdown in the period after 2011 due to a decline in Chinese demand in the same period. This was a consequence of the slump in the Chinese industrial output that had depressed international commodity prices in the following period of iron ore, soybean, sugar, coffee and crude oil (Fig 1). International price of iron ore fell to one-third its value between 2011 and 2015. Additionally, Brazil's next top partner, the United States was unable to fully recover from the financial crisis of 2009, and as a result, there was an obvious reduction in exports to the United States in the following period. Thus, *external factors* were responsible for the crisis in 2014-2015, during which, Brazil's exports fell by 16.5 percent and imports by 23.7 percent between 2014-2015, while the Real depreciated by 47 percent between January and December 2015.

Simultaneously, Brazil began to face *internal monetary pressures* as well due to rising inflation in the economy. Inflation rate had reached 10.5 percent and 9.6 percent in 2014 and 2015 respectively. As mentioned earlier, Brazilian authorities had implemented an inflation-targeting regime after the 1999 crisis and naturally began to raise interest rates to counter the inflationary pressures. Interest rate rose from 7.12 percent in January 2013 to 14.25 percent in September 2015; although it had the potential to raise profits of capital owners, it certainly depressed public demand as consumption fell by 3.4 percent in 2015. As the economy was already facing a slowdown in the economy due to external factors and a fall in aggregate demand, and the authorities were forced to provide tax reliefs to the industrial sectors to stimulate

⁵⁵ https://mpra.ub.uni-muenchen.de/6200/1/MPRA_paper_6200.pdf

investment and production, but these reliefs ended up increasing profits of the industrialists rather than production or investment. Consequently, capital investment tumbled and production of capital goods fell by 36.2 percent in 2015. Total investment fell by 12.7 percent in the first half of 2015 and industrial output by 5.6 percent in the same period.

Private employment fell by 5 percent and almost 800,000 jobs were lost in 2014-2015, while total unemployment rose from 6.9 percent to 8.4 percent in 2014. This situation of weak economic growth and high inflation caused a period of *stagflation* in the economy in 2014-2015. GDP shrank by 4.26 percent in the third quarter of 2014 and by 5.8 percent a year later; overall it fell to 21.2 percent of its value between 2013 and 2015. An issue that began with inflationary pressures in the economy ended up in a crisis led by private capital.

President Dilma announced *austerity measures* to reduce the pressure on the rising public debt as a result of lower tax collections due to lower levels of production, sales, consumption, wages, imports and credit. Gross public debt rose to 67 percent of GDP in 2015, while the primary deficit was at 2 percent of GDP and the overall deficit had risen to 10 percent of GDP from just 2 percent in 2010 (Cepal, 2015). These austerity measures (Provisional Measures 664 and 665) were anti-labor in nature as they called for reduction in pensions and centrally-sponsored schemes such as health and unemployment benefits. President Dilma also ordered a tax hike on fuel and credit that further reduced demand, increased inflation and depressed the economy.

The last leg of the crisis was the *corruption charges* against the state-owned oil giant Petrobras, which dragged many politicians of the Workers' Party (*Partido Dos Trabalhadores*) and President Dilma as well. The gargantuan corruption scandal (The Economist, 2016) of 2013 that involved Petrobras triggered confidence effects in the whole economy, shook the reputation of the Workers' Party and undermined the credibility of the government as well as President Dilma. As the corruption charges were being investigated, Dilma was accused of having used "*creative accounting methods (pedalada fiscal) to put a positive veneer to government accounts*" (de Miranda, 2018) as a way to disguise the true nature large fiscal deficit through delayed payments to the commercial banks that acted as unauthorized credit to the government, and by "unlawfully" issuing presidential decrees that granted credit amounting to US\$

700 million in 2015 from public banks to the government, in order to pay the outstanding public debt. As a result, impeachment proceedings of President Dilma began in December 2015 and she was impeached by August 2016. This political crisis in Brazil added to the declining economic situation and Brazil slipped into recession in 2015.

Overall, the 2015 downturn in the Brazilian economy was driven by domestic monetary factors, low commodity prices and the decisions taken by politicians belonging to the Workers' Party, including President Dilma. Cepal (2015) summarized the crisis as "Political difficulties, in conjunction with the uncertainty surrounding the implementation of the fiscal measures, the scant impact the high interest rate policy had on inflation, compounded by the exchange rate volatility and flat foreign trade, all combined to create a difficult environment for the investors and consumer-decision-making on medium and long-term commitments."

MULTILATERALISM IN BRAZIL

Brazil has always been a strong supporter of a system that united developing country voices to counter the stronghold of the developed countries: by getting better and stable prices for commodity exports, or through advocacy for special preferences for exports of industrial goods by developing countries, or in the availability of external financing for developing countries. This long history of struggle for greater recognition and a voice at the table lay the foundation for the basic mentality of the Brazilian external and trade policy. This is the same mentality that was reflected in the call for the creation of UNCTAD, the G77, Cairns Group, G20 and later for Mercosur as well. Mercosur was born out of the Brazilian need to pool collective political clout in the Americas to counter the hegemonic pressures exerted by the United States in South America through MNCs involved in extractive industries; and through pure influence of Latin American policymaking.

Back in the sixties, the Cairo declaration of 1962 witnessed the LATAM nations, headed by Brazil and led by the eminent economist Raúl Prebisch joining hands with Afro-Asian countries; they called for the establishment of an international conference on international trade, primary commodity trade and economic relations between developing and developed countries. The creation of UNCTAD was formulated under Resolution 1785 in 1962 and agreed on a negative list of issues the signatories objected

to, rather than a positive idea of a clear vision for a new international order. Prebisch also called for a general system of preferences (now, the GSP) for manufactured products exported by developing countries to developed countries and a clear system to allow them to subsidize marketing of these products through active export promotion.

The OPEC countries had already called for an artificial supply halt of oil in the international market to counter the falling prices, and caused the first oil shock of 1973. The United States was afraid of an OPEC-like cartel developing among the G77 countries for exports of essential commodities that were used as inputs in industrial sectors at home. However, it was inevitable and developing countries through the G77 coalition were unified by Brazil and India under a common umbrella, calling for the application of the New International Economic Order. “*The NIEO Declaration (UN Resolution 3201) demanded a restructuring of the international economic system to make it operate more favorably towards poor nations. At its core was equity, sovereign equality, interdependence, and cooperation between states as well as a call to correct inequalities and redress existing injustices, so as to eliminate the widening gap between developed and the developing countries and ensure steadily accelerating economic and social development.*”⁵⁶

Abdel-Fadil (1979) notes that the main areas of negotiations were threefold: first, secure prices, indexation of exports of primary commodities and the establishment of a producers’ association to help stabilize markets and prices, enable developing countries to plan ahead and use export earnings for industrial development, bringing in “*New Age of Prosperity*”; second, better terms for technology acquisition in developing countries, control over the activities of multinational corporations in their territory and greater opportunity to sell domestically produced industrial goods to developed country markets; and last, greater access to international credit without compromising on their national sovereignty, and greater participation in the management of international credit institutions such as the International Monetary Fund.

⁵⁶ <https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1548&context=lcp>

The oil price rise in 1973 put faith in the program by showing that prices of raw material could rise and be sustained. It was believed that the NIEO would provide the developing countries with permanent sovereignty over their natural resources and greater control over their economic fate. Much to USA's dismay, developing countries also attempted to use its control over exports of raw materials that were used as inputs for production of manufactured goods in developed countries, to create scarcity, destroying the basis of their industrial development. G77 realized the enormous power they could exert if they organized themselves into a collective action over commodity supply and prices, as there was power in unity. This idea was perceived as an OPEC-like situation by the United States and it proposed private investment in processing and distribution of natural resources to supplement the export process of developing countries; an idea that was outright rejected by the G77 as it was a shadow of neo-colonialist exploitation (Abdel-Fadil, 1979). Consequently, NIEO did not work out in their favor as it was rife with differences between the needs of the members, under a façade of unity. The developed countries did not pay heed to these requests, consequently, the G77 were unable to organize themselves and following the second oil crisis of 1979, they spiraled into economic crises. As a result, they were forced to accept the American way of liberalization in the form of the Washington Consensus in exchange of securing an aid package from international financial institutions.

Another important element of Brazil's relationship with the multilateral trading system dates back to when the GATT was negotiated for the first time and it can be said that Brazil was one of the founding fathers of the GATT. GATT was basic set of rules to regulate commercial policies on a multilateral basis and survived till the creation of the World Trade Organization (WTO) in 1995. One of the most important ministerial rounds in the history of GATT was the 8th round, the Uruguay Round that lasted from 1986 to 1993. Through this round, Brazil was successful in negotiating tariff cuts with the European Commission, the United States and Japan on main Brazilian agricultural exports including tea, coffee, orange juice, sugar, oilseeds, etc. In the same round, Brazil also bound all its tariff at 35 percent for industrial products and 55 percent for agricultural products. Simultaneously, Brazil adopted unilateral trade liberalization in the early nineties to showcase its commitment to an open-market policy under the GATT/WTO system. Brazil had placed great emphasis on unilateral trade liberalization

before the conclusion of the Uruguay round and had offered deep tariff cuts, as well as a reduction in non-tariff barriers.

Brazil's interest in the multilateral trading system assured access to its exports on all markets and ensured agricultural liberalization as well. However, the authorities considered that Brazil's concessions were not matched by the developed countries and many of Brazilian exports continue to face tariff peaks in the major markets. Moreover, the Marrakesh Agreement that established the WTO was also fully incorporated into the Brazilian legal system by decree 1355 of December 1994. The WTO agreement is thus an integral part of the Brazilian legislature and worked on complementary internal regulations such as anti-dumping, countervailing duties and safeguard measures.

Brazil has also continued to advocate for better terms for developing countries in the multilateral system, and later, in 1986, the Cairns Group of 18 countries was set up to push to bring agricultural commodities under the trade subsidy rule of the GATT. Still, Brazil wanted to adopt a stronger pro-liberalization stance and before the 2003 WTO ministerial meeting in Cancun, Brazil took the initiative in organizing the G20, a group of developing countries that pressed the EU and the USA for greater liberalization of agriculture than they were willing to concede.

AGRICULTURAL AND ENERGY POLICIES

EVOLUTION OF BRAZIL AS AN AGRI-FOOD GIANT

“The Brazilian agri-food system has transitioned from a traditional to an increasingly global and industrial model” (Chaddad and Jank, 2006). Brazil has historically produced large amounts of agricultural and animal-based products for domestic use as well as for export purposes. Sugar has been one of the oldest crops to be cultivated by the Portuguese and the Dutch in the seventeenth and eighteenth century, and continues to be an important Brazilian crop even today. At the time, the production of sugar was supplemented by cotton, tobacco, gold, brazil wood, cocoa, and rubber, and cattle-rearing for their meat. Later, towards the beginning of the twentieth century, coffee became an important crop for domestic and export purposes, such that Brazil supplied 75 percent of the world's output by 1920. Coffee was an important crop for the Brazilian development and states such as São Paulo and Paraná flourished during the coffee boom in the first half of the twentieth century (Nicholls, 1970). Due to the two

wars and the depression, the production of coffee declined and by early 1960s, Brazil exported only 41 percent of the world's total coffee exports.

The heels of the *Great Depression* reduced the dependence on foreign trade and stimulated a great demand for domestic agricultural and domestic goods. As a result, most agricultural savings came to be invested in the industrial sector, but the economy continued to face large scale imports of consumer and industrial goods during the fifties. This period was also marked by an elaborate exchange rate system that discriminated against traditional exports of coffee, cocoa and cotton, aimed at a more stable and conservative system oriented towards supplying the rapidly growing food needs of the domestic markets, while using domestically produced agricultural machinery and cheap imported fertilizers. Around the same time, Brazil began to manufacture its own clothing and textiles, transportation equipment, mineral products, metallurgical products, leather, chemicals, drugs and wood products as a result of the ISI policy. Subsequently, the newly developed industrial-urban sectors attracted the highly-mechanized and commercialized agriculture in sugar, potatoes, rice, cotton, cattle rearing and livestock product, thereby transforming Brazilian agriculture. Locally, increased farm incomes were invested in farm machinery; however, the role of the state declined substantially in terms of credit and research due to the concentration on coffee price support policy in place. Had these resources been devoted to improving agricultural services, the face of crop and livestock production would have improved dramatically.

The commercialization of agriculture contributed towards rising food prices and a bout of inflation in the economy; the application of food-price controls exacerbated this problem as prices of inputs rose alongside declining farm wages. The government stepped up efforts to develop road networks, storage facilities, modern marketing, and price support systems, standardization to help integrate farm commodities and inputs market. Brazil's livestock sector also needed public assistance and state intervention as it remained technologically backward and traditional. Yet, it managed to produce enough to feed the poorest in Brazil despite the lack of disease control and improved pastures.

1963-1990: Prior to 1964, the government had applied a strong bias towards exports that discriminated against agriculture. However, after 1964, most export controls were

eliminated, exchange rate was unified and export promotion policies were established under the trade policy of 1968. Agriculture's participation in international trade increased but it could have been larger if it were not for the restrictions that stemmed from overvalued *cruzeiro*, the prohibitions on certain food exports and the lack of access to cheaper imported farm inputs (de Andrade Alves and Pastore, 1978).

The period from 1963 up to the first oil crisis in 1973 was characterized by an outward oriented export promotion scheme that benefitted the agricultural sector. One of the main developments was the eradication of the coffee program to reduce the overproduction. This led to a relative increase in the output of other domestic food-crops such as wheat, soybean and citrus products. The previous ISI policy had created a strong basis for domestically produced agricultural inputs such as equipment, chemicals and fertilizers. The new policy allowed agribusinesses to import machinery, fertilizers and other inputs. Moreover, rural credit was finally made available to supplement the agricultural policy. The impact of the relaxation of the overvalued exchange rate in the sixties was felt strongly in the seventies; it was marked by an expansion and diversification of agricultural exports, particularly processed and semi processed goods. Most of this growth was associated with the upsurge in soybean and processed soybean products in the export basket. Soybean production grew by 18.61 percent from 1971-1980. This coincided with the expansion of sugarcane-derived alcohol to replace imported and expensive gasoline. Ethanol was converted into a promising export product in Brazil in the following period. Other export-oriented cash crops were Oranges, Sugar, Tobacco, Cacao, Coffee and cotton; and production of these crops adversely affected the production of domestic crops such as corn, rice, cassava and beans.

As means to supplement the new agricultural policy, the government applied a program of export subsidies in the form of direct export premium, tax exemptions on VAT, income tax credits, drawbacks on duties for imported inputs, and credit subsidies (loan with negative real interest rate). The net effect of the reforms of the seventies was the rapid expansion in agricultural exports, especially processed agricultural exports with high domestic value addition. These policies played a dominant role in shaping the performance of Brazilian agriculture through the eighties. The government has long maintained an overvalued exchange rate to support the ISI policy, yet, it was forced to

follow a policy of devaluation following the crisis in 1980s, to counter growing inflation concerns due to rising food costs (Graham, Gauthier and Mendonça de Barros, 1987). Another important development in the late eighties was the creation of the Cairns Group of 19 agricultural exporters in 1986 during the Uruguay round of the GATT. It included developed and developing countries such as Brazil's neighbors, Argentina, Uruguay and Paraguay. Cairns group was focused on multilateral trade liberalization of agricultural goods. These efforts were supported by unilateral liberalization efforts to reduce taxes on exports and barriers to trade in agricultural goods during the early nineties, in association with the Plano Real (da Motta Veiga, 2005)

1991-Present: Following the trade liberalization efforts in 1991-1994, Brazilian agricultural exports grew exponentially. Notably, from 1992-2002, net exports of soybeans increased by 444 percent; and soybean oil by 288 percent. Brazil was also a net exporter of corn and cotton, bovine meat, and swine meat; this trajectory has been highlighted in the next section. The growth of food-based exports came as a direct result of the broad range of institutions and programs implemented by the government to support the development and modernization of agricultural production. For example, EMBRAPA is an agency that is involved in a wide range of activities related to agricultural research and technology, including plant breeding, pest management, food safety and hunger relief. As a result of the government policies, Brazil's agricultural sector transformed into a large-scale, commercially-oriented, forward-looking sector that was well suited to compete successfully in the international commodity markets. Today, continuing trade expansion and diversification of markets and products remain at the core of Brazil's agricultural growth strategy (Matthey, Fabiosa and Fuller, 2004).

“Despite these favorable developments and the availability of labor and natural resources, agri-food growth in Brazil faces significant internal and external constraints. In the external environment, trade barriers and subsidies to domestic producers and exporters, especially in developed countries, significantly impact Brazilian agri-food exports. As a result, Brazil adopted a more aggressive position in international trade negotiations at the World Trade Organization (WTO), bringing three high-profile dispute cases against developed countries and taking leadership in the formation of a coalition of developing countries known as the G-20.” (Chaddad and Jank, 2006).

During the WTO Ministerial Conference in Cancún in 2003, Brazil as a major exporter and producer of agricultural goods, pushed for greater market access and reduction/elimination of domestic support schemes for agricultural exports. Argentina was also an integral part of this coalition and its role has been highlighted previously. It was not a coincidence that many of the G20 members were also members of the Cairns Group and their respective positions in the two forums supported each other. The push for the establishment of the G20 countries reaffirmed Brazil's trade policy stance at that time of greater south-south integration. Brazil assumed the role of the leader of developing countries that were also exporters of agricultural goods; the Brazilian government also began to face pressure from the domestic agribusinesses to adopt an aggressive negotiating position in future trade talks. One of the biggest roles played by Brazil in the coalition was assisting in consensus building within the group that required the design of technically consistent proposal to maintain the image of the G20 and drive agricultural negotiations successfully (da Motta Veiga, 2005).

PROÁLCOOL

Brazil has historically been largely dependent on oil imports and the burgeoning oil bill was a growing concern in the seventies. Post the first oil shock in 1972-73, international oil prices rose dramatically and negatively affected the import spending. At its peak, Brazil imported 80 percent of its entire demand for oil. The government launched the *Proálcool program*⁵⁷ in 1975 as a response to counter this dependency on imported oil. The program was established through Decree 76.593 aimed at stimulating bioethanol production as a substitute for petroleum products and was also responsible for ethanol price setting. This program was motivated by the lower price of ethanol than gasoline and guaranteed remuneration to the producers to increase production capacity and benefit to the consumers in the form of reduced taxes for vehicles running on hydrous ethanol. The bioethanol production in Brazil was guided by three factors: it increases with rise in international oil prices; it is strengthened through national policies aimed at raising production and end-use of ethanol; and also increased with rise in international sugar and ethanol prices.

⁵⁷ Adapted from: Cortez et al. 2016 and Giacomazzi, 2012: <http://www.oecd.org/sti/emerging-tech/Giacomazzi.pdf>

The Proálcool program was implemented in five phases. Phase One lasted from 1975-79 and was characterized by production of anhydrous ethanol (a mixture of ethanol and gasoline) that came to replace pure gasoline in domestic use. Mixture in gasoline increased from less than 5 percent in 1975 to more than 15 percent in 1979. It was followed by Phase Two from 1979-1985 and witnessed the second oil shock as international oil prices tripled in 1979. At the time, Brazil's oil imports comprised a 46 percent share in total imports. The resulting pressure on the trade balance led to the production of hydrous ethanol with financial support from international organizations including the World Bank. Between 1979 and 1985, hydrous ethanol production rose from 3,396 million liters to 11,829 liters at the end of Phase two of the Proálcool program. Consequently, the share of hydrous ethanol in total ethanol production grew from 23 percent in 1979 to 73 percent in 1985. This phase was also marked by the growth of ethanol vehicles (E100) following the development of a prototype by car-manufacturing companies like Volkswagen, General Motors, Ford and Fiat.

The next phase of the Proálcool program (Phase Three: 1986-1995) witnessed the end of the military rule in Brazil and a new republic regime was established with the election of President Tancredo Neves in late 1985. The program was cancelled as a result of the new government but Brazil was forced to produce ethanol as domestic demand for E100 vehicles and ethanol increased and exacerbated the already constrained supply. As international oil prices began to decline in the period, the excess demand for ethanol drove up international sugar prices. As a result, Brazilian exports of sugar increased, followed by deregulation of sugar prices and an increase in production of anhydrous ethanol that used surplus sugarcane in the market. Subsequently, the mixture in gasoline was increased to 22 percent by 1987. The sector came to be shaped by active government policies that favored the use of alcohol-based fuels over other transport fuels. The authorities incentivized production of cars with primary fuel as ethanol, such that, the share of cars running on ethanol in total production in Brazil rose from mere 0.3 percent in 1979 to 80.6 percent in 1986 (OECD, 2012). This positive outlook was slowed down by the rise in international sugar prices viz-à-viz petroleum prices in 1988 along with a shortage of public funds towards investment in production of energy. Together, they led to a shortage of Ethanol in Brazil, such that over one billion liters of ethanol was imported from the United States to meet domestic needs through the nineties.

As a response, the government released a new official blending mandate (rabo de galo) that was increased from 22 percent (ethanol mixed with gasoline) in 1998 to 24 percent in 2000. The sugar and ethanol industry also created a representative organization, UNICA that aimed to transform the sugar-energy sector into a modern agro-industry that was planned, regulated and had strong interlinkages with the state. This was the Fourth Phase of the Proálcool program that lasted from 1995 to 2000. The last phase was implemented from the turn of the century and was met with a rise in oil prices and a coinciding growth of the sugarcane industry in Brazil. A new form of fuel was introduced in March 2003 termed as Flex Fuel, along with flex fuel cars that were first developed by Volkswagen in 2003 as well. The subsequent deregulation of the sector reduced the government subsidy on ethanol and the adoption of the Kyoto Protocol in 2005 emphasized the adoption of methods to reduce greenhouse gas emissions, thus increasing the importance of ethanol production and consumption.

Production increased to 28 billion liters per year in 2008/09 from 11 billion liters per year in 2000/01, with production of 18.5 billion liters per annum of hydrous ethanol and 9.5 billion liters per annum of anhydrous ethanol in 2008/09. With 60,000 sugarcane growers, over 400 processing industries in Brazil and productivity growth of just under three percent per annum, the industry generated approximately one million jobs and contributed to 2.2 percent of GDP in 2008-09. This was the new Proálcool phase that was based on increasing energy security in Brazil, witnessed growth in use of agri-tech and was marked by a reduction in GHG emissions by approximately 2.2 kg carbon dioxide per liter of fuel viz-à-viz gasoline consumption, thereby improving the level of sustainability in the economy. Overall, the sugarcane ethanol industry employs a large chunk of agricultural jobs, has high export potential and supplies enough ethanol to meet the global demand.

Even today, the participation of renewable sources in meeting the growth of energy consumption was prioritized in the elaboration of the PDE 2026 (Plano Decenal de Expansão de Energia), which maintains the Brazilian commitment to promote its economic growth based on a clean energy matrix, adhering to the National Policy on Climate Change (PNMC) and to the other international commitments signed by Brazil. The PNMC established the expansion of renewable and clean energy usage as a part of the national strategy for medium-long term. The expansion of energy supply and

consumption envisaged in PDE 2026, made available for Public Consultation, meets the energy sector's stated goal in terms of the absolute value of greenhouse gas emissions in the year 2020. It also sets out a goal to reach 48 percent renewables share in 2026 in the oil equivalent energy needed by the Brazilian economy⁵⁸. An international commitment signed by Brazil is the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP21). Under the framework, Brazil carried out a series of public consultations with different representatives of the civil society and environmental organizations. Among the government goals are the elimination of deforestation in the Amazon forest, the creation of strategies for a massive reforestation within the country and the establishing of means for monitoring all Brazilian biomass.

Summary of Trade Trends

Brazil has followed a mixed trade policy and its impact can be seen in Fig 3 & 4. Until the eighties, Brazilian trade policy was characterized by import-substituting industrialization policy, under which, authorities implemented import restrictions to protect the process of domestic industrialization. However, Brazilian manufacturers continued to import inputs and capital goods. Following the trade liberalization efforts that reduced import and export barriers, the authorities attempted to re-launch Brazil into the global trading system. Simultaneously, Brazil was engaged in multilateral as well as regional trade integration policies. One of the historic steps taken by Brazil was the signing of the *Treaty of Asuncion* that established the regional bloc comprising of Brazil, Argentina, Uruguay and Paraguay. Mercosur finally came into effect in 1994 with the application of the Common External Tariff (CET). The impact of these liberalization efforts can be seen in the expansion of total trade for Brazil in the nineties. Given majority of the changes in tariff policy aimed at reducing import restriction, tariffs (applied and bound) and simplifying of registration and authorization procedures, imports rose faster than exports in the period 1994-2000.

Post the financial crisis of 1999-2000, Brazilian trade rose dramatically due to a momentous increase in Chinese demand for foodstuffs, agricultural products and

⁵⁸ http://www.mme.gov.br/web/guest/pagina-inicial/outras-noticias/-/asset_publisher/32hLrOzMKwWb/content/pde-2026-preve-48-de-fontes-renovaveis-na-oferta-interna-de-energia

natural resources, and energy demand from the United States. As a result, exports grew faster than imports in the period that followed until the 2008 global financial crisis and the more recent crisis in 2015-16 in Brazil. Notably, exports grew by 16 percent per annum from US\$ 58 billion in 2001 to US\$ 197 billion in 2008; dropped to US\$ 159 billion in 2009 and then reached its historic peak of US\$ 256 billion in 2011. Thereafter, exports as well as total trade followed a downward trend as exports fell by 6.5 percent per annum in the crisis period 2013-2016 due to declining commodity prices and imports fell faster at 13 percent per annum in the same period to US\$ 137 billion in 2016. The depreciation of the Real and the economic downturn in the region translated into a lower demand, both for imports and domestic commodities. The most affected sector was the mining sector, including iron and steel and fuels. Weak infrastructure continues to be a significant bottleneck for agricultural development in Brazil and the sector continued to face deteriorated growth pattern due to the recessionary phase since 2016. Exports and imports slightly recovered in 2017.

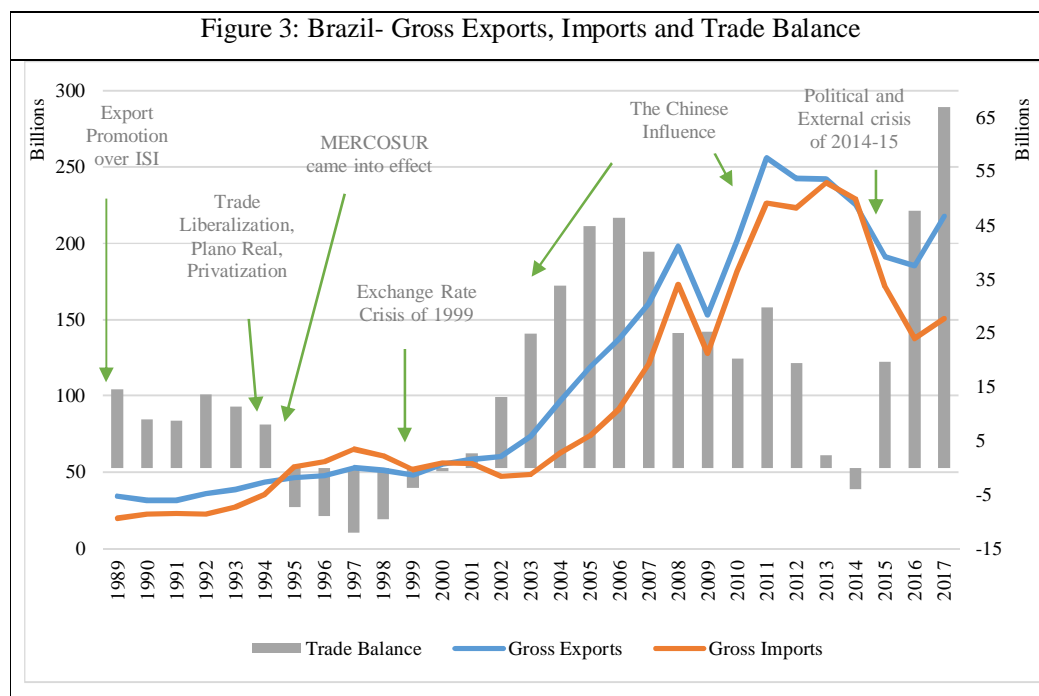
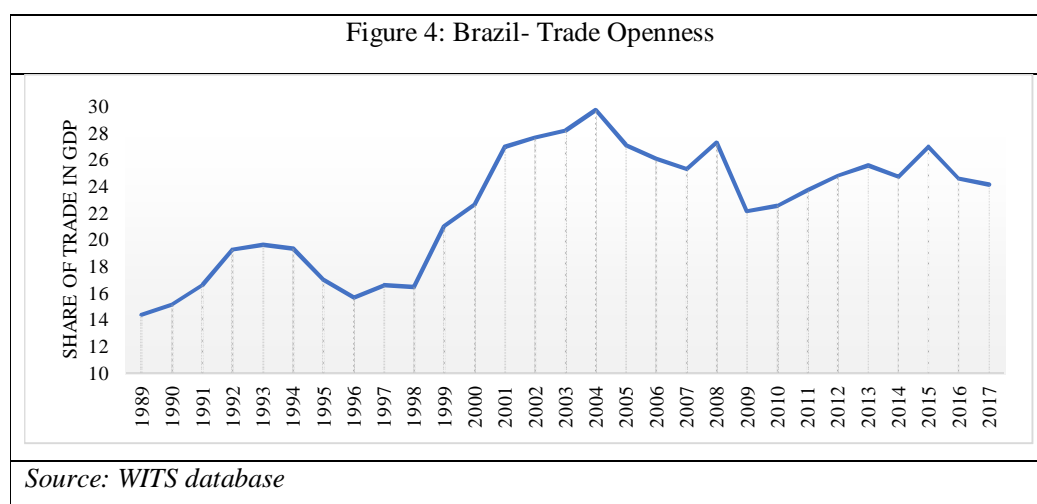


Fig 4 shows that Brazil has been an inward-looking country as trade openness was as low as 14 percent in 1989. Trade liberalization efforts and the trade expansion of the new millennium increased the share of total trade in the GDP from 16.6 percent in 1990 to 29.7 percent in 2004, while trade openness averaged around 25 percent in the period that followed. Brazil has historically had very low trade openness, perhaps due to low

imported content in exports, i.e. high local content addition to exports; old and recent policies aimed at increasing local content requirement in overall production; high transactional and logistical costs for trading as northern Brazil remains underdeveloped and disconnected from the south; and because a very small number of large enterprises are actually export-oriented in Brazil as most of them supply to the large internal domestic market.



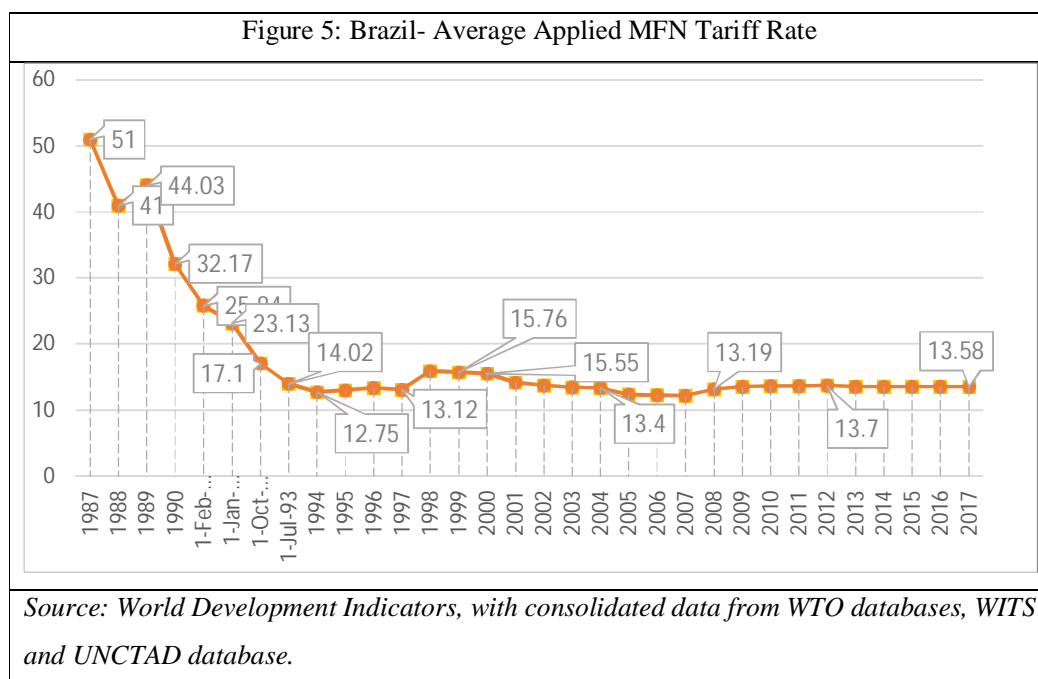
TARIFF REGIME SINCE 1992

Imports

Until early nineties, import licensing was the pivotal protection tool used by the Brazilian government to implement trade and industrial policy. Post trade liberalization efforts that abolished import licensing system in Brazil in March 1990, tariffs became the main policy instrument for protection of domestic activities. The system of import tariff applied before 1990 was highly complex and non-transparent. High nominal import tariffs were frequently offset by exemptions or reductions on capital inputs used by the domestic manufacturing industry (WTO, 1992). Brazilian tariffs are applied on *ad valorem* basis to the c.i.f. value of the product and does not apply seasonal, temporary or variable levies; or any tariff quotas. Brazil granted at least MFN to all countries. At present, all commercial imports must be declared in the Integrated Foreign Trade System (SISCOMEX). Upon completing their first transaction in SISCOMEX, importers are automatically registered in the Registry of Exporters and Importers (REI)

maintained by the Secretariat of Foreign Trade (SECEX) at the Ministry of Industry, Foreign Trade and Services (MDIC).

Average applied MFN tariff rates were as high as 51 percent in 1987. Since then, tariff rates have reduced systematically, with the fastest decline from 44.03 percent in 1989 to 12.75 percent in 1994, a decline in average applied tariff rate by 71 percent in a period of five years. The trade reforms were also aimed at **reducing maximum tariff rates** (bound rate); the maximum rate was 105 percent in 1987, that was reduced to 65 percent in 1992 and 55 percent for agricultural goods and 35 percent in non- agricultural in 1993, owing to the Brazil's bound-rate commitments in the Uruguay Round in 1993. Since 1994, Brazil has applied the **Common External Tariff (CET)** of the Mercosur tariff regime, with tariff varying over the bound range of 0-20 percent from 1994-1997 and 0-23 percent post 1997. Several **tariff concessions** to the CET mechanism have been in place called *Ex Tarifário*, under which, tariff on capital goods (BK) and ICT goods (BIT) was reduced to the range of 0-2 percent, granted by CAMEX Resolution No. 35 of November 2006. Typically, rates are reduced for a period of 2 years. Brazil has been authorized to maintain its BK and BIT lists until end-2021. The CET also permits a list of national exceptions of up to 100 lines. Mostly recently, the deadline for the elimination of Brazil's basic list of national exemptions has been extended until 31 December 2021 according to CMC decision No. 26/15 of July 2015.



Before the application of the CET, in 1992, the *most common rates applied* was in the range of 20 to 40 percent rate, applied to 32.5 percent of total lines, followed by 0-10 percent applied rate on 3,528 lines or 27.6 percent of total lines, 10-20 percent on 26.8 percent lines, and over 40 percent applied rate on 13 percent or 691 lines. The highest rate of import duty in 1991 was on toys at 85 percent. Additionally, 16.1 percent lines were duty-free in 1992 and from 1993 onwards, some goods were subject to zero tariff, including orange juice, iron ore, cellulose, cement, copper and zinc. This schedule evolved after the application of the CET, such that in 2000, fifty percent of all tariff lines were subject to a tariff rate in the range of 14-21 percent, with maximum tariff on dairy, beverages, textiles and clothing, and transport equipment. However, 1.5 percent of total lines were duty-free in 2000; by 2004, more than 12 percent lines were duty-free; and by 2017, only 7.7 percent lines remained duty-free. The average MFN applied tariff rate fell to its lowest rate ever of 10.4 percent in 2004. Since then, the average applied rate has hovered around 13.5 percent. Notably, the total average rate was 13.58 percent in 2017, 10.2 percent on agricultural goods and 13.9 percent on non-agricultural goods.

An important feature of the tariff schedule is the occurrence of *tariff escalation* by stage of processing such that higher tariff is applied on finished imports, as opposed to semi-processed goods and raw materials. In 1991, it was the highest for the textile industry, with 5 percent on raw materials and 47.6 percent on finished textile products. In 1991, tariff escalation was also high for basic metal industries, wood industry and leather industry and remained so thereafter. Over the years, the protection accorded to the manufacturing sector has remained unchanged. For example, in 2017, the average applied rate on raw materials was 7.1 percent, 9.5 percent on semi-processed products and 14.0 percent on fully-processed goods.

Brazil levies a *number of taxes, other than the import duty*, that apply to domestically produced goods as well as to imports. The net impact of these taxes differs across products. The two most common value-added internal taxes are the Industrialized Products Tax (IPI) and Merchandise Circulation Tax (ICMS). Other fees affecting imports included port fees, import processing fees, airport tax, handling charges and a social benefits contribution. Brazil had an automatic regime that granted duty and tax exemptions contingent to export balancing and local content requirement, that was

phased out by 1999. Moreover, goods entering free-trade zones such as Manaus in Amazonas, need not pay customs duties or IPI taxes if they are meant for consumption in the zone or are meant for use by the industries situated in the zone as an input. The same exemptions apply to goods in transit on designated ports. According to Decree 3.880 passed on August 1st, 2001 by the Ministry of Health, medicines and pharmaceutical products have also attracted zero percent tariff since 2001. Moreover, all government imports have remained exempted from duties and taxes.

The importation of a few products is *prohibited* under the Brazilian law and includes weapons and ammunitions, some chemicals, luxury boats and yachts, and used consumer goods, including motor vehicles and retreaded tires according to Article 27 of MDIC Ordinance No. 235, dated December 7th, 2006. Some prohibitions may also arise due to health and sanitary regulations, for example live animals, hormone treated poultry and meat under Ministry of Agriculture, Livestock and Food Supply (MAPA) Normative Instruction No. 17 of 18 June 2004. Other prohibitions include imports of illicit drugs, hazardous waste, and endangered flora and fauna; others in compliance with international agreements and United Nations resolutions that placed trade embargoes on certain countries.

Most imports into Brazil are subject to *import licenses* before they are shipped by the exporting country. Import licenses are issued “automatically”, unless products are subject to special import authorization. Automatic licenses are maintained and granted for statistical and monitoring purposes. However, non-automatic licenses are used to administer special duties and tax concessions such that imports go through a similarity check with domestically produced goods. Brazil grants *preferential access* to countries that have signed preferential trade agreements with Brazil, including those signed by Mercosur after 1995. The most important preferential agreement is ALADI and Mercosur. Tariff preference under bilateral trade agreements differ in product coverage and rules of origin. In 2017, Brazil applied preferential tariff rate quotas under five such agreements: Brazil–Guyana (AAP.A25TM-38), Brazil–Suriname (AAP.A25TM-41), Brazil–Mexico (ACE-53), MERCOSUR–Mexico (ACE-55) and MERCOSUR–Andean Countries (ACE-59). Other tariff preferences are granted under GSTP among developing countries. According to the authorities, the share of aggregate preferential

imports in the total value of Brazil's imports was some 14.5% in 2013, 13.6% in 2014, 12.9% in 2015, and 13.7% in 2016 (WTO, 2017).

Exports

The registration and customs clearance procedures for commercial exports are similar to those for imports. They are required to be declared through the SISCOMEX and registered through the export registry. Under the current trade policy, exports of goods and services are exempt from all internal taxes including IPI and ICMS; they are also eligible for credit in case their inputs were taxes. However, Brazil continues to use ***export taxes***, subject to the destination country of exports, with a ceiling of 30 percent that may be altered by CAMEX for foreign exchange or trade policy purposes. Specifically, export taxes are only applicable on a few products such as cigarettes and arms and ammunition exported to South and Central America and the Caribbean at 150 percent; and overall exports of raw hides and skins at 9 percent. Brazil also maintains export prohibitions on goods on the basis of environmental protection, and in compliance with international agreements or United Nations Conventions. Such products include raw hides and leather of amphibians, certain organic chemicals, and exports of wood in the rough. ***Export licensing and authorization requirements*** are also in place for a large number of products, mainly for health, safety and environmental protection reasons. In some cases, more than one agency might be responsible for providing authorization for a single product. The main product categories requiring prior export authorization include live animals, wood products, pharmaceuticals and chemicals (WTO, 2017). In particular, Brazilian exports of bovine meat and poultry are subject to export licensing procedures that marks each exporter as a 'safe exporter' based on international regulatory guidelines; in special cases, Brazilian meat and sugar exports may also face export quotas in the EU market.

Brazilian authorities maintain several ***fiscal programs to boost exports*** and increase the competitiveness of Brazilian exporters, especially MSMEs abroad. In 2015, the Government launched a National Export Plan (2015-18) based on five action pillars, namely: "market access; commercial promotion; trade facilitation; export finance and guarantees; and tax regimes and facilities for export support" (WTO, 2017). Most of the export-oriented enterprises remain exempt from application of IPI tax on inputs, whether domestic or imported. Previously, a Brazilian Special Exports Program

(BEFIEEX) was in place that provided for exemptions or reductions of import duties and IPI taxes on capital imports used by the manufacturing industry and for imports used as inputs for exported industrial goods. This program was however discontinued in 2002, and replaced by a new regime called Special Regime for the Purchase of Capital Goods for Exporting Enterprises (RECAP), which suspends selected internal taxes on purchases of new (unused) capital goods by export-oriented companies. Under the Reintegra scheme, exporters are also eligible to apply for reimbursements up to 3 percent of their gross export receipts against non-VAT along the production process; given their imported content may not exceed 40 percent of their export price. However, a 65 percent threshold applies for pharmaceuticals, electrical appliances, aircrafts, medical or surgical instruments; and clocks and watches (Decree No. 8,415 of February 27th 2015, as mentioned in WTO, 2017).

Brazil's *drawback system* allows suspension or exemption of tariffs and other federal taxes on imported inputs used to produce exportable goods as per Decree-Law No. 37 of November 18th, 1966, and updated via Ministerial Act SECEX No. 36 of November 22nd, 2007. This scheme allows exporters to defer ex ante on taxes on inputs. Another such system RECOF allows suspension of import duties and indirect taxes on imported or local inputs for industrial transformation of products destined for export or the domestic market. As of 2016, Brazil authorities have relaxed the sector specific and product specific limitations on the scheme's scope. A similar scheme is in place for the IT sector called REPES, under which, software and IT companies are exempt from the IPI tax on imported goods, given they export services worth at least 80 percent of their annual gross income.

Brazil has also set up dedicated *export promotion zones* (EPZs) in various parts of the country. These EPZs are authorized to "purchase local or imported goods and services with the suspension of import duties and internal taxes". They are also exempted from licensing and authorization requirements for exports and imports, except for those related to sanitary, environmental and safety regulations. The National Council of Export Processing Zones (CZPE) is in charge of implementing Brazil's EPZ policy, including "authorizing the creation of EPZs and the establishment of companies". One of the pre-conditions is that 80 percent of their turnover should be from exports. EPZ licenses are granted for a period of 20 years and may be extended. However, any

products that are sold domestically, along with their inputs are subject to duties and internal taxes (WTO, 2017).

Apart from offering fiscal incentives to exporters in order to increase their competitiveness and support their operations, Brazil also has a dedicated ***export promotion agency*** (Apex-Brasil) that is in charge of managing and implementing policies for the promotion of Brazilian goods and services in the international market, for internationalization of companies and attract FDI. It particularly focuses on MSMEs, increasing their participation in global value chains, fostering innovation, design and technology transfer. Apex-Brasil provides market analysis reports, assists on capacity building, and brand promotion of Brazil through participation in trade fairs and trade missions to strategic partners. Export promotion support also involves cooperation agreements between Apex and the private sector associations and may take the form of co-financing opportunities. Along with Apex, several other authorities are available for assistance in internationalization of small companies such as MDIC, MRE and *Banco do Brasil S.A.*

In some cases, exporters may need ***financial support pre-shipment (production of exportable goods and services) and post-shipment (commercialization overseas) to meet financing gaps***. This federal scheme is supported by the BNDES-EXIM program and can take two forms: direct financing (PROEX-Financing) and interest rate equalization (PROEX- Equalization). PROEX-Financing was established through Resolution No. 126, dated December 26th, 2013 and mainly targets MSMEs; it provides direct credit for up to 100 percent of value of exports, applicable for a period of 2 months to a maximum of 2 years. PROEX- Equalization on the other hand, aims to level the international playing field by partly offsetting the cost of credit obtained domestically or internationally to finance exports. It is applicable on credit obtained by exporters to facilitate shipment as well by foreign importers of Brazilian products. Similar to the PROEX-Financing program, equalization can be granted on credit financing up to 100 percent of total exports for a period ranging from 6 days to 15 years (WTO, 2017). Overall, the BNDES-EXIM program may target strategic industries or products such as transport equipment, machinery, and construction services.

PARAGUAY

Paraguay is a landlocked and agrarian economy and is largely driven by exports of a few products as hydroelectricity to its neighbors Brazil and Argentina, soybean, meat, cotton, wheat, corn, among other agricultural products. It also remains dependent on imported consumer and capital goods. A peculiar feature of the economy is its unique geographical position that has transformed it into a “transshipment point for unrecorded trade with its neighbors” and is a center of triangular trade between Argentina, Brazil and Paraguay, such that goods are imported into Paraguay attracting low duties and taxes and then sold to Argentine and Brazilian “tourists” (WBG, 2001). This Tourism trade with Argentina and Brazil however, attracts lower than import duties than other imports (WTO, 1997).

The following analysis of the trade policy in Paraguay is organized in three subsections: the first subsection summarizes the policy trends before the inception of Mercosur in 1991, the second subsection highlights the importance of Mercosur in Paraguay’s trade policy in the nineties, and reviews the current trade policy followed by the country, including an emphasis on its tariff policy and measures to promote trade.

PRE-MERCOSUR TRENDS (1960-1991)

Paraguay has experienced favorable economic growth during the sixties at an average GDP growth rate of 5.9 percent per annum. The World Bank (2001) has attributed this growth to agricultural expansion led by rapid cultivation of land under soybean and cotton, development of hydroelectricity resources, and a relatively open economy as opposed to its neighbors Argentina and Brazil. The growth in seventies accelerated due to the construction of the Itaipú project on Paraná river. However, due to financial contagion from Argentina and Brazil, it slid into recession in the eighties, and the government attempted to induce demand through greater public spending that resulted in inflation and accumulation of debt. As a response, the military government established a multiple exchange rate system that favored imports over exports, thus encouraging corruption and slower growth (WBG, 2001).

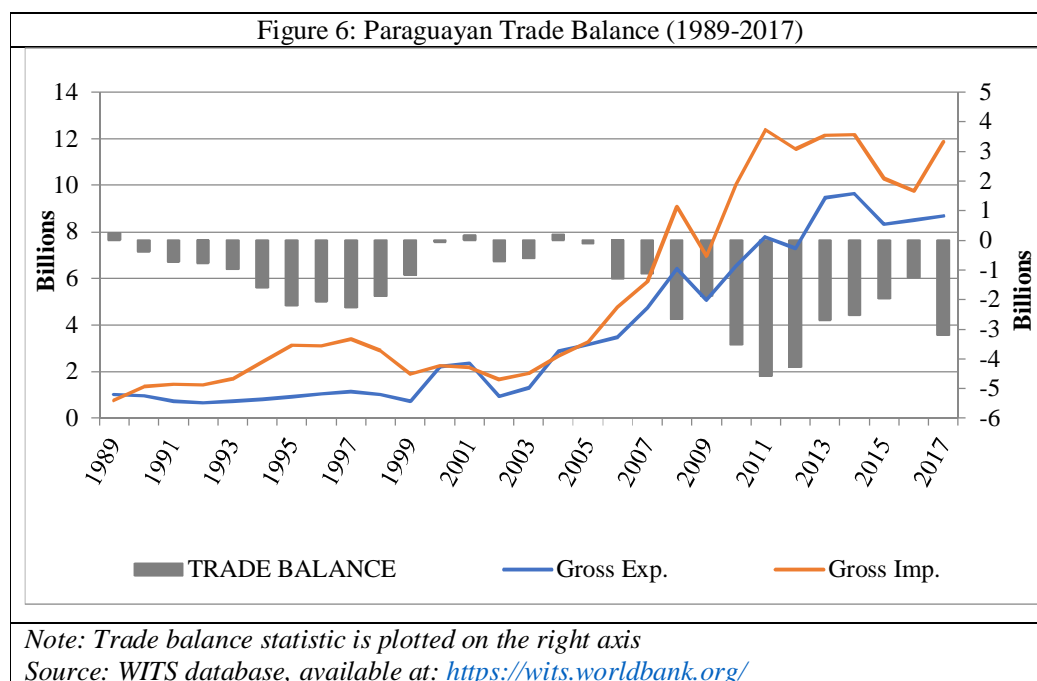
Finally, Paraguay's turbulent history of political authoritarianism under Stroessner that had resulted in the dismal state of the economy ended in a military coup in 1989 (Beittel, 2010). The newly elected government initiated a number of reforms to reduce corruption, raise government revenues, strengthen the domestic financial system, reduce poverty, support agricultural development in the country (WBG, 2001; Beittel, 2010) and rationalize its trade regime by simplifying the tariff structure and reducing duty rates. The government also adopted a new legislative framework in trade policymaking driven by its accession to GATT in 1994 and to WTO in 1995. This included reforms in customs valuation through harmonization of customs according to HS96 version, instituting free trade zones, and by adopting improvements in pre-shipment inspection, sanitary measures and storage facilities (WTO, 1997). This move was a closer step towards greater integration in terms of trade and supplemented by the formation of Mercosur in 1991.

TRADE TRENDS AND POLICY ANALYSIS SINCE CET (1995-2017)

Paraguay viewed the formation of Mercosur as a complement to its efforts to open its economy and supported the adoption of a sub-regional trade policy through the CET (WTO, 1997). Mercosur was a platform to overcome its structural deficiencies such as the small size of its domestic market and higher transport costs due to its landlocked geographical position. In general, its pre-CET tariff rate of 9.1 percent was lower than the CET rate of 9.6 percent in 1997. These low import duties were backed by the surprising fact that Paraguay, unlike all other Mercosur members, never followed an ISI policy to promote certain sectors at the cost of other sectors. Before the application of the CET, it applied seasonal tariffs to protect its sensitive agricultural domestic producers on an ad hoc basis. After the CET, it began to implement tariff escalation to protect processing industries, export prohibitions on unprocessed and semi-processed wood on grounds of domestic deforestation. At the WTO, Paraguay has pushed for provisions for agricultural export-led growth and is a member of the Cairns group along with the other Mercosur members (WTO, 1997).

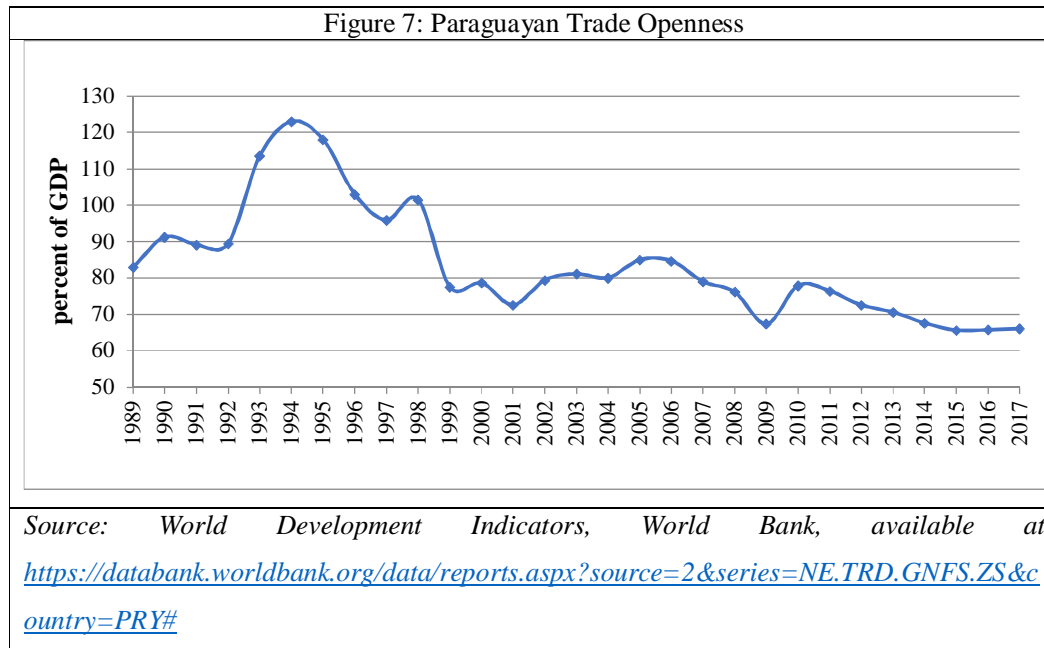
During the next decade, the Paraguayan economy enjoyed robust macroeconomic and political stability. This has boosted the external sector of the economy, with a strong performance by the food and agricultural sector. Figure 6 displays the rising trend in both exports and imports since early 2000s, notably post the upward swing in global

commodity demand and prices in 2003. When contrasted with the previous decade, trade hit a phase of stagnation in Paraguay after the signing of the Treaty of Asunción that formed the trade bloc Mercosur in 1991 and remained dormant till the treaty came into effect in 1995. Figure 6 also shows that imports picked up faster than exports, and have continued to outgrow total exports, leading to a widening trade deficit with the rest of the world. Despite that, exports have grown from US\$ 1.3 billion in 2003 to US\$ 8.68 in 2017, owing to the contributions from the crop and livestock industry in the form of soybean, whole and factions, and bovine meat exports to the rest of the world. Paraguay’s imports from the rest of the world displayed a steady-upward trend from 2001-2017 with a slight downturn in 2008-09 owing to the global financial crisis and in 2014-16 due to the recession in the neighboring economies, Argentina and Brazil. Total imports grew from US\$ 1.6 billion in 2002 to US\$ 11.87 billion in 2017



The overall importance of trade in Paraguay’s economy can be seen in Fig 7. Trade openness is total trade expressed as a percent of GDP. With the exception of the period 1992-1997, openness has continued to decline from its peak in 1994 at 123.08 percent of GDP to only 66.1 percent of GDP in 2017. This could be attributed to its landlocked geographical position; as it is situated between Brazil and Argentina, its position creates heavy dependency on its neighbors. Naturally, Paraguay does not have maritime infrastructure; it instead maintains warehouses and free ports in certain seaports

belonging to Argentina, Uruguay, Brazil and Chile, for loading and unloading of exports and imports. This contributes to the high transport costs and has a negative impact on prices. However, the river transport system is highly developed (Paraná) and carries 80 percent of volume of trade, annually.



It is known that Paraguay's economy is highly susceptible to the consequences of crises in its regional partners, most notably, Argentina and Brazil, and the crises of 1999 and 2000 contributed to the trade stagnation in Paraguay in the period. Moreover, as the economy and trade are heavily dependent on the agricultural and food produce, they continue to be vulnerable to climatic factors and international commodity prices.

However, the government has taken steps to avoid these pitfalls. Paraguay is already a member of the agricultural G20 and lays great emphasis on issues such a market access and export subsidies. For the purpose of promoting exports, the Paraguayan government maintains special customs regimes, including free zones and the *maquila*. Further, the government supports the farmers by granting tax concessions, by offering advantageous government procurement procedures and accessible lines of credit. Moreover, exported goods are exempt from paying any VAT or other internal taxes. They, however, do not offer any export subsidies of any kind. Paraguay is also a beneficiary of the Generalized System of Preferences (GSP) scheme of the European Union, Japan, The Russian Federation, Turkey and the United States. Bovine meat,

essential oils, hides, skins, cane sugar, wood charcoal and oilcakes are some the products that benefit from this preferential access. These are also the product categories that dominate overall Paraguay's export basket.

Today, imports in Paraguay attract Mercosur' Common External Tariff (CET) rates, with a large number of exceptions that are typically lower than the CET. Along with Uruguay, Paraguay is permitted to apply 0-2 percent tariff on capital (under the BK regime) and ICT goods (BIT regime) till 2023 and zero tariff on agricultural inputs, which have to be notified to the Mercosur Trade Commission in advance. The highest average tariff (ad valorem) was attracted by Arms and Ammunition (20 percent), sugar and confectionery (18.8 percent), footwear (18.6 percent), textiles (16.8 percent), alcohol and tobacco products (16.5 percent), motor vehicles from inside the area (5.7 percent), motor vehicles from outside the area (7.8 percent) and dairy products (14.9 percent). In general, the MFN tariff applied in 2017 was 9.9 percent on agricultural products, and an average of 8.2 percent on non-agricultural goods (WTO, 2017). Thus, the average applied tariff of 8.4 percent is lower than the MERCOSUR CET of 11.5 percent. Additionally, Decision CMC No. 30/15 allowed Paraguay to increase the CET on a group of dairy products (0402, 0404, 0406) to 28 percent until December 2023. However, tariff preferences have been granted to Israel under the FTA, to India under the PTA and to countries belonging to the South African Customs Union under the Mercosur-SACU PTA.

In addition to tariffs, imports are subject to payment of various internal charges including valuation tax for the supply of customs services, consular fee, and a tax to finance the Paraguayan Indigenous Institute. The VAT is also applied on all imported products (generally 10 percent) along with a consumption tax (ISC) on selected products not deemed to be essential (for example, cigars, tobacco, alcohol, petroleum-based fuels, perfumes, jewelry, etc.). Imports are also subject to mandatory certification and this affects most of the capital goods imported from extraregional partners; in May 2017, this list included some fuels, measuring equipment, steel rods and bars, polyethylene bags, cellular devices and toys.

URUGUAY

“Uruguay's general trade policy objectives include increasing access for Uruguayan products in foreign markets and deepening the integration of the country into the world economy. This has been pursued through multilateral, regional, and bilateral trade negotiations as well as through autonomous reforms.”

– (WTO, 1998)

The first trade policy review held by the GATT for Uruguay was in 1992⁵⁹. It characterized Uruguay as an export-oriented policy to support agricultural exports, with the larger aim of integrating its economy in global trade. Although it pursued an import-substituting policy till the seventies and experienced financial contagion from its neighbors in the eighties, it displayed an overall positive growth trend since the nineties due to active trade policies that focused on promotion of exports and macroeconomic stability. The following section on the evolution of Uruguay's trade policy is divided into two three subsections: the first subsection highlights the key policy and macroeconomic trends that has shaped its current trade policy that is presented in the second subsection. Finally, the pattern of trade openness and balance is highlighted in the last subsection.

HISTORICAL PERSPECTIVE

Uruguay, like other Mercosur members, Argentina and Brazil, also followed an import-substitution industrialization (ISI) policy till the seventies. Through the sixties, quantitative restrictions were eliminated, export subsidies were introduced, however so were export taxes on unprocessed hides and skins to encouraged further domestic processing. However, these import relaxations led to a shortage of foreign exchange and the government was forced to adopt exchange controls and restrict through application of complex tariffs, temporary prohibitions, and reference prices (GATT, 1992a).

The next round of liberalization occurred in 1974 when the tariff structure with simplified and rationalized; tax and tariff concessions were introduced on imported

⁵⁹ Document by GATT (1992): C/RM/S/26A

inputs for exportable goods in industries declared as national interests. This tariff structure existed in Uruguay till the application of the CET in 1995. This liberalization of 1974 helped to relocate resources from the import competing industries to exporting sectors (GATT, 1992a). It is imperative to highlight the economic environment in which these liberalization efforts were introduced. Hanson and de Melo (1983) note that “*Uruguayan prospects appeared dismal*” as inflation and fiscal deficit were high, terms of trade were low due to the oil price shock, and the international partners had blocked imports of Uruguayan bovine meat. Hence, there was an urgent need for the liberalization efforts 1974.

In the post-war era, Uruguay sustained GDP growth averaging at 5.4 percent between 1944-1951, primarily led by increase in global demand for food. However, its agricultural sector experienced a slowdown in 1951 and an immediate response in the form of tighter import substitution policies including high tariffs was implemented. Subsequently in the next fifteen years, the economy was caught in a “*stop-and-go cycle of inflation, stabilization and devaluation*” (Hanson and De Melo, 1983). An IMF stabilization package in 1957-658 resulted in some improvement in inflation but at the cost of growth, fiscal deterioration in terms of low revenue to GDP ratio through the sixties and capital flight due to high and rising inflation to 100 percent per annum in 1966-68 (Harberger, 1975). It seemed that the economy had “reached its limits” with the ISI policy in the late fifties, despite efforts to sustain it with export taxes on agricultural commodities that depressed growth. By 1967, another IMF stabilization package was unable to sustain the economy that finally crumbled in 1971 due to fiscal excesses and collapse of the balance of payment (Hanson and de Melo, 1983).

Thus, the liberalization efforts of 1974 were a part of the overall development plan of 1973-1977 aimed at deregulating domestic commodity sector, reducing the influence of the ISI and state intervention to enable a gradual insertion into the global economy and financial liberalization to enable use of foreign capital in financing investment in Uruguay. These reforms were supplemented by commodity market reforms that removed price controls, simplified the tax system lowered export taxes, provided fiscal incentives, removed restrictions on imports through abolition of import quotas in 1975, relaxed controls on capital imports and aimed “*consolidated all import surcharges, taxes and tariffs into a uniform rate of 35 percent*” in the next decade. As a result, the

GDP expanded, inflow of capital increased, exports expanded in the next years due to a reduction in the export bias that was earlier promoted under the ISI policy. However, the unfavorable conditions in its neighbors, Argentina spread to Uruguay and considerably slowed down the export-led growth of the last decade. By 1982, it had already led to a loss in competitiveness in exports, deterioration of the current account, and inflation (Hanson and de Melo, 1983).

This recession by 1983 due to hyperinflation and exchange rate crisis in Argentina forced the government to apply export-reference and minimum prices to provide protection to its exporters. This partly offset the tariff rationalization of 1974 and hinted to reversal of policy that reflected elements of the ISI policy once again (GATT, 1992a). However, it was met by simultaneous reduction in import tariffs to a maximum of 24 percent, down from 50 percent at the time, especially to offset these ISI tendencies. These measures were part of an economic readjustment plan that was fully implemented in 1985 to address the fall in GDP and rise in unemployment (GATT, 1992a). As a result of the plan, public deficit reduced along with a decline in inflation to 57 percent in 1987 from 83.3 percent in 1985 and the GDP grew by 8 percent in 1986-87 (Bucheli and Gustafsson, 1996). However, the next year was met with a drought that affected the exportable agricultural reduction including that of corn, soybean, pork and bovine meat.

As it has been mentioned earlier, Uruguay's economy is highly integrated with the economies of its neighbors and it is easily affected by any financial contagion. The ongoing inflationary crises in Argentina and Brazil, coupled with an increase in demand for Uruguayan exports in its neighbors and wage-indexation led to an inflation of 130 percent in 1990 despite fiscal tightening undertaken by the government in 1990. Finally, the IMF intervention, inflation rate reduced to 85 percent in 1991, 68.4 percent in 1992 and to 15.2 percent by 1997 (WTO, 1998). This intervention was supplemented by domestic reforms including fiscal strengthening, de-indexation, monetary discipline and allowing the currency to appreciate to avoid inflation.

The reform package also included modification of the tariff schedule. In 1992, Uruguay administered a four-tier tariff system of 0, 10, 17 and 24 percent tariff applicable on imports. This was a comprehensive policy with an inherent mechanism for compensation from loss of tariff revenue through a simultaneous increase in indirect

taxes. However, tariff escalation and peaks were rampant in the primary sector including in fishery, tobacco, wool, cotton and leather industries; so were export taxes on live animals, boned bovine meat, bovine fat, greasy wool and hides and skins. However, to promote overall exports as per GATT/WTO standards, they removed export subsidies but continued to use drawback schemes that offered tax and duty rebates on exports, established free trade zones (WTO, 1998).

A probable threat to its export competitiveness was currency appreciation and inflation. Hence, the government maintained a crawling peg with fixed band of 6 percent. The absence of forex controls also led to frequent inflows and outflows of capital (capital flight). Another exogenous factor was the tariff and non-tariff barriers faced in developed country markets. Similar to Argentina and Brazil, the production of many sectors (including bovine meat and dairy) was centrally controlled; Uruguay too sought to privatize some sectors to attract foreign direct investment in early nineties. These reforms were formalized under the foreign trade and investment plan and the National Debureaucratization Program to simplify state procedures and raise coordination between different government departments. This positive policy environment saw the development of regional trade relations under ALADI and Mercosur- a move to increase exposure to world competition (GATT, 1992).

This period was marked abolition of reference prices in 1994, but minimum export prices continued to be applied on clothing, textiles and sugar. Overall exports of agro-industrial products were liberalized, all export prohibitions were eliminated but raw hides were still subject to taxes. The appreciation of the Uruguayan peso led to an increase in dependency on imported inputs, especially from Mercosur members. GATT (1992) noted that Uruguay has followed policies aimed at deregulation of trade for over three decades- it allowed imports of raw materials and capital, promoted processing of domestic raw materials and diversification of exports to promote agro-businesses and industries alike. In December 1997, Uruguay also modernized of customs through customs decentralization and computerization, as well as the creation of a unified procedure; a single window for import formalities that further streamlined the system (WTO, 1998).

It has also been a strong advocate of eliminating non-tariff barriers. This advocacy at the multilateral level was a part of Uruguay's priority to implement its commitments in

the Uruguay Round negotiations that began in 1986. This included further trade liberalization and reduction of discriminatory treatment against agricultural exports. It has also ratified a number of WTO agreements by Law 16.671 of December 13, 1994 such as the Agreement on Agriculture, Anti-Dumping, Customs Valuation, Import-licensing procedures, Rules of origin, subsidies and countervailing duties, safeguards, TRIPS, TRIMS, GATS, technical barriers to trade among others (WTO, 1998).

The overall trade policy trend in the nineties has been summarized by Casacuberta and Vaillant (2004). They note that “*Uruguay experienced a gradual, slow and long process of trade reforms*”. This process was dampened by the bargaining power of various industries because of the compensation mechanism that “*offered protection to industries from increased international competition with larger power to influence the government*”. The nineties were marked by an acceleration in fall of import tariffs and greater adherence to international agreements. Their reciprocal nature reduced the power of the government to continue to offer protection. Hence, it can be said that the “*international agreements deepened the trade liberalization process*” in the decade.

CONTEMPORARY TRADE POLICY

It has been noted that the government is highly inclined towards increasing trade volumes and diversifying its merchandise export basket and has taken various measures, with the aim of promoting exports to the world, attracting FDI and diversification in terms of both, markets and products⁶⁰. The Uruguay XXI is one such agency responsible for the showcasing the country brand of Uruguay, as a way of increasing foreign trade. The government has also developed *Free Zones* in the country that are exempted from all taxes and duties. Goods moved to these free zones are considered as exports. They can be stored or processed in these free zones and are re-exported to the rest of the world. Goods can also be imported in the free zones and are exempt from customs duties.

As a primary agricultural exporter, Uruguay actively participates in the WTO G-20 talks by advocating for broader market access and elimination export subsidies for agricultural products. Moreover, Uruguay is also member to the Cairns Group, a coalition of 19 agricultural countries that account for over 25 percent of world’s

⁶⁰ Trade Policy Review, 2018

agricultural exports. The latest statement by the group in May 2017 calls for disciplines on production and trade-distorting domestic support and increased market access *through substantial progressive reductions in protection* to help the farmers (WTO, 2017)⁶¹. In practice, Uruguay does not impose any export duties or taxes, except a 5 percent on raw hides, to encourage processing in the domestic industry. However, exporters in Uruguay are required to pay *Port Duties* every time merchandise leaves a designated port. This varies across HS chapters, with dairy and pharmaceutical products attracting the lowest US\$ 5.67 per ton, bovine meat at US\$ 8.73 per ton, nonedible goods of animal origin like hides and wool were charged at US\$ 12.76 per ton, while tobacco and gold attracted the highest duty of US\$ 22.67 per ton.

Uruguay's tariff structure is based on Mercosur's common external tariff regime (CET), with minor exceptions. The simple average MFN rate applied in 2017 was 10.3 percent, agricultural products were subject to a higher average tariff of 9.9 percent, while non-agricultural products were subject to an average of 10.4 percent. The highest tariffs were applied on clothing (20 percent), dairy produce (17.9 percent), sugars and confectionery (17.2 percent), textiles (16.1 percent) and leather, rubber footwear (15.4 percent)⁶². Some products are subject to a tariff higher than 20 percent and include soya oil, fruits and nuts, and motor vehicles for the transport of passengers and goods. In general, sugar and automotive industries are not included under the CET regime. Thus, members are free to choose the applied tariffs on these industries. Automotives from outside the Mercosur zone are subject to 0-23 percent tariff, with a national average of 15.7 percent, while automotives from inside the zone attract an average of 6.9 percent. It is well known that the sugar industry is highly protected in all members of Mercosur and Uruguay is no exception. Sugar from outside the region is subjected to 5-23 percent tariff, while those from inside the zone are subject to a flat 35 percent tariff.

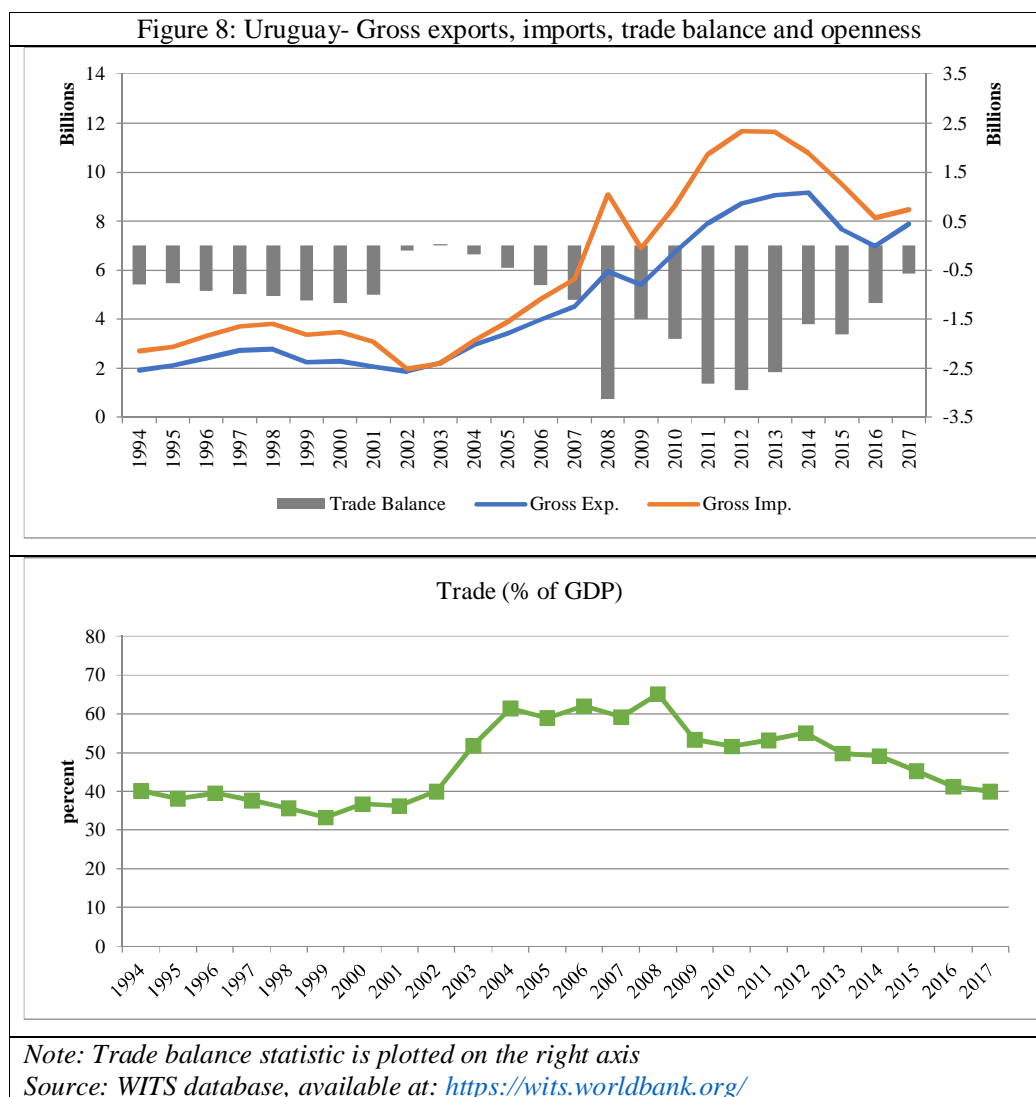
The CET also allows some exceptions for imports that are used as inputs for domestic industry and intended for the domestic market only. Imports of Agricultural inputs, consumer and capital goods for industrial use and inputs for production of renewable sources of energy are exempt from any import tariffs. The BK and the BIT regime

⁶¹ More information at <https:// CairnsGroup.org/Documents/CG%20Objectives%20for%20MC11%20and%20Beyond.pdf>

⁶² Trade Policy Review, 2018: section 3.1.3

granted to Paraguay also applies to Uruguay such that tariff on capital and ICT goods attract a tariff of 0-2 percent till 2022-23. Moreover, Uruguay does not maintain any tariff quotas. However, preferential quotas are granted under its existing trade agreements to regional trade partners, including Brazil for motor vehicles, Argentina, Peru and Mexico. Uruguay also applies non-preferential rules of origin only when the goods are being considered under the anti-dumping measure.

TRADE OPENNESS AND TRADE BALANCE



Imports rose faster than exports after the formation of Mercosur in 1991 and the application of the CET in 1995. Similar to other Mercosur members, Uruguay too is a large agricultural exporter and experienced robust growth in exports due to the

commodity supercycle starting in 2002. The composition of its export basket is analyzed in the next chapter. The previous analysis has already identified the importance of trade in Uruguay's growth trend. However, the share of trade in GDP declined since its peak in 2008 of 65 percent of GDP. This was also marked by a downturn in imports in 2008-09, owing to the global financial crisis. Overall trade then picked up in the next five years but slowed down once again due to the crisis in its neighbor Brazil in 2014. However, there has been a slight reversal in exports as well as imports since 2016. In 2017, while exports totaled US\$ 7.9 billion, imports stood slightly higher at US\$ 8.5 billion, together contributing to trade openness of 40 percent. Historically, it can be seen in Fig 8 that imports have risen faster than exports, and Uruguay has consistently run trade deficit vis-à-vis the world during 1994-2017, except in the year 2003 when exports exceeded imports by a slight margin of US\$ 17 million. The next chapter analyzes the composition of this trade and offers a plausible explanation for this phenomenon.

CONCLUSIONS

This chapter analyzed the evolution of trade policy in four of the Mercosur members, including its two largest members, Argentina and Brazil and its two smaller members, Paraguay and Uruguay. These four economies can be characterized as large and global exporters of agricultural goods. They are all members of the Cairns Group that promotes liberalization of agricultural exports through greater market access, reduction of export subsidies, simplification of sanitary and phyto-sanitary rules faced by raw or semi-processed goods of animal and plant origin and technical barriers to trade faced by semi-processed or processed agricultural exports.

Historically, all members, with the exception of Paraguay, followed the import-substituting industrialization policy till the late seventies and promoted some strategic sectors at the cost of others, especially those supplying exportable goods through application of prohibitory measures. The ISI policy adopted by the two large countries had similar features, however, there were pertinent differences between the two policies that had a greater impact on the overall development of the economies. Although Argentina adopted the ISI policy to promote industrialization to reduce dependency on

imported capital, Brazil implemented similar import-substituting protectionist policies to ensure energy and agricultural self-sufficiency.

Both the national agendas were aimed at development of the domestic sectors to serve their large internal markets, but the Brazilian policy agenda specifically targeted two main economic sectors: the export-oriented agricultural sector to increase competitiveness in the international market and ensure steady supply of food to the Brazilian people; and the energy sector – to reduce the dependency on international oil imports (import substituting) through exploration of alternate sources like biofuel, hydropower, wind farms and natural gas. Over time, the Brazilian energy sector gathered momentum such that Brazil turned from a net-importer to a new-exporter of energy in the twenty-first century.

On the contrary, the import-substituting industrial development in Argentina never really took off as they lagged in adoption of technology and were unable to produce at globally competitive prices, despite the abundance of minerals and natural resources. They also continued to be dependent on imports of intermediate and capital goods as inputs to the domestic production. The ISI was also followed by Uruguay as well, but it was unable to sustain the policy due to a small domestic market for the import-competing output by protected industries that were not globally competitive.

The decision to form Mercosur in late eighties, amidst ongoing political tensions and domestic economic crises was a way to liberalize bilateral trade between the two natural trade partners, Brazil and Argentina. The trade policies in both the countries unfolded in a similar way; they witnessed similar development trajectories owing to the simultaneous periods of growth and crisis in their respective countries. These similarities in the trade-policy experience have reinforced the need to cooperate on economic and trade issues. Coincidentally, both the countries were faced with hyperinflation in the eighties that coerced them to adopt a new currency and trade liberalization policies in the nineties.

The contagion from these crises affected the macroeconomic stability of their smaller neighbors and Mercosur members, Uruguay and Paraguay; following which, they both spiraled into an inflationary crisis in the late eighties. As a result of this downturn, all members, with the exception of Paraguay obtained a stabilization package from the

IMF to apply wider trade and macroeconomic reforms during the late eighties-early nineties. Mercosur's formation coincided with these trade liberalization reforms in 1991.

All Mercosur members successfully adopted the CET in 1995 with special and differential treatment of goods, exclusion of automobiles and sugar, national negative national lists and tariff escalation. This has led to a haphazard pattern of the CET seen in the four members' trade policy. Due to the asymmetry in size vis-à-vis the other two members, Brazil and Argentina, the smaller members have been accorded with special provisions on imports of capital good and ICT goods. In particular, the BK and BIT regime permits Paraguay and Uruguay to apply 0-2 percent tariff on capital and ICT goods till 2022-23 as opposed to a higher tariff applied by Brazil and Argentina on these goods to protect their domestic industrial base. Since their application in 2015, these measures have helped Paraguay and Uruguay to import cheap capital goods to complement their domestic manufacturing industries.

The analysis of Uruguay and Paraguay confirms the 'small country narrative' found in the literature (chapter 2) that predicted high dependency of small countries on its larger neighbors and regional bloc members due to a multitude of reasons related to securing market access for its products and importing tariff-free capital goods to boost its domestic industrial sector. Among the Mercosur members, Paraguay and Uruguay have displayed the highest trade dependency within bloc. This is reflected in the high trade openness of both the countries; Paraguay has a higher trade openness than Uruguay due to its geographical limitations and underdeveloped domestic sectors. As a result, both the countries have aligned their trade policy with the overall agenda of Mercosur, chiefly due to the high level of dependency on the other members of the bloc. Thus, there is *greater policy coordination* in these countries, than in Brazil and Argentina where the national industrial policies have been favored over the commitments made in the Mercosur agreement. This idea has been further explored in Chapter 5.

The parallel experiences have also led to similar trade policies in Argentina and Brazil. They have been characterized by a large internal market and domestic policies aimed at protecting their industrial sectors through high tariffs and local content requirements. This policy is a product of the import substituting industrialization followed by the countries till the eighties. These features have led to low dependency on trade (trade to

GDP ratio) due to emphasis on promoting industrial growth, however, Brazil has the lower ratio Argentina. This low dependency on international trade has also closed the economies to foreign competition and imported capital inputs for domestic production.

Despite the formation of Mercosur with the aim to coordinate trade policies with other members of the bloc, Argentina and Brazil have continued to follow a unilateral and nationalistic policy with clear manipulation of the tariff regime. Although the members followed the CET since 1995, the national policies contributed to the *lack of harmonization* in trade policy between members, as opposed to the terms of the Treaty of Asuncion. Thus, the lack of coordination in intra-bloc economic matters has hindered the full application of the terms of the agreement in forming a common trade policy with respect to non-members.

While this chapter traced the evolution of trade policy in the four members of the bloc, the next Chapter 4 analyzes the trade relations of the four members and focuses on their composition of trade baskets and partners. The present level of policy harmonization by the smaller members predicts trade-related dependency by Paraguay and Uruguay on Mercosur for both imports and exports; on the contrary, the lack of harmonization in Brazil and Argentina foretells low volume of trade with Mercosur members. These hypotheses are tested in the next chapter that also comments on the level of trade integration achieved among Mercosur members in the last thirty years.

CHAPTER 4: EVOLUTION OF TRADE RELATIONS

INTRODUCTION

The previous Chapter 3 has traced the evolution of trade policy in the four Mercosur members, from the import substitution policies in Argentina and Brazil, to the trade liberalization efforts that led to the formation of the bloc in 1991, and the recent changes in tariff policies in the bloc. This analysis revealed the lack of policy alignment with the overall agenda of Mercosur in Argentina and Brazil. On the contrary, Paraguay and Uruguay have been policy “takers” and have oriented their domestic policies towards fulfillment of the Treaty of Asuncion. Thus, the industrial policy directly affected the formulation of trade policy in all four members.

This chapter analyzes the impact of the evolution of trade policies on the members’ trade relations with each other, with regional partners, as well as with extraregional partners. In particular, it examines the trade trends in the period 1989-2017, with focus on the composition of export-import baskets and choice of trade partners. It also identifies the most competitive sectors in the member countries that have contributed to the highest growth in trade, and the main trade partners. The recent growth of trade with China has pointed towards the “commodification” of Mercosur members due to large exports of agro-based products and natural resources (Jenkins, 2015 and Kessler, 2018). This chapter will quantify the trade relations with China and analyze its impact on trade patterns with other members, including intra-bloc trade. Moreover, this analysis will also reveal the level of trade dependency of the smaller countries Paraguay and Uruguay on the internal Mercosur market and on imports of capital goods from the larger members Brazil and Argentina.

The chapter is organized as follows, in the first subsection, the trade relations of Argentina are analyzed at length with a focus on exports of motor vehicles and biofuels and imports of mineral fuels, and main trade partner China. In the next subsection, the relations of Brazil are analyzed with a focus on its extraregional partners, EU12⁶³, the

⁶³ Preliminary analysis revealed that EU12 rather than EU28 members are one of the top trade partners for the Mercosur bloc and its members. Hence, the following analysis used EU12 members

United States and China. This subsection on Brazil will highlight the large share of agro-based products in its total exports and will supplement the analysis in the previous chapter that highlighted the evolution of Brazil into a “food giant” over the last century. Trends in composition of trade in Paraguay will be presented in subsection 3, with an emphasis on some of its largest exports including meat, soybean and electricity. Last, subsection 4 will highlight similar trade trends in Uruguay in terms of composition of export-import baskets and trade partners. The last two subsections will stress on the importance of internal as well as external markets for the smaller members of the bloc and quantify their level of dependence on the Mercosur members for trade since 1991.

ARGENTINA

EXPORTS

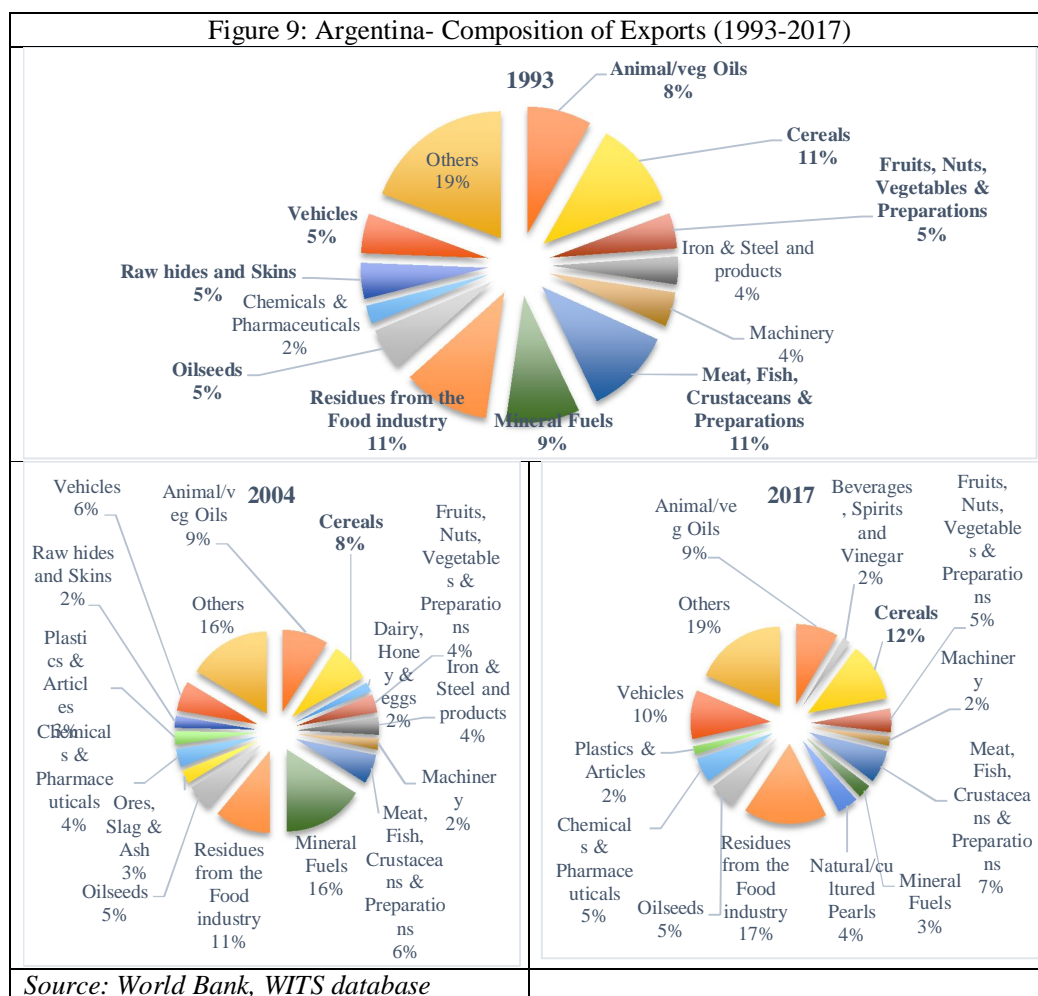
Over time, the Argentine government has adopted policies to improve competitiveness, together with an active trade promotion policy, resulting in increase in exports, the diversification of the export basket and the opening up of new markets. WTO’s trade policy review for Argentina (2013) noted that Argentina sought to increase and diversify Argentine exports with respect to not only destinations, but also regions and products. The aim had been to strengthen exports to traditional trading partners as well as open up promising new markets. Efforts had also been made to diversify export supply, notably products with greater value addition and local tech content to support quality employment in the country.

The previous chapter highlighted the role played by Argentina as the provider of food to the world since the second world war. Despite periods of export restrictions to maintain a stable domestic price and supply of food, Argentina continued to export agro-good based products. For example, in the period 1993-2017⁶⁴, over fifty-percent of the exports comprised of products from the agro-based industries such as animal & vegetable oils, cereal, meat, fish and crustaceans, and residues from the food industry to the world (Fig 9). In particular, the top goods exported were soybean oilcakes, maize, soybean oil, crustaceans, wine, meat. Other non-food based top products exported by

including Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherland, Portugal, Spain and the United Kingdom.

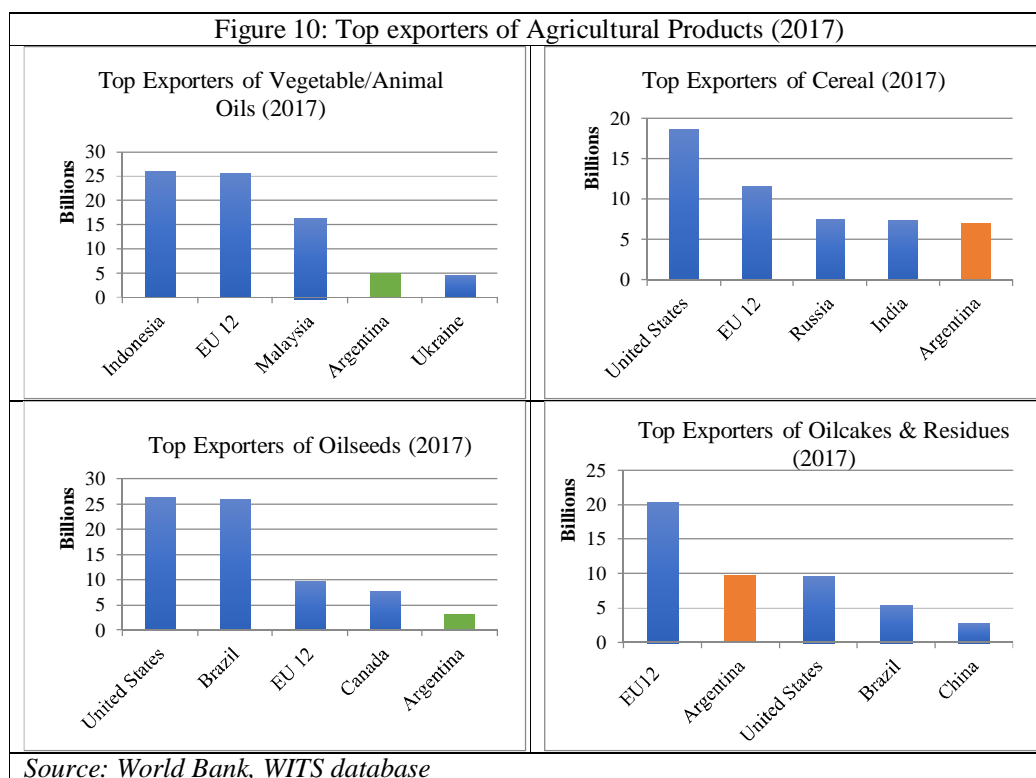
⁶⁴ Due to the paucity of disaggregated data, the analysis has been conducted for the period 1993-2017.

Argentina included mineral fuels, vehicles and parts and raw hides and skins. Between 1993 and 2004, the total trade basket changed marginally as Argentina began exporting ores, slag and ash, plastics and articles, and dairy products by 2004. The exported value of raw hides and skins increased from US\$ 603 million to US\$ 814 million in the same period, although its relative share in the export basket shrank by 3 percentage points. Additionally, the exported value of product group of oilseeds (notably comprising of soybean exports) almost tripled between 1993 and 2004, from US\$ 696 million to US\$ 1.833 billion and grew at an average rate of 9 percent per annum.



According to Fig 9, minor changes are also seen in the export basket between 2004 and 2017. Argentina began exporting US\$ 900 million worth of beverages as well as, natural and cultured pearls worth US\$ 2.5 billion to the world in 2017. Moreover, the share of mineral fuel fell drastically in the same period from 16 percent of total exports

and a value of US\$ 5.5 billion in 2004 to just 3 percent of total exports in 2017, amounting to a little over US\$ 1.6 billion. Although the share of animal and vegetable oils remained at 9 percent of total exports between 2004 and 2017, exports increased in value from US\$ 3.15 billion to US\$ 5.01 billion in 2017.

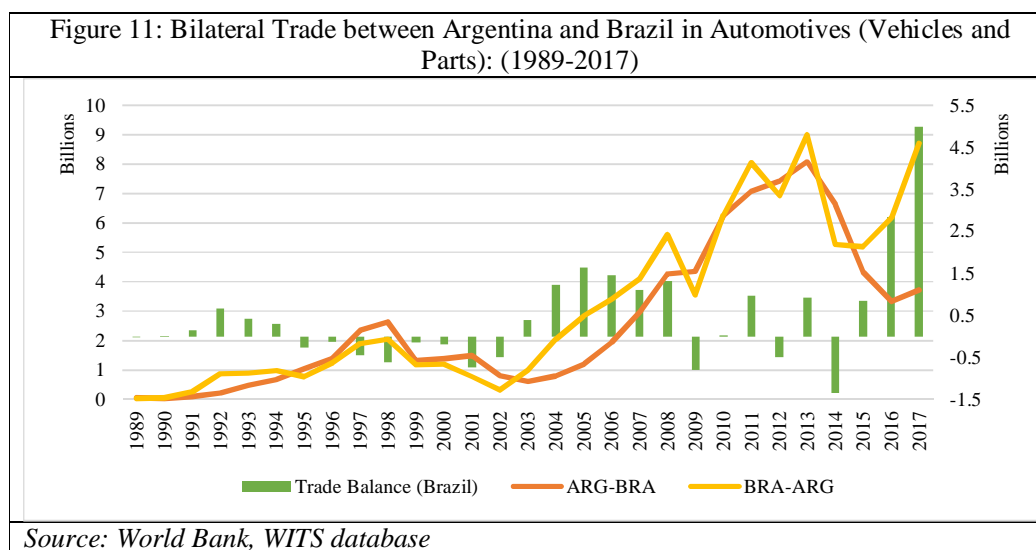


As mentioned previously, exports of cereal comprised a substantial share in total exports, mainly in the form of maize exports. Given Argentina was the fifth largest exporter of cereal in the world (Fig 10), total value of cereal exports almost tripled from US\$ 2.68 billion in 2004 to US\$ 6.96 billion in 2017, and their share in the total exports also rose from 8 percent in 2004 to 12 percent in 2017. Apart from cereals, the largest share in total exports in 2017 belonged to group of residues from the food industry, especially soybean oilcakes, with a share of 17 percent in total exports. According to Fig 10, oilcakes and residues have historically formed an integral part of Argentina's export basket; from 1993 to 2017, their export value increased from US\$ 1.45 billion in 1993, to US\$ 3.83 in 2004, and US\$ 9.82 billion in 2017. Overall, oilcake exports grew at an average of 8.3 percent per annum in the twenty-four-year period between 1993 and 2017. Moreover, in 2017, Argentina was the single largest exporter country of oilcakes and residues in the world, with a value of US\$ 9.8 billion. It was also the

fourth largest exporter of animal/vegetable oils in the world, with a value of US\$ 5.01 billion; and the fifth largest exporter of cereal and oilseeds in 2017, with an export value of US\$ 6.97 billion and US\$ 3.15 billion respectively.

MOTOR VEHICLES

Argentina has been an important player in automotive trade in the Mercosur region. Automotive trade between Argentina and Brazil benefits from the *Common Automotive Policy* that was signed by the two countries as a part of the *Economic Complementarity Agreement No. 14* in 1990. They aimed to diversify and expand the bilateral trade in the automotive sector, with increasing participation of regionally produced parts (Agreement of Economic Complementation No. 14, Annexure VIII: Economic Complementation in the Automotive Sector, Article No. 1, 1990). Recently, the agreement has been extended till 2020 that includes cars, trucks, tractors and auto-parts.



In Fig 11, trade between Argentina and Brazil in the group motor vehicles and parts can be seen. In the case of Brazil, although the figure shows a general trend of positive net exports in the period 2003-2017, automotive exports to Argentina greatly deteriorated in 2013 as the region experienced severe crisis, only to recover in 2017 to pre-crisis levels of US\$ 8.7 billion. In turn, Argentine net automotive trade with Brazil has been negative except in a few exceptional years that were unfavorable to the

Brazilian automotive industry. Though auto part exports to Brazil fell dramatically since 2009, vehicle exports were able to reverse some part of the Argentine deficit with robust growth of the motor vehicle manufacturing industry; however, overall automotive trade continued to remain in deficit with Brazil (Gárriz, Panigo and Gallo, 2014).

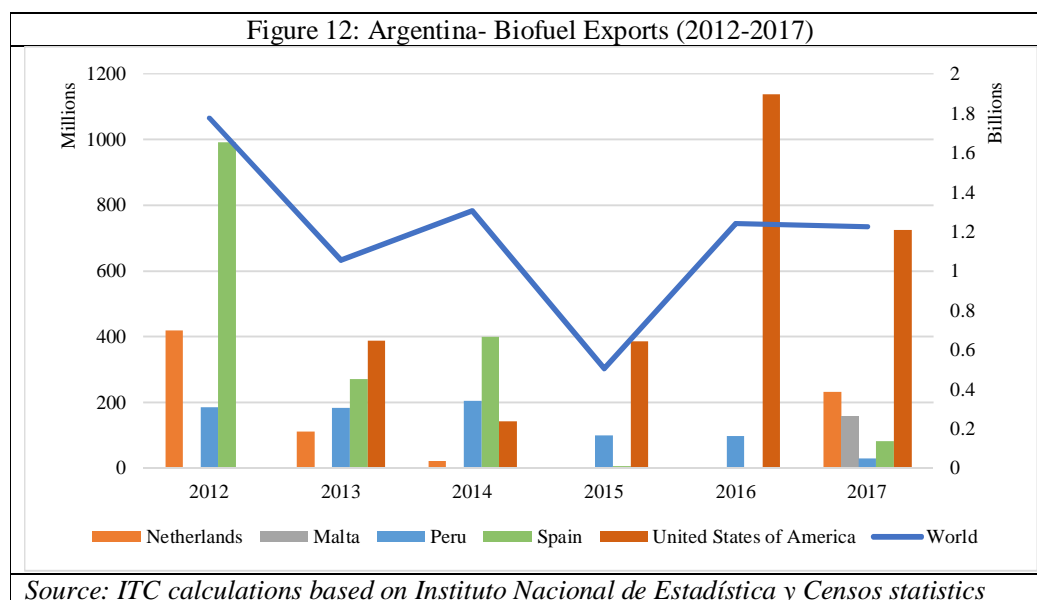
The newly elected government under President Macri in 2015 reduced export duties on a few items in late 2015 that led to an inflationary phase in 2016, accompanied by appreciation of the peso that hurt the manufacturing sector as well. This was accompanied by the recession in Brazil that led to a fall in demand for industrial goods by Brazil, especially affecting exports of Argentine automobiles to Brazil (Cepal, 2017). This led to a reduction in price of motor vehicles and affected the local production in Argentina adversely. Nevertheless, in 2017, 65 percent of all vehicles (for passengers and goods) exported by Argentina found their way to Brazil valued at US\$ 3.14 billion. In 2017, Argentina also imported motor vehicles from Brazil valued at US\$ 8.71 billion.

BIOFUELS

Since 2007, Argentina has had a regulatory framework in place to promote the production and use of biofuels. The *Biofuels Law of 2006* also set mandates for the mixture of 12 percent bioethanol in gasoline and 10 percent biodiesel in diesel in the country. The main objectives of this framework were to diversify the supply of energy and to foster environmental conservation, among others. Argentina has a large biodiesel industry based on soybean oil and a growing ethanol industry based on sugarcane and more recently grains (USDA, 2017a).

With the growing environmental concern around the world about usage of non-renewable sources of fuels, the period following 2012 witnessed a rise in the demand for a safer option in the form of biofuels. Argentina stepped in the right time as an important supplier to the world. In 2017, Argentina was the fourth largest exporter of biofuels in the world, with a share of 11.1 percent of total exports and a value of US\$ 1.224 billion. It exported 1,650,312 tons of biofuels in 2017 at an average price of US\$ 724 per ton, thus making Argentine exports the cheapest in the world. Notably, the United States was the top destination for Argentine biofuels from 2014-2017. In 2017,

59.3 percent of total exports of the product reached the US market (Fig 4), although Argentine exporters faced an average tariff of 5.6 percent in the US market in 2017. With these exports, Argentina supplied two-thirds of the US's demand for biodiesel in 2017. Anti-dumping duties imposed by the US government in 2016-2017 (USDA, 2017c) forced Argentina to seek other markets, notably Spain and Netherlands in the EU. Consequently, exports to the US declined causing distress to the exporters. In 2017, biodiesel exports to Spain and Netherlands occupied a share of 25 percent of total exports of the commodity. However, Argentina's biodiesel exports also faced duties in the EU owing to the claim of subsidized production and dumping of cheap Argentina biodiesel in the EU market. This had an adverse effect on local production by the local EU producers.



EXPORT DESTINATIONS

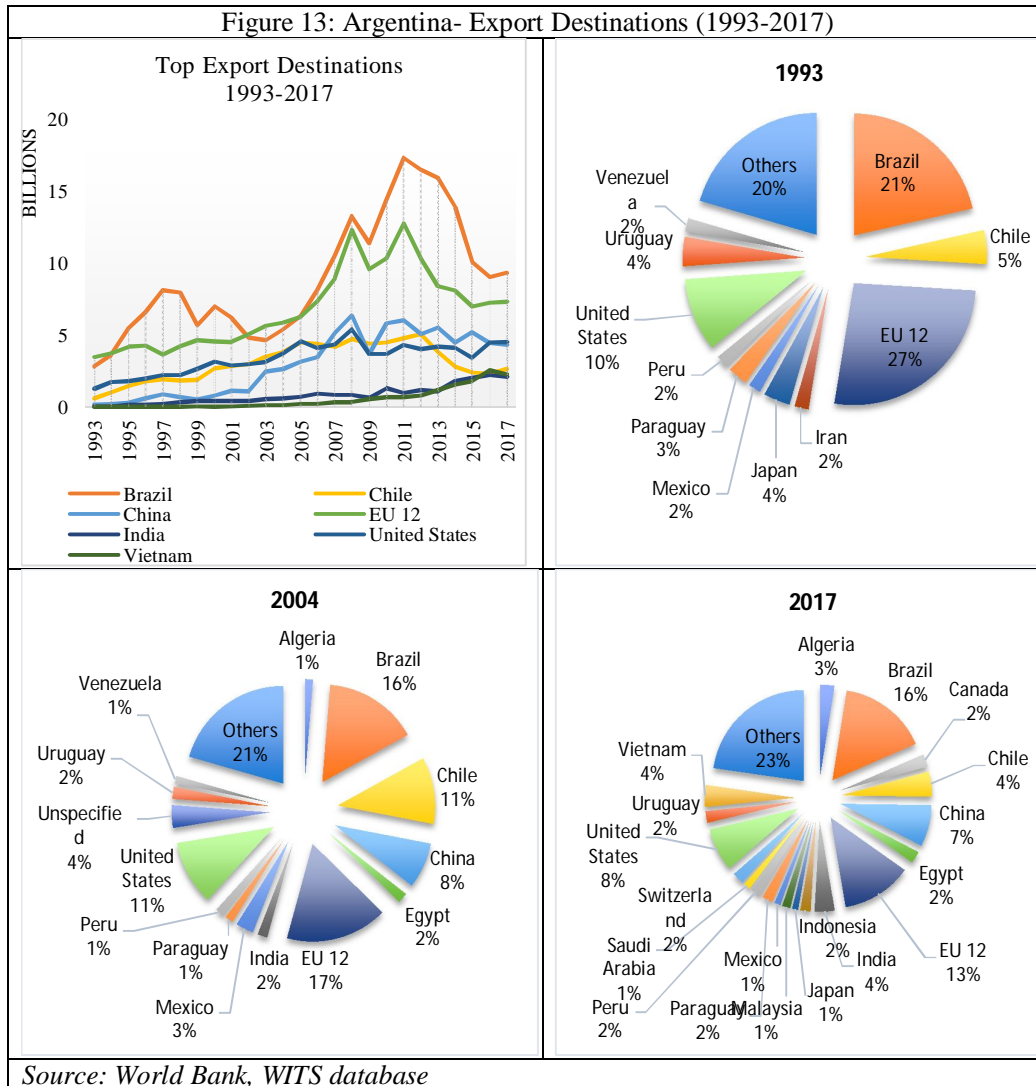
Brazil remained the top destination for Argentine exports, followed by the EU 12 members, especially: Spain, Netherlands, Germany, and Italy (Fig 13). Combined exports to Brazil and EU 12 markets peaked at US\$ 30 billion in 2011, but fell to only US\$ 16.6 billion in 2017. Together, they constituted a share of 48 percent in total exports from Argentina in 1993, but fell to 33 percent in 2004 and 29 percent in 2017. This reflects the declining importance of these traditional markets in Argentina's merchandise exports. In addition to Brazil, other important regional markets such as Chile, Mexico, Uruguay, Peru, Paraguay and Venezuela were a mainstay in Argentina's

basket of export destinations and their relative shares in total exports have remained stagnant over the period 1993 to 2017. Of these, Chile continued to be the most important destination as it was the fourth largest buyer of Argentine goods exports in the same period.

Of the EU12 countries, Argentina mainly exported residues from the food industry to Spain and Italy; groundnuts to Netherlands; biodiesel to Spain (only 2012-2017) and Netherlands (only 2016), and bovine meat to Germany in 2017. Oilcake exports to EU12 totaled US\$ 2.36 billion in 2017, while total oilcake exports to the world stood at US\$ 9.08 billion, making the EU12 the top destination, with a share of 26 percent of the exports. EU12 also imported bovine meat (specifically under the heading 0201) and comprised a share of 74 percent in total such exports, with a total of US\$ 453 million in 2017. The United States was also an important extraregional market for Argentine goods in the period 1993-2017. Export growth followed a steady path and doubled in value between 2001 and 2008. Despite the crash in exports in 2009 due to the financial crisis in the United States, exports to the US continued to grow till 2014 but were unable to reach their peak of 2008. A slight downturn in 2015 was followed by the devaluation of the peso in late 2015, along with favorable economic policies by the newly elected government in the form of reduction of export duties on foodstuffs that quickly overturned the downward trend in 2016. The period 2016-17 was a positive year, especially for exports of primary products.

Argentina managed to diversify its export markets between 2004 and 2017 (Fig 13) and reached an array of Asian economies comprising of (in order of importance) China, India, Vietnam, Japan, Iran, Egypt, Indonesia, Malaysia and Saudi Arabia. The importance of China has grown since 2002 as it overtook Chile and the USA in 2006 to be the third most important market for Argentine exports. The growth of India and Vietnam as export destinations is however relatively recent as total exports crossed US\$ 1 billion only in 2013. In 2017, Vietnam was the fifth largest export destination for Argentina and occupied a share of 4 percent as well. It was the top destination for the product group: residues from the food industry (especially soybean cakes) and maize in 2017. India also emerged as the sixth largest market in 2017, with a share close to 4 percent as well and mainly bought soybean oil from Argentina. By 2017, India, Vietnam and Chile comprised of equal shares of 4 percent in total Argentine exports.

Figure 13: Argentina- Export Destinations (1993-2017)

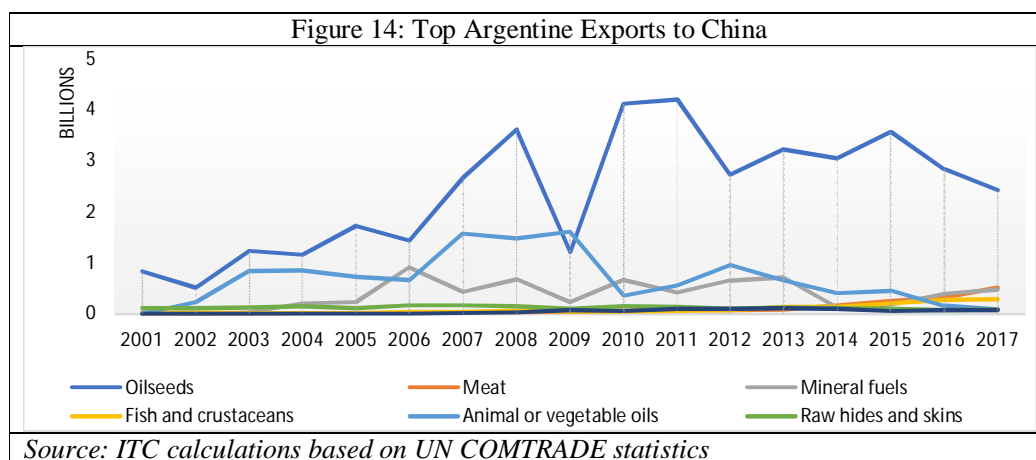


CHINA

China continues to be the second largest non-regional destination for Argentine exports from the turn of the century. It occupied a share of 7.4 percent of total exports in 2017. The period between 2001 and 2008 witnessed exponential growth of commodity exports to China in the form of soybean, bovine meat, crustaceans, and mineral fuels (Fig 14). Following the global financial crisis and the severe drought in Argentina, overall exports crashed to half their value in 2009. Notably, oilseed exports fell from US\$ 3.6 billion in 2008 to just its one-third value of US\$ 1.2 billion in 2009. The next two-year period (2010-2011) marked a noticeable improvement due to high demand for oilseeds, especially soybean and meat by Chinese consumers. This led to a rise in

international prices for these products. FAO reports that international prices of foodstuffs increased by 17.2 percent in 2011 alone. Thus, the high soybean price from 2010-2011 helped Argentine exporters to increase exports to China.

As international prices for foodstuffs began to fall in late 2011, so did exports. This trend continued for the next few years as total exports to China fell to US\$ 4.3 billion in 2017 from US\$ 6.03 billion in 2011. However, 27.5 percent of all bovine meat exported by Argentina in 2017 was still consumed by China, while 88.3 percent of soybean exported found its way to Chinese markets as well in 2017. Therefore, China continued to be largest buyer of bovine meat and soybean in 2017 despite unfavorable prices. Argentina also exported fish and crustaceans to China in 2017, amounting to a share of 18 percent of total exports of the product.

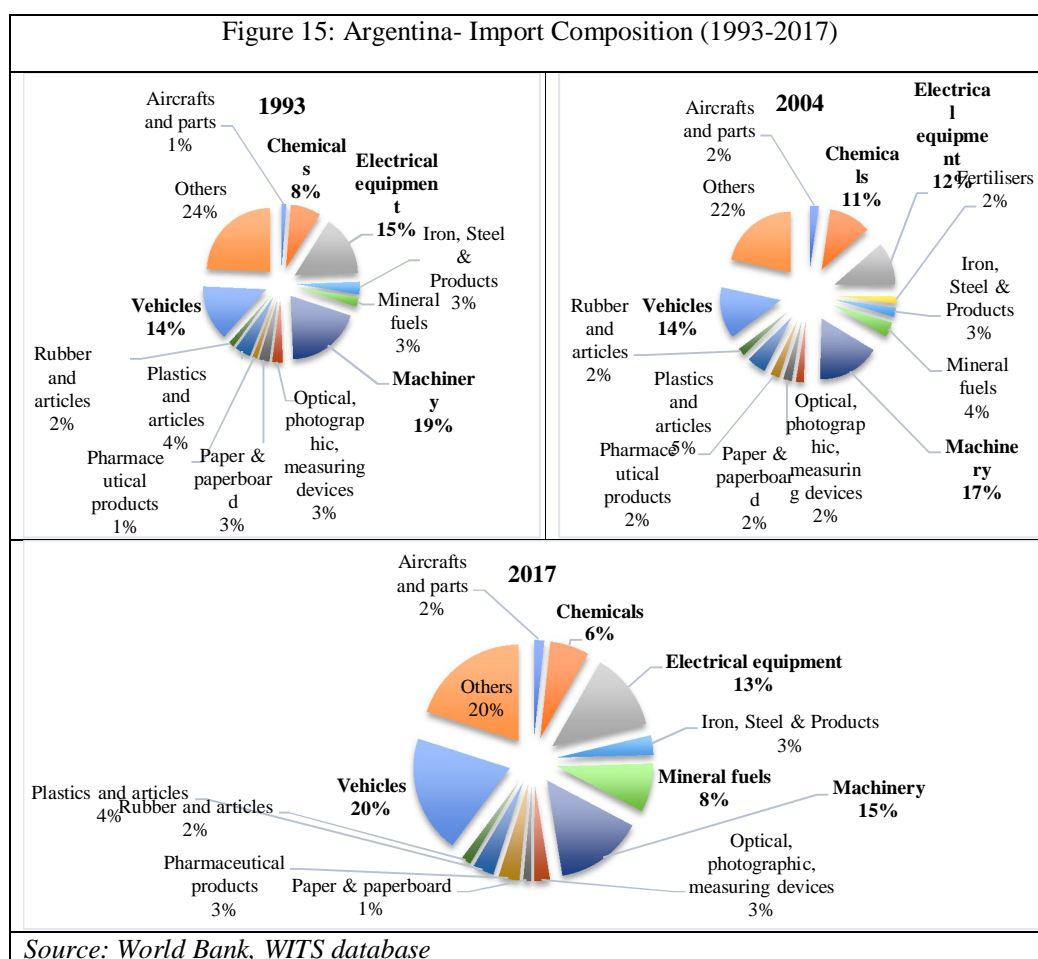


IMPORTS

As mentioned in the previous chapter, Argentina has historically imported capital goods to supplement the domestic industrial sector. This has been the trend in the period 1993-2017 as well; Argentina mainly imported industrial and capital goods with high value added in this period (Fig. 15). The import basket remained unchanged in term of products imported, however, their relative shares have changed over time. The top imports were electrical and mechanical equipment, with a combined share of 34 percent in total imports in 1993, down to 28 percent in 2017; motor vehicles with a share of 20 percent in 2017 and a value of US\$ 13 billion; and mineral fuels, comprising a share of 8 percent of total imports in 2017. The period from 2004 to 2017 was beneficial for the imports of motor vehicles and capital goods due to the appreciation of the peso in 2010-

2011 and the growing domestic demand in the same period (Cepal, 2011). Moreover, Argentina was also the main market for automobile makers in Brazil and over two-thirds of Brazilian exports from the industry found their way across the border to Argentina in 2017. Argentina imported 70 percent of all automobiles imports from its regional partners Brazil and Mexico in 2017 (UNCTAD, 2018).

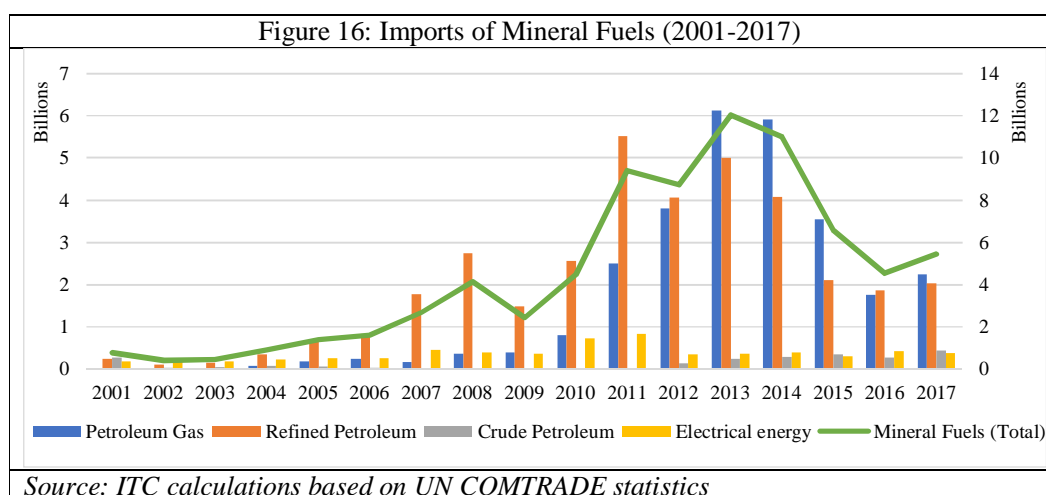
Other important imports from the world included chemicals, photographic-optical and measuring devices, plastics and articles, iron, steel and products, rubber products and pharmaceutical products. The share of chemical products was 11 percent of total imports in 2004, with a value of US\$ 2.5 billion, however, its share dropped to just 6 percent in 2017, as the total value almost doubled to US\$ 4.4 billion (Fig 15). Although these products comprised small individual shares, their combined share averaged to 22 percent in the total period.



MINERAL FUELS

Argentina imports a variety of mineral fuels from the world. Argentina has signed several regional agreements on integrating energy, for example, the North-Eastern Argentina Gas Pipeline with Bolivia, Transitional Energy Exchange Agreement with Brazil, South American Gas Interconnector with Venezuela and Brazil, among others (WTO, 2013). Fig 16 shows the top four products under this category, of them, the largest import has been of natural gas, followed by refined petroleum, crude and electrical energy. Bolivia was the largest source of imports of Natural Gas in 2009. However, from 2009- 2016, Trinidad and Tobago, along with Qatar supplied the largest quantities. Subsequently, in 2016, Bolivia regained its top spot and supplied natural gas worth US\$ 1.18 billion in 2017, with a share of 52.7 percent of total gas imports. Argentina has faced a growing domestic demand for natural gas since 2008 and was forced to import, especially from Bolivia. About one-third of imports is for industrial use, another third goes for electricity industry, while the rest is divided between household consumption and as fuel for vehicles (WTO, 2013).

The United States was the largest supplier of refined petroleum with a peak in 2013, followed by Netherlands, Russia and Brazil. Although Argentina itself is a large producer of crude in Latin America, it imported crude from Nigeria (post 2013) and USA (post 2015). In 2017, Nigeria supplied 844 thousand tons of crude, comprising a share 76.5 percent of total crude imported by Argentina, and valued at US\$ 349 billion. Moreover, Argentina mainly imported electrical energy from Paraguay and Uruguay.



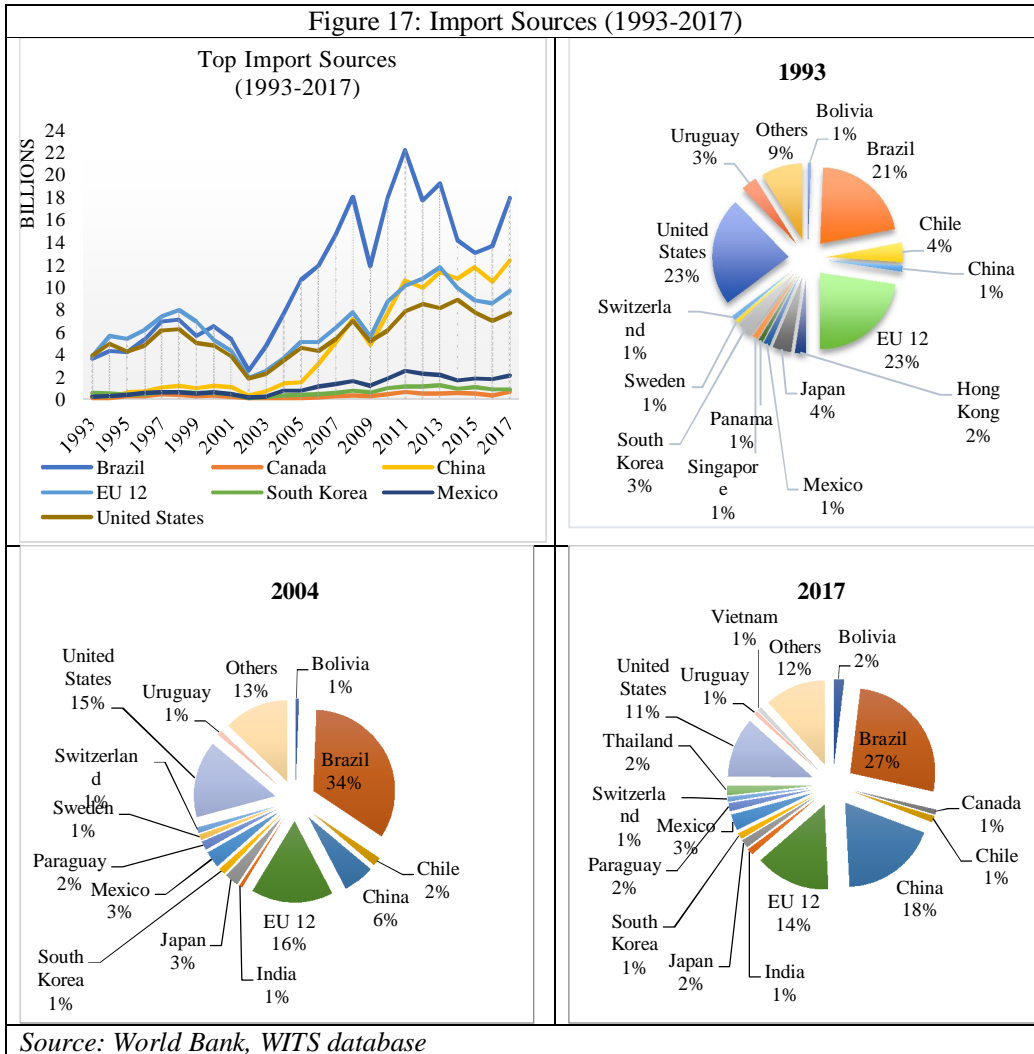
IMPORT SOURCES

Argentina's top import sources have been Brazil, China, EU 12, the United States, and Mexico (Fig 17). EU 12, Brazil and the United States have remained Argentina's top import sources since 1993. Together, they comprised a share of 69 percent of all imports in 1993. Argentina mainly imported consumer goods and capital goods from the United States in the period 1993-2017 and they made up a combined share of about 80 percent over the entire period. Refined petroleum, packaged medicaments and medical instruments, cars, aircrafts, and vehicle parts were some of the top imports. The rest of the 20 percent imports from the US comprised of plastic polymer, iron products, pesticides and other chemicals. Argentina's imports took a massive hit as the economy grappled with its worst financial crisis in 1998-2002. Shortly after the default in 1998, imports fell till 2002, but gathered momentum from 2003 such that Brazil became the top import source, with a relative share of 34 percent in total imports in 2004.

It can be seen (in Fig 17) that the gap between the value of imports from the Brazil and from the EU 12 members widened post 2003. As imports from Brazil increased to US\$ 17.9 billion in 2008, those from the EU 12 members, the United States and China averaged to just US\$ 7 billion. The global financial crash of 2009 affected the Argentine economy drastically, especially in terms of imports from its top three partners. Imports from Brazil crashed from its peak in 2008 of US\$ 17.9 billion to just US\$ 11.8 billion in 2009. However, the economy recovered quickly and imports from Brazil surged ahead of its 2008 peak to reach US\$ 22.2 billion in 2010. Subsequent financial crisis in Brazil and Argentina in the period that followed led to a decline of imports from Brazil until they finally recovered in 2016-2017.

China's importance in the Argentine market can be seen with its expanding share in total imports between 2004 and 2017. China's share grew from 6 percent to 18 percent in the same period. The turning point was in 2009, when China overtook USA to be Argentina's second largest extraregional import source, and then it overtook EU 12 as well in 2013 to be the top extraregional source for Argentina, with a value of US\$ 11.3 billion. Despite the crisis in the period 2013-2015, imports from China did not fall, unlike those from Brazil.

Figure 17: Import Sources (1993-2017)



Overtime, apart from its traditional regional partners Brazil and Mexico, Argentina imported goods from other regional members, namely, Chile, Uruguay, Paraguay and Bolivia. They remained important to Argentina’s economy despite their shrinking-relative shares over time. A few extraregional countries also joined the bandwagon, notably Asian economies like Japan, South Korea, Viet Nam, Thailand, Singapore and Hong Kong. However, their shares have remained very small (1-2 percent only) over time.

EU 12

The EU12 has been an important market for Argentina and continued to supply 14 percent of total imports by Argentina, valued at US\$ 9.61 billion in 2017. Of this, 22 percent were in machinery, amounting to US\$ 2.12 billion, 12 percent in electrical

equipment, while, 11 percent of total imports were under the motor vehicle category in 2017 (Fig 18). Moreover, more than half of the pharmaceutical products imported by Argentina in 2017 originated in the EU12 members. This share remained fairly constant in the period 2013-2017 (UNCTAD, 2018). In general, capital goods have occupied a 40-45 percent share in imports from the EU12 in the period 1993-2017, followed by consumer goods (roughly 30 percent) and intermediate goods (25-30 percent). Luxury tax on imported cars that affected imports from the EU was removed as part of the Macri government reforms in 2015. As seen in Fig 18, imports of vehicles and parts rose after this policy change from US\$ 690 million in 2015 to US\$ 1.02 billion in 2017, registering an annual average growth of 137 percent in the period. The Argentine government under President Macri also scaled back on export duties on several agricultural and industrial goods, while relaxing the requirement of non-automatic import licenses on all lines except 1500 lines. These lines directly affect 26 percent of all imports from the EU (European Commission, 2019a).

CHINA

The importance of China as an import source rose tremendously after 2005 and China even overtook the US in 2009 to be one of its biggest import partners. Over the period 1993-2017, intermediate goods occupied a share of 20 percent of total imports from China and included chemicals and fabrics to meet the needs of the domestic textile industry. Next, consumer goods comprised a share of 60 percent in 1993, consisting of clothing items and sports footwear, but took a hit in the period as their combined share dropped to a mere 20 percent in 2017. They were overtaken by capital goods (and parts), as their share in total imports from China grew from 20 percent to 60 percent in 2017 (Fig 19). They consisted mainly of personal electronics consisting of mobile phones, computers and tablets, broadcasting accessories, motorcycles and railway cars (Fig 18). As expected, Argentina did not import raw materials (agricultural goods, fuels, metals) from China. China overtook the United States in 2007 and Brazil in 2010 to be the top import source for goods belonging to the machinery and mechanical appliances category. Notably, due to the reduction in import tariff in 2016 on portable computers and handheld tablets, imports soared in 2017 to reach value of US\$860 million in 2017 from just US\$ 380 million in 2016. China has also been the only supplier of telephones and mobile phones in Argentina since 2006.

Figure 18: Top Imports from EU 12 and China (1993-2017)

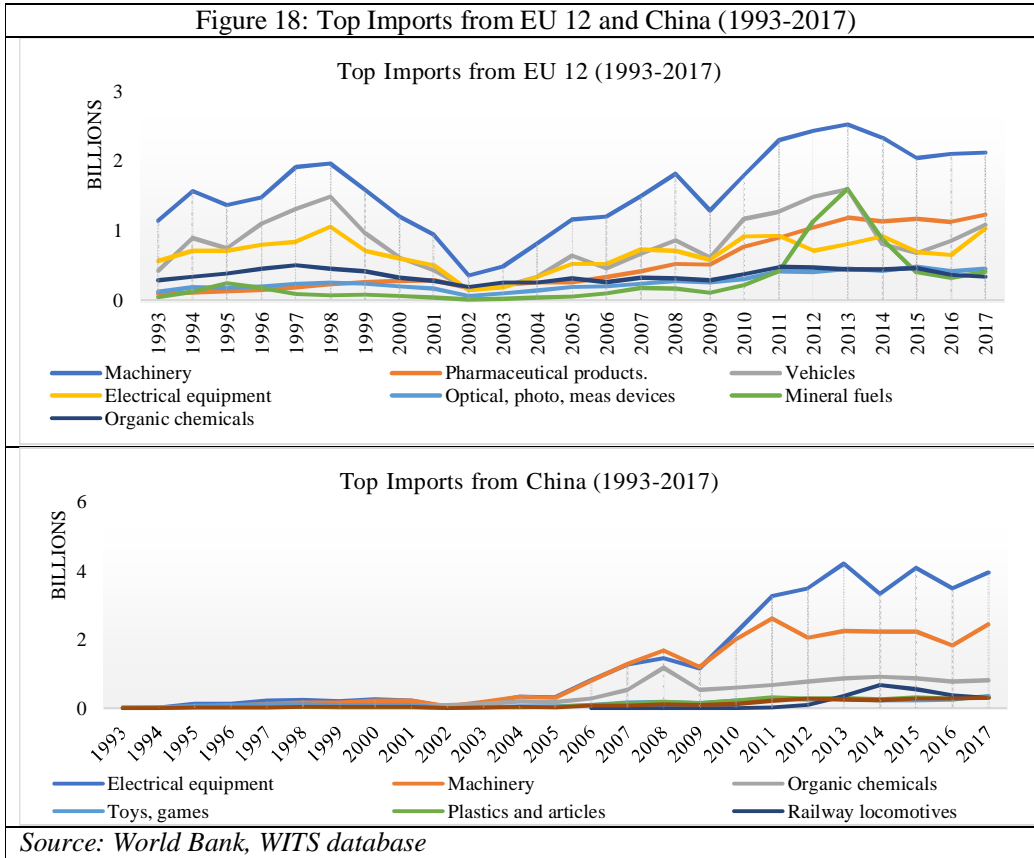
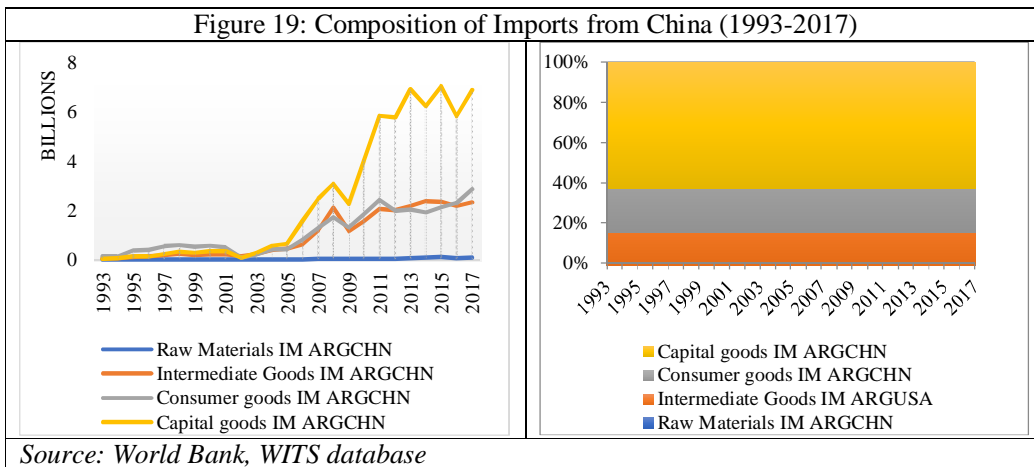


Figure 19: Composition of Imports from China (1993-2017)



BRAZIL

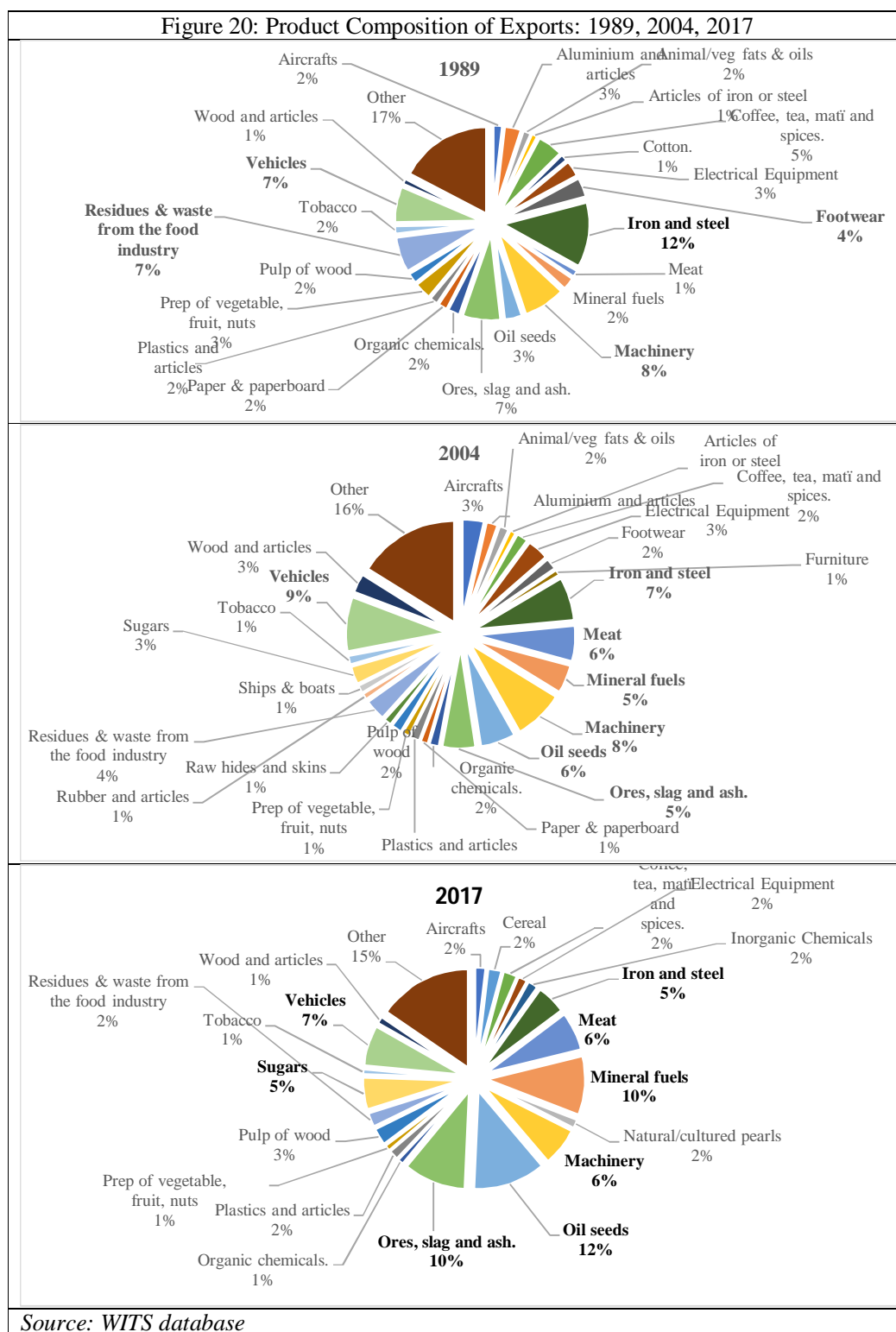
EXPORTS

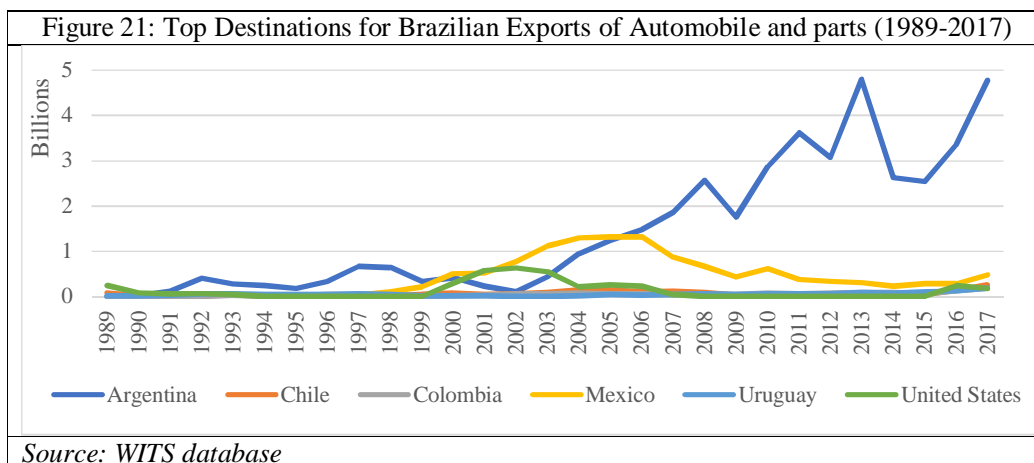
Historically, Brazil has exported a variety of goods to a number of destinations in the region and around the world. Although Brazil has been an inward-oriented economy, with exports contributing under 30 percent to GDP, its export basket has been highly diversified. Manufactured products like aircrafts, transport equipment, including vehicles, machinery and electrical equipment, and iron and steel semi-manufactured products were a mainstay in the Brazilian export basket since 1989, and although their combined share declined from 32 percent in 1989 to 22 percent in 2017 due to the increasing importance of other products; their combined exported value more than quadrupled between 1989 and 2017, from US\$ 10.9 billion to US\$ 46.8 billion (Fig 20). Brazil was one of the most prominent exporters of automobiles and parts in Latin America and the top destinations for Brazilian automobile and parts exports in the region were Argentina, Chile, Uruguay, Mexico, Colombia and the United States (Fig 21).

Brazil, like Argentina as well, has been a pioneer in domestically manufacturing automobiles and parts and supplies motor vehicles to regional markets. However, due to the recession at home, the domestic sales have declined in the period following 2015, but have been offset by increasing exports to international markets. Till 2004-05, Mexico was the top destination, but as previously highlighted, following the signing of a new automobile agreement between Argentina and Brazil, majority of the Brazilian automobile exports found their way to Argentina post 2005 (Fig. 21). Brazilian exporters have also made efforts to export other manufactured goods as well, for example, organic and inorganic chemicals, plastic and rubber products, paper and paperboard products, wooden articles, and footwear⁶⁵. The manufacturing sector has been unable to reap full benefits as it remains less competitive than the rest of the sectors of the economy due to its weak integration into the world economy and continues to benefit from import protection and high tariffs. For example, clothing, textiles, transport equipment and automotive industry are the most protected, and the

⁶⁵ Footwear comprised of a share of 4 percent in total merchandise exports in 1989

automotive sector has attracted tariff jumping FDI inflows that are common and abundant.



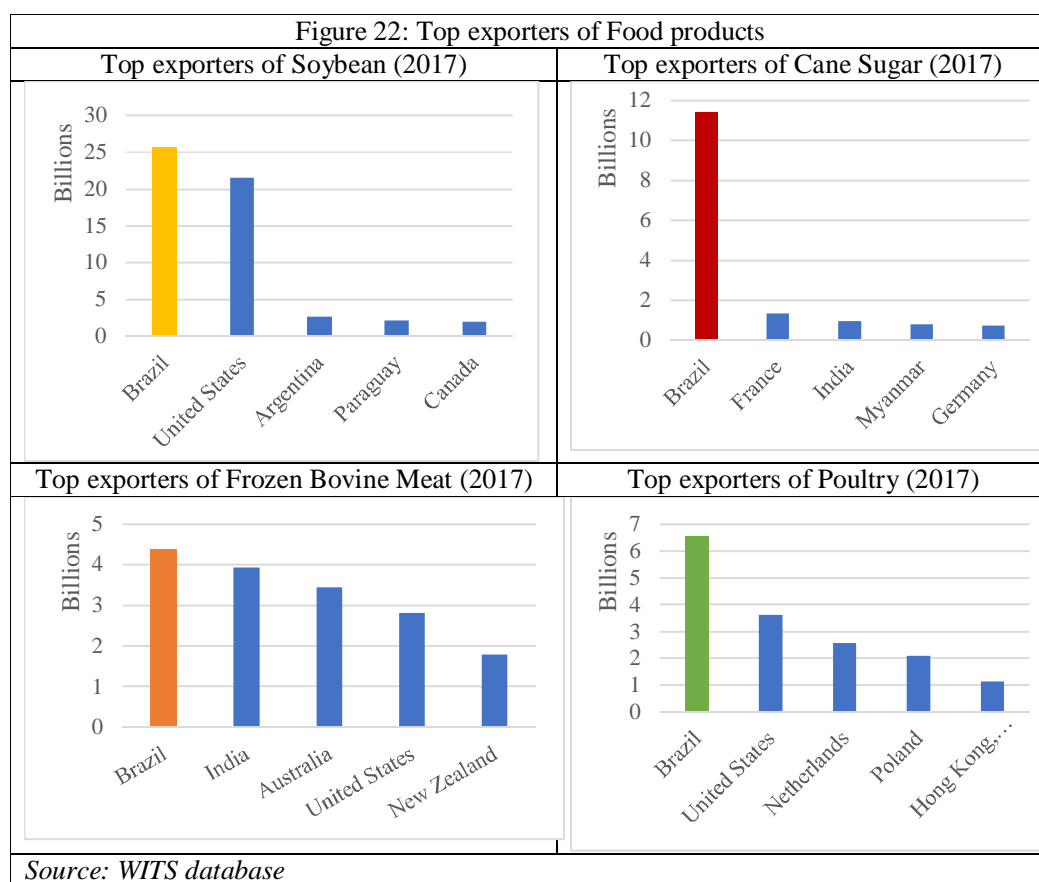


Similar to other Mercosur members Argentina, Uruguay, and Paraguay, Brazil has also been a major exporter of agricultural products and foodstuff to the world, including commodities such as soybean, poultry and bovine meat, sugar, orange juice, and coffee. Throughout the seventies and eighties, coffee was also a major export to the world and constituted 5 percent of total exports, with a value of US\$ 1.65 billion in 1989. However, its share declined in the subsequent periods, and Brazil exported coffee worth only US 5 billion in 2017, with a share of 2 percent in total exports. Similarly, residues from the food industry, especially soybean cakes were an integral part of the export basket in 1989, however soybean faction exports were replaced by exports of whole soybean in the early 2000s.

This period witnessed the commodity supercycle due to the swelling of the global middle class and the industrial growth in China. Brazilian exporters faced higher international prices as a result of this supercycle and increased the volume of exports of goods such as oilseeds, meat and sugar to meet the international demand. As a result, the share of oilseeds in total exports doubled between 2004 and 2017, as its value increased five-fold from US\$ 5.4 billion to US\$ 26 billion, with a growth rate of 12 percent per annum, thus making Brazil the largest exporter of soybean in the world in 2017 (Fig 22).

Brazil began to export poultry and bovine meat (chilled and frozen) to the world such that their combined value increased from US\$ 5.5 billion to US\$ 13 billion between 2004 and 2017. Brazil continued to be the top exporter of frozen bovine meat with a value of US\$ 4.385 billion; and poultry with a value of US\$ 6.577 billion in 2017 (Fig 22).

Moreover, increased global demand for sugar and confectionary products in recent times was met by Brazilian exports worth US\$ 11.56 billion in 201s, of which, cane sugar alone accounted for US\$ 11.41 billion worth of exports in 2017, placing Brazil in the top position in the ranks of global exporters of cane sugar in 2017 (Fig 22). **Sugar** is used either as a sweetener or to produce ethanol, a biofuel. Since gasoline prices climbed in 2017 and those of sugar declined, the demand for ethanol had increased; this helped Brazilian producers offset the declining price of sugar due to overproduction in the world market. Notably, value of exports from the food and agricultural sector grew alongside their share in total exports of goods in the period 2004-2017, such that their combined exported value leaped from just US\$ 4.7 billion in 1989 to US\$ 58.75 billion in 2017; and their combined share doubled from 12.5 percent to 26 percent in 2017.



Brazil also exported mineral products like ores, especially iron, copper, manganese and aluminum; and mineral fuels including crude, refined petroleum, petroleum coke, and gas in the period 1989-2017. Together, they were one of the largest exports from Brazil, with combined share climbing from 9 percent in 1989 to 10 percent in 2004 and to 20

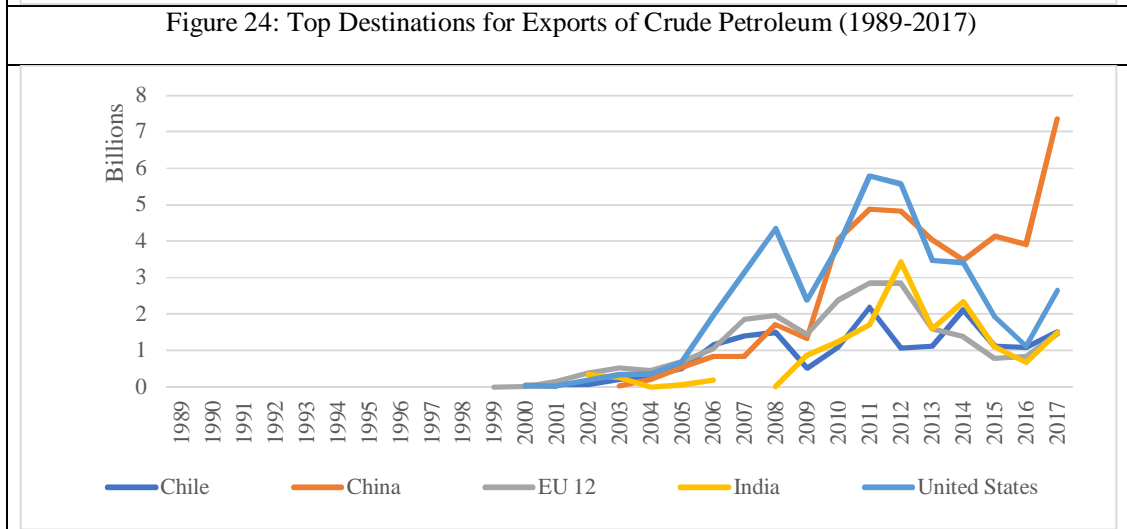
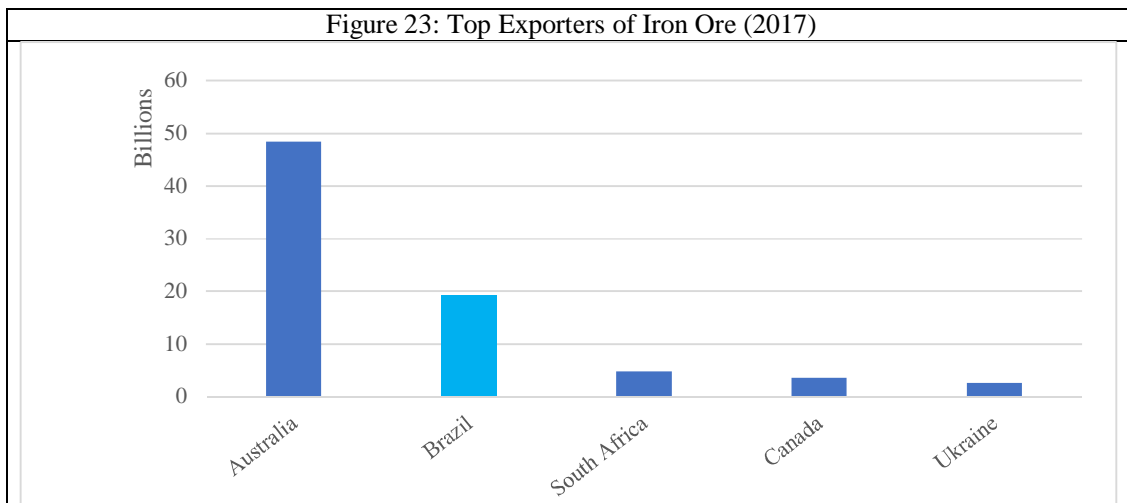
percent in 2017. Brazil has been the second largest exporter of ores in the world, and comprised a share of 11 percent in global exports in 2017 (Fig 23) and a value of US\$ 22.4 billion and a quantity of 344 thousand metric tons⁶⁶. Starting from 2001, Brazil exported its peak value of ores in the period 2011-2014, with an average of US\$ 80.5 billion due to high international price. The international prices have had a huge impact on the mining companies located in the two largest iron ore mining states, Pará and Minas Gerais. Because of them, Brazil is the third largest producer and the largest exporter of iron ore in the world. Mining activity peaked in 2011-12 and declined till 2016 owing to the falling international prices. It had bounced back in 2016 due to a rise in commodity prices once again. The mining equipment market in Brazil is very competitive such that most multinational companies are required to produce the equipment and parts locally with at least 50-90 percent local content requirement.

Over 50 percent of iron ore exported found its way to China in 2017, followed by Japan, Malaysia, Netherlands, Korea, Oman and Italy. Together, the EU12 members occupied a total share of 15.4 percent in Brazil's iron ore exports. The period from 2013 to 2017 was characterized by falling value of exports, despite an increase of 4 percent in the quantity of iron ore exported by Brazil, owing to the sharp decline in international prices for iron. Brazil was the largest supplier of iron ore to Italy in 2017, with a total value of US\$ 460 million, and occupied a share of 69 percent in total imports of that commodity by Italy. Exports of iron ore have declined drastically since their peak in 2011-2013 (export growth was negative 20 percent between 2013 and 2017), but overall export growth picked up in 2016-2017 at a rate of 29 percent per annum.

Brazil only began to export crude petroleum by 1999-2000 and specialized in heavy crude. In general, Brazil is a net importer of mineral fuels as it imported refined petroleum, while exporting heavy crude. A large majority of crude was exported to China, United States, Chile, EU12 and India (Fig 24). However, Brazilian crude exports have been very erratic and have responded to demand-supply gaps in its partners countries. PETROBAS, the state-owned enterprise that is solely responsible for purchasing, selling and transporting petroleum products, is not obliged to meet domestic demand of crude oil before exporting the remainder. Crude exports to the

⁶⁶ CEIC data available at: <https://www.ceicdata.com/en/brazil/iron-ore-exports-by-port>

United States rose in 2008-12 at an average of US\$ 4.388 billion, and a peak of US\$ 5.78 billion in 2011. Between 2008 and 2012 crude export to the United States grew at an average rate of 5.1 percent per annum, but plummeted thereafter to be replaced by the Chinese demand in the period 2013-2017. Brazilian crude exports to China grew at an average rate of 12.75 per annum to peak in 2017 at US\$ 7.351 billion. Falling international oil prices contributed to PETROBAS's large financial losses in 2014-15. The period 2013-2015 also witnessed a sharp decline in the value of crude oil exports from Brazil; for example, their exports to China fell from US\$ 38 billion in 2013 to just US\$ 28 billion in 2015. Exports recovered only in 2017.



Source: WITS database

EXPORT DESTINATIONS

The EU 12 countries, along with the United States were the main export destinations for Brazilian goods from 1989-2017. While the EU 12 was the single largest market from 1989 but its relative importance declined after 2013 owing to the rise of Chinese demand, and by 2017, its share had declined to just 15 percent of total exports from 26 percent in 1989. Given the overall trend in Fig 25, exports to EU12 members rose exponentially after the signing of the Interregional Framework Cooperation agreement between Mercosur and the EU in 1999. Notably, exports grew at an average annual rate of 10.6 percent such that, total exports of goods to EU12 stood at US\$ 49.42 billion in 2017.

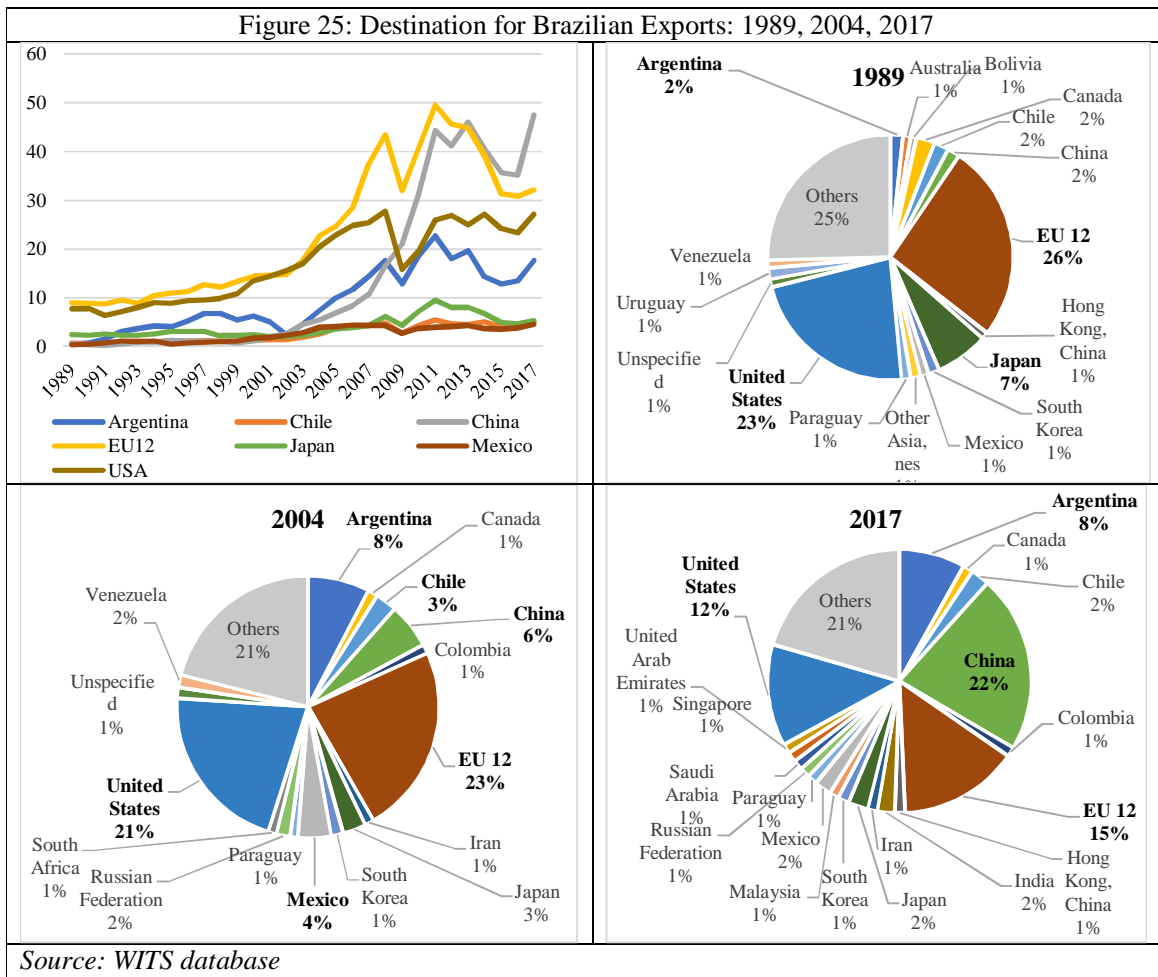
The rise of the importance of China is indisputable in the Brazilian export growth story. From 2002, China began to purchase large volume of agricultural goods such as soybean, and meats, notably poultry and bovine meat, along with iron ore from Brazil. Although Brazil exported only 2 percent of its total merchandise exports to China in 1989, valued at US\$ 563 million, the share grew tremendously to 22 percent of total exports in 2017, valued at 90 times its value in 1989 at US\$ 47.5 billion. By 2013, China had displaced EU 12 as the largest buyer of Brazilian commodities and other exports. Between 2002 and 2017, exports to China grew at an annual average rate of 21.6 percent, from just US\$ 2.5 billion to almost US\$ 50 billion in 2017.

China is not the only Asian country that has attracted Brazilian exports. Post the new millennium, there has been a rise in importance of other Asian countries on the ranks of top destinations. For example, while Japan and South Korea have long been major Asian destinations from the beginning, by 2017, Brazil was also exporting goods to Hong Kong (China), India, Iran, Malaysia, Saudi Arabia, UAE, Russia and Singapore. The total share of all top Asian destinations (except china) equaled that of the United States in 2017 and stood at 12 percent of total merchandise exports. The United States was the third largest buyer of Brazilian goods in 2017. Until 2009, it was right behind EU12 and was the second largest destination, but the rise of China displaced the United States.

As seen in Fig 25, Brazil has managed to diversify its export partners. Before the trade liberalization efforts of 1990, Brazil mainly exported to its regional partners such as

Argentina, Bolivia, Chile, Colombia, Mexico, Paraguay, Uruguay and Venezuela. Approximately, one-tenth of total exports found their way to these seven countries alone. However, after the signing of Mercosur in 1991 and its implementation in 1994, the relative importance of Argentina increased to reach 8 percent of total exported goods in both 2004 and 2017. Other regional partners that remained relevant were Mexico, Chile, Colombia and Paraguay and Venezuela. Their combined share along with Argentina was over 17 percent in 2004, although individually these regional countries (except Argentina) each comprised a share of 1-2 percent in total merchandise exports. Hence, the overall importance of Latin America as a destination for Brazilian exports increased between 1989 and 2004, although it declined in the subsequent period as Brazil found a replacement in Asian markets. Surprisingly, the shares of Mexico, India and Japan were equal at 2 percent of total exported goods in 2017, while their composition was quite diverse.

Figure 25: Destination for Brazilian Exports: 1989, 2004, 2017



Overall pattern of export destinations shows that Brazil concentrated its exports to its regional partners and developed countries before the trade liberalization efforts in early nineties. However, it diversified to include other developing countries as destinations for its exports in the new millennium, perhaps due to its increased efforts at promoting south-south cooperation through its trade policy.

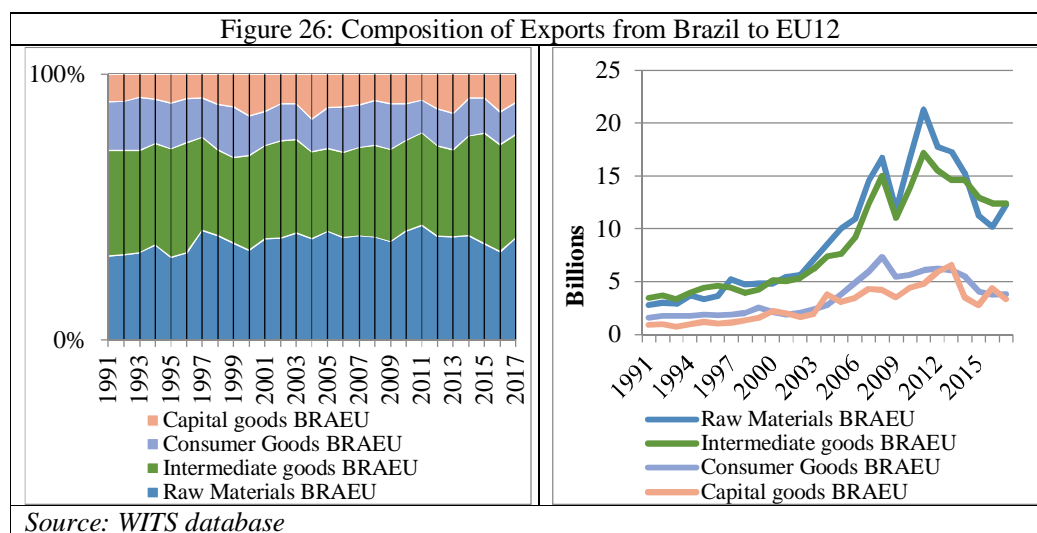
EU 12

Over time, Brazil's largest trading partners in the EU 12 have been Netherlands, Germany, Spain, Italy, and Belgium. The combined share of all EU 12 members was 15 percent in 2017, down from 26 percent in 1989; while the combined value of exports almost quadrupled from US\$ 8.9 billion in 1989 to US\$ 32 billion in 2017. Per the overall trend, exports peaked in 2011 and then followed a downward trend due to crisis in the Brazilian economy. Amongst the EU 12 members, Netherlands was the largest buyer of Brazilian goods valued at US\$ 9.252 billion in 2017, followed by Germany at US\$ 4.91 billion and Spain at US\$ 3.84 billion.

Raw materials and basic agricultural products comprising of soybean, coffee and iron and copper ore constituted a constant share of 35 percent in Brazil's exports to the EU12 countries in the period 1991-2017 (Fig 26). Coffee was chiefly exported to Germany, Spain, Italy and France. Intermediate goods equaled their share at 35 percent as well, comprising of Woodpulp, ferro-alloys and semi-finished iron goods. Almost 50 percent of the coffee exported by Brazil to the world found its way to EU12 in the period 2015-2017, valued at an average of US\$ 2.6 billion; while over one-fifth of Brazil's iron and steel was exported to EU12, averaging a value of US\$ 1.9 billion in the same period. Consumer goods and capital goods occupied a share of 20 percent and 10 percent respectively in 2017. The main consumer goods exported by Brazil were soybean meal, prepared meat, and fruit juices to Netherlands.

According to 2017 data, of the US\$ 9.25 billion worth exports to Netherlands, over US\$ 1.5 billion was in Soybean products (Soybean seeds and Soybean meal), while Iron ore and wood pulp (primarily for industrial use) were valued at US\$ 1.02 billion and US\$ 720 million respectively. Export value of Soybean meal had declined post the recession in Brazil such that exports in 2017 were valued at only 46 percent of their peak in 2013 in terms of US dollars. Moreover, exports of soybean seed from Brazil

have also declined at a rate of 15 percent, while those from Uruguay have risen by 8 percent in 2013-2017. This was accompanied by a decline in quantity exported by 5 percent for Brazil and an increase by 21 percent for Uruguay in the same period. This may suggest that Uruguay has eaten into Brazil's share of Soybean exports to the Netherlands due to more competitive prices in 2013-2017. Brazil exports Fruit juices to Netherlands with a share of 5 per cent of total merchandise exports or at an average of 20 percent of all foodstuff exported by Brazil to Netherlands, valued at US\$ 591 million in 2017. Brazil remained the largest exporter of Fruit Juice to Netherlands and the world in 2017, with an overall upward trend in value of fruit juices exported to Netherlands in the period 2013-2017. Brazil also exported Special purpose Ships (8905) and Valves (8481); Netherlands is a net exporter of Special purpose ships and the fourth largest exporter and importer in the world. They have exported and imported Special purpose Ships simultaneously from Brazil since 2003. Another such product exported and imported simultaneously between Brazil and Netherlands was Refined Petroleum (2710) during the commodity price boom in the period 2009-2015.



About a quarter of total exports to Spain in 2017 consisted of crude petroleum, followed by a third of total exports in soybean and maize, one-tenth in iron and copper ores, and about 3 percent in coffee. In terms of exports to Italy, Brazil continued to be the largest exporter of Coffee for Italy, with a market share of 28 percent in 2017, a total export value of US\$ 502 million and faced an average applied tariff of 2.1 percent (Trademap, ITC). Brazil also exported an array of intermediate products to Italy in 2016-2017

including Woodpulp, Leather (tanned and processed) and Ferro alloys and semi-finished iron products. In 2008, Iron ore was the largest export from Brazil to Germany, valued at US\$ 2.3 billion and Brazil occupied a share of 34 percent in total iron ore imports for Germany, followed by motor vehicles (8703) at US\$ 1.17 billion. In 2009, iron ore imports crashed to only 56 percent of their value in 2008, possibly due to the global financial crisis. Exports of iron ore recovered in the post crisis period to reach their peak in 2011 at US\$ 3.97 billion, but followed a downward path till 2017 due to the crisis period in Brazil.

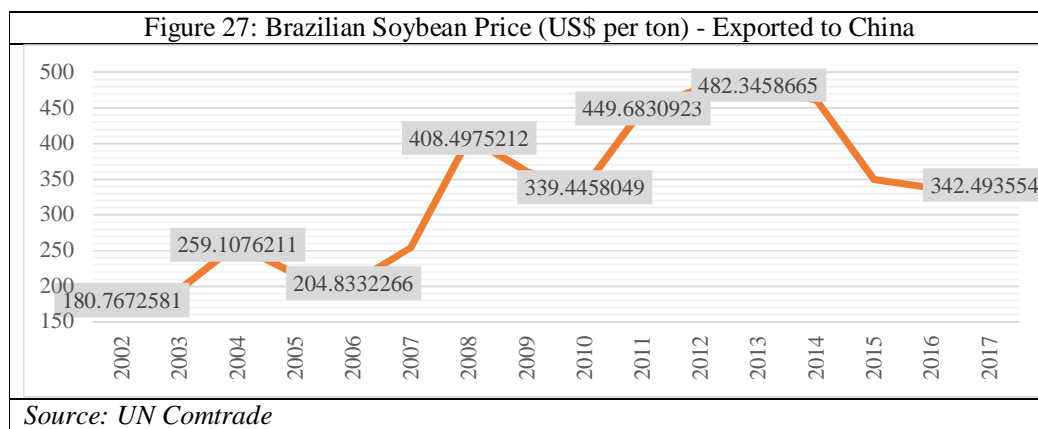
However, in 2017, Coffee was the largest export from Brazil to Germany, valued at US\$ 879 million, comprising a share of 18 percent of total exports. Others top exports to Germany were similar to those exported to Netherlands as well, including, copper ore, chemical wood pulp, steel and alloys, iron ores, and soybean oilcakes; together they comprised a share of 32.5 percent of total exports in 2017. Apart from raw materials and intermediate products, Brazil exported an array of capital goods and parts to Germany, such as parts of internal combustion engines, parts and accessories of tractors, electric motors and parts, gas turbines, powered aircrafts, and pumps for liquids.

CHINA

Brazil's exports to China are mainly concentrated in a few primary and agricultural goods. Brazil profited tremendously from the boom in the Chinese economy in the period following 2002. This period also coincided with an upswing in global commodity prices that lasted till 2015 and accrued benefits to commodity exporters in Brazil. A common belief is that Brazil experienced a state of de-industrialization due to its export focus on commodity sector. However, Brazil's export basket to its other top destinations, notably the EU12 members, displays continuous exports of manufactured products as well during the period following 2002. Perhaps Brazilian authorities continued to support the domestic industrial sector along with the export-oriented commodity exporters, to reap rewards from the commodity supercycle as well continue diversifying its exports to destinations other than China.

However, Brazil's exports to China fell over the period 2013-2016 by 27 percent, mainly due to the recessionary phase in Brazil and declining global commodity prices.

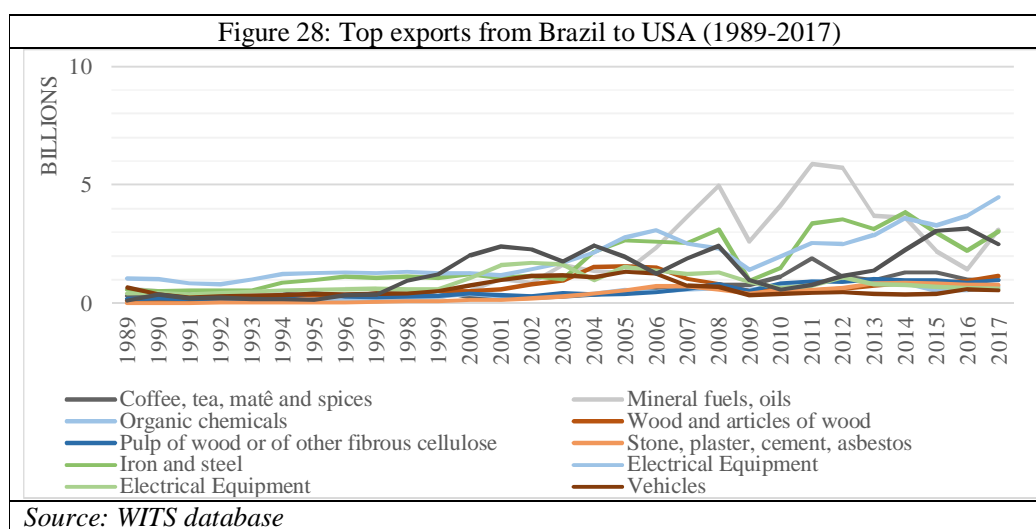
Despite that, China remained the top merchandise export destination for Brazil in 2017. Exports in the raw materials category (UNCTAD, SOP classification), included iron ore, crude petroleum, soybean, poultry, bovine and swine meat, raw sugar and raw tobacco. Raw materials and foods comprised 85 percent of total exports to China in 2017, an exceptional growth from the 15 percent share in 1993. The rest of the merchandise exports comprised of intermediate products such as wood pulp, ferro alloys and alum for industrial use. They comprised a share of 55 percent of total exports in 1991, that rose to 70 percent in 1993-1996 and fell dramatically over the next decade to about 10 percent in 2017.



Soybean alone constituted half of exports from Brazil to China in 2017, valued at US\$ 20.3 billion. On the Chinese side, Brazil fulfilled more than half of the Chinese demand for soybean in 2016-2017. On an average, soybean exports have remained north of US\$ 15 billion since 2013. Since 1996, Brazil's Soybean exports have been exempted from the interstate tax on the circulation of goods and services (ICMS), leading to more competitive prices in the international market. However, Brazilian soybean continued to face an average tariff of 1.5 percent in the Chinese market and exported soybean at a rate of US\$ 342.5 per ton to China in 2017 (Fig 27). Historically, since the commodity supercycle that began in 2002, soybean prices have increased dramatically; they doubled between 2006 and 2008 from US\$ 204 per ton to US\$ 408 per ton. However, they peaked towards the end of the supercycle in 2013 at US\$ 482 per ton but fell to the latest value of US\$ 342 per ton in 2017.

UNITED STATES

The overall trend of export to the United States has been quite favorable to the Brazilian exporters and despite the slowdown in Brazilian exports to the world as a response to internal ongoing crisis since 2014, overall exports to United States maintained a constant flow between 2013-2017. Brazil's export basket has historically been highly diversified, with equal contributions from raw materials, intermediate goods, consumer goods and capital goods (Fig 28). Exports of raw materials such as crude oil, iron and steel and coffee grew during the commodity supercycle from 2001-02, and comprised a share of approximately 30 percent of total exports in the period 2005-2016. Crude oil exports particularly rose during the financial crisis in the United States that had depressed the overall economy as well between 2008 and 2012. While the United States is the second largest buyer of Brazilian crude oil, Brazil supplied only 2 percent of the American demand in 2017.



Another 30 percent of total exports in the overall period of 1989-2017 were capital goods including aircrafts, machinery such as gas turbines, electrical equipment such as transmission devices, and vehicles such as bulldozers and motor cars. Moreover, a third of the total exports included an array of intermediate and semi-processed products. For example, semi-finished iron and steel products and alloys, wood pulp and other wooden articles, building materials (stone, plaster, cement, asbestos), and organic chemicals like ethanol have been some of the top exports to the United States over the years. Another major export from Brazil is fruit juices, especially orange juice. Brazil was the largest exporter of orange juice in the world and exported about a third of its total

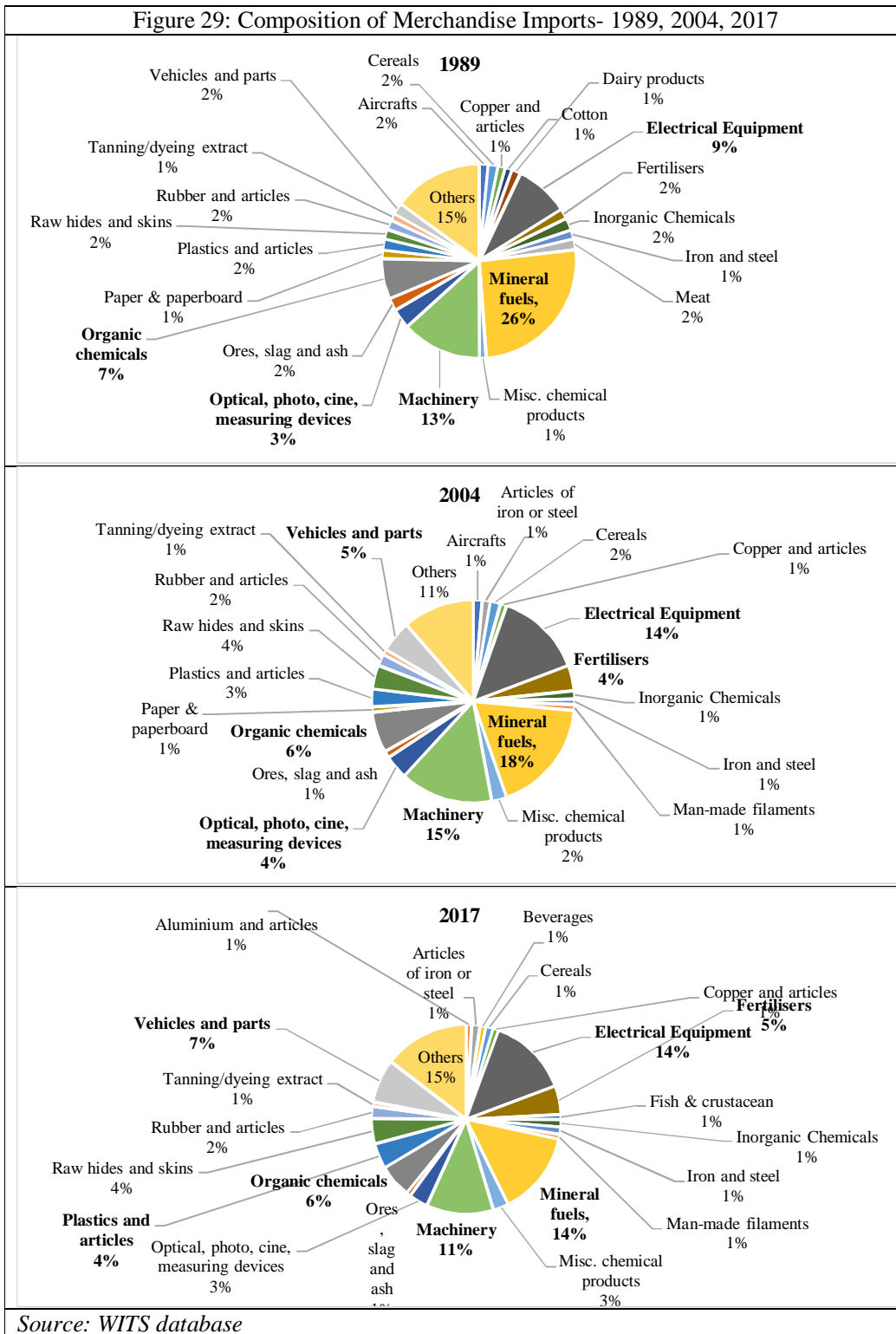
exports to the United States in 2017. As both Brazil and the United States are large producers and exporters of bovine meat, in 2016, they concluded negotiations for the “reciprocal opening of their markets for fresh and frozen bovine meat” (WTO, 2017). Post the conclusion, Brazil exports of frozen bovine meat to the United States crossed US\$ 1 million for the first time and were valued at US\$ 56.35 million in 2017.

IMPORTS

As mentioned in the previous chapter, Brazil, like the other countries in Latin America, had followed an import-substituting industrialization trade policy in the twentieth century up till the late eighties and was forced to adopt a more liberalized trade policy in the nineties, with the aim of integrating Brazil into the global market. As a result, imports increased dramatically in the nineties and have grown at a tremendous pace since then. On an average, imports grew at a rate of 7.5 percent per annum (CAGR) from 1989 to 2017, notably the highest growth rate was witnessed between 2009 and 2013 as imports doubled from US\$ 127 billion to US\$ 239 billion, with a CAGR of 13.5 percent per annum. Few of the largest imports have been mineral fuels such as refined petroleum, crude petroleum, coal briquettes and petro gas; vehicles and associated parts mainly from its neighbor Argentina; mechanical and electrical equipment; chemical products such as pharmaceuticals, fertilizers, some plastics, and organic chemicals; and copper alloys, among others (Fig 29).

While Brazil has historically imported petroleum products like refined petroleum and natural gas to meet its domestic demand, it also continued to produce and use biofuels under the Proálcool program to compliment the supply of gasoline and counter its erratic international prices. Brazil was a net importer of refined oil products, most of which originated in the United States, Algeria, Nigeria and Bolivia. Total mineral fuel imports increased from US\$ 5.1 billion in 1989 to US\$ 21.5 billion in 2017. Brazil’s recessionary phase from 2014-2016 has temporarily depressed the import demand for fuel, however, imports of manufactured products remained steady during the period. Over half of the total imports have comprised of manufactured capital goods since 1989, including vehicles, aircrafts, telephones, transmission devices, integrated circuits, data processing machines, and optical and measuring devices. Chemicals and related products have also been a mainstay in Brazil’s import basket and have constituted an average share of 20 percent of total imports for the entire period as well.

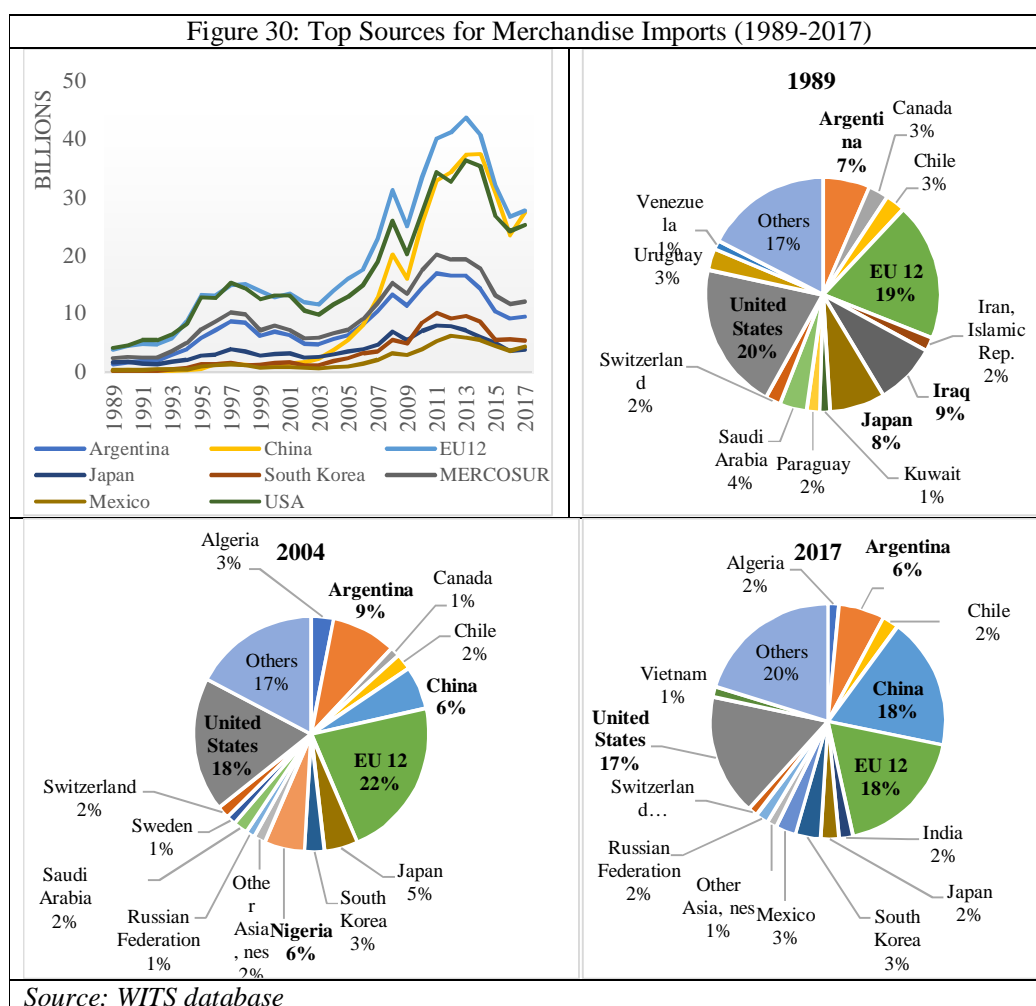
Figure 29: Composition of Merchandise Imports- 1989, 2004, 2017



Source: WITS database

IMPORT SOURCES

Brazil imported from a variety of import sources around the world, but the top sources for imports have remained unchanged over the period 1989-2017. These import sources such as EU12, the United States, Argentina and more recently China are similar to the top export markets for Brazilian products. While the EU12 and the United States comprised of a combined share of 39 percent in 1989, their share was 40 percent in 2004, and reduced to a share of 35 percent in 2017. Fig 30 shows the overall trend of imports from its top sources.



One common feature of these sources is that overall imports grew from 1989 until the slowdown in the Brazilian economy in 1999 and then grew once again until the next crisis in 2014-15. Until 2009, China was the third largest supplier of merchandise goods to Brazil, but by 2010, it had overtaken the United States to be the second largest import source; and in 2017, it became EU the top source with an 18 percent share in total imports,

equaling the share of Brazil's historically most important partner EU12. Germany was the top import source in the EU, with imports valued at US\$ 9.23 billion in 2017, followed by Italy and France at US\$ 3.97 billion and US\$ 3.73 billion respectively. Brazil's imports from EU12 members included chemicals, refined petroleum, medicaments, electronic equipment, machinery and parts, and aircraft and helicopters. Together they have occupied a collective share of 60 percent in total German exports to Brazil since 2009.

EU12 was closely followed by the United States with a 20 percent share in total imports in 1989 and 17 percent in 2017, valued at US\$ 25.11. Of the total American merchandise imported by Brazil in 2017, 95 percent contained processed goods including, intermediates like plastic polymers and iron products to cater to the Brazilian industry needs, processed petro products like petroleum, natural gas; packaged medicaments and medical equipment, and capital goods including large aircraft and gas turbines. Capital goods have historically comprised 30 percent of total American goods imported by Brazil from 1989 to 2017. Brazil also imported food grain, especially wheat from the United States in the period 2012-2015 to overcome the effects of a bad harvest. Short term imports also included refined petroleum valued at US\$ 15 billion mainly post the financial crisis, leading up to the oil price crash in 2014 that coincided with recession in the economy of Brazil.

The next top import source was the Mercosur bloc, with Argentina supplying 78.5 percent of total imports from the four Mercosur members. In 1989, Uruguay and Paraguay each contributed 3 percent and 2 percent respectively to Brazil's imports, but their relative importance has declined over the years, while Argentina has maintained its share in total imports. Top imports from Argentina included motor vehicles and parts with a share of 40 percent in total imports, and food products such as wheat, malt, prepared vegetables, onions, milk, barley and maize with a share of 50 percent in 2017. Other top regional import source was Mexico, although its share in total imports has only increased recently with imports of motor vehicles and some chemical.

Similar to its export destinations, Brazil's portfolio of import sources has also diversified over time to include South and South Asian partners. Although Japan was already an important source of capital imports such as vehicles, machinery and electrical equipment in 1989, by 2017, the portfolio included other countries including

India, South Korea and Vietnam. To imports from South Korea and Vietnam were quite similar to those from Japan, while Brazil imported organic chemicals and pharmaceutical products from India, valued at US\$ 2.95 billion in 2017. Further, the inclusion on China is undisputed. Between 1989 and 2017, its share in total imports has increased from less than 1 percent to a mammoth 18 percent in 2017. Since the basket of goods supplied by China is quite similar to those by Japan and South Korea, it may be the case that China's share has increased at their expense.

China's role in supplying merchandise goods to the Brazilian market began in 2001-2002 that coincided with an unprecedented growth in China and as a result, with an increase in global commodity prices. Total Chinese imports grew from US\$ 1.328 billion in 2001 to its peak of US\$ 37.3 billion in 2014 and declined slightly due to the slowdown in the Brazilian economy to US\$ 27.3 billion in 2017. As already mentioned, top Chinese imports have chiefly included mechanical and electrical equipment. Telephone and mobile phones have been the single largest import since 2008. In 2017, merchandise imports from China comprised of 50 percent capital goods, including telephones, broadcasting accessories, computers, and vehicle parts. Capital goods have witnessed an increasing share from a mere 15 percent in 1991 to 50 percent in 2017, completely displacing raw material imports.

Moreover, the combined share of intermediate goods and consumer goods remained constant at 50 percent in the period. Brazil continued to import synthetic yarn and fabrics, along with nitro compounds and other organic compounds mainly for industrial use from China, among consumer goods like rubber tires, glazed ceramics and wooden articles over the period 1989-2017. However, some Chinese agricultural imports were restricted by tariffs higher than MFN, such as on dairy products (18.6 percent), beverages, spirits and tobacco (16.6 percent), sugar and confectionery (16.7 percent), coffee and tea (14.5 percent), and cereals and preparations (11.5 percent) (WTO, 2017).

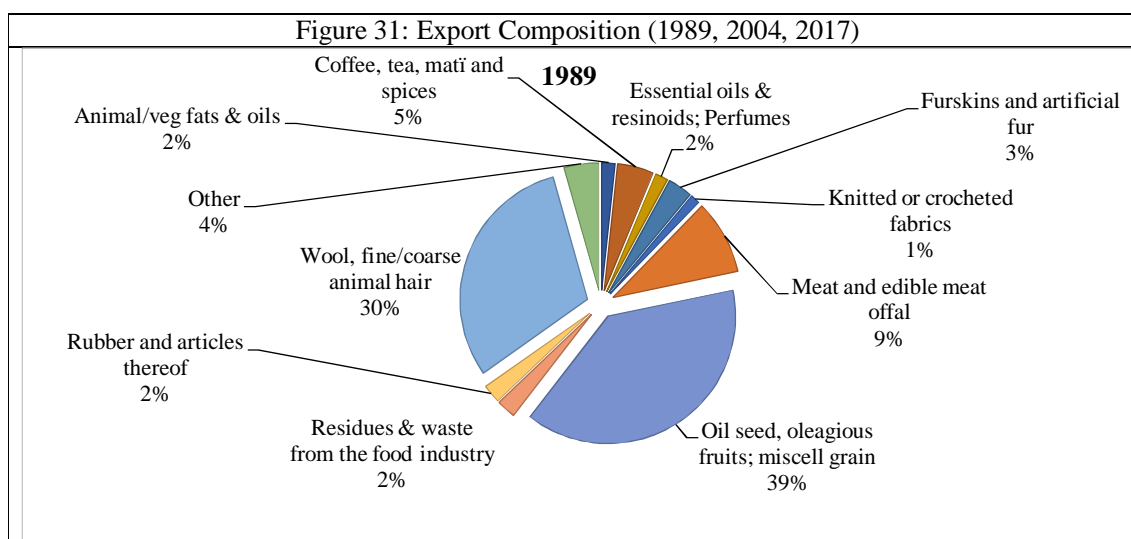
As mentioned earlier, Brazil has historically been dependent on mineral fuel imports, including crude, refined petroleum, coal and petroleum gas. Based on the import source of mineral fuels, the importance of countries in Brazil's import portfolio has changed over time. For example, Iraq and Saudi Arabia were supplying petroleum products to Brazil in 1989, and each contributed a share of 9 percent and 4 percent in total imports, respectively. By 2004, imports of mineral fuels had shifted to Nigeria and Algeria, apart

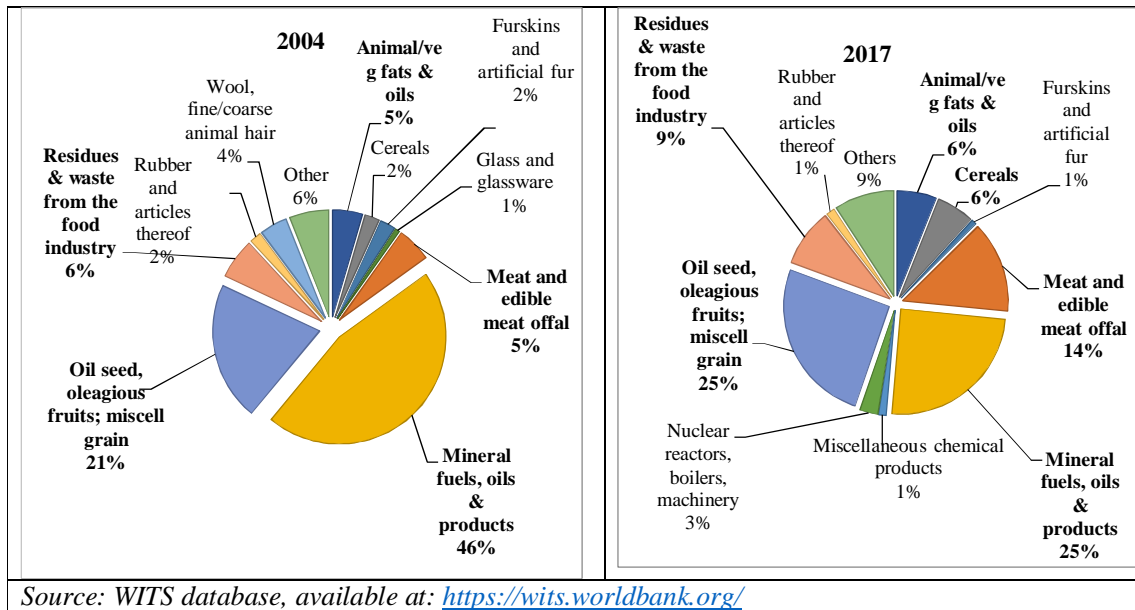
from the United States, and their combined share was 9 percent of total imports. However, in 2017, the United States alone contributed to 37 percent of Brazil's imports of mineral fuels, followed by Algeria with a 10 percent share, and a 6 percent share for both Saudi Arabia and Bolivia. Bolivia mainly supplied petroleum gas to Brazil in 2017 worth US\$ 1.23 billion, with a contribution of over 50 percent of total gas imports.

PARAGUAY

EXPORTS

Paraguay is a net exporter of products from the crop and livestock industries, as seen in Fig 31. There are two distinct trends in the pattern of exports, before 2004 and after 2004. The composition of merchandise exports changed drastically between 1989 and 2004. Wool, coffee, perfumes and crocheted fabrics dropped out by 2004 but occupied a combined share of 38 percent in 1989. However, oilseeds remained an important item in the basket. On the contrary, composition of the export basket has remained largely unchanged since the global commodity boom in 2004 and centered on similar product groups including soybean seeds and factions (oilcakes and oil), meat, mainly chilled and frozen bovine meat, along with bovine leather and animal hair (wool); and electricity (fuels). In 2004, the single largest export was fuels with a share of 46 percent. However, over time, it lost its share to meat exports that grew from US\$ 150 million in 2004 to US\$ 1.2 billion in 2017. Despite loss of share, exports of mineral fuels also doubled in value from US\$ 1.3 billion to US\$ 2.2 billion in 2017.





BOVINE MEAT

Paraguay lies in the world's top 10 largest producers and top 12 exporters of bovine meat. It exported a total value of US\$ 1.15 billion in 2017 and stood behind other regional exporters of bovine meat including Brazil and Argentina (Fig 32). Bovine meat exports picked up after 2003 and have grown at exponential rates except the brief slowdown in the period 2010-2014. Over 60 percent of exports of bovine meat consisted of frozen meat and 40 percent was the chilled variety. Its main markets include Chile, Russia and Brazil. Together, they constituted 75 percent of all bovine meat exports from the country in 2017-18.

Due to its very nature fresh/chilled bovine meat was mostly exported to close neighbors (Fig 33). Total exports in 2017 surpassed the peak value of 2010, with a value of US\$ 571 million. Chilled bovine meat exports within the region reached Chile (over 80 percent of total regional exports of chilled bovine meat till 2010 and over 50 percent thereafter) and Brazil. Outside the region, the EU12 members remained the top importers of chilled bovine meat under the Hilton and the 481 quotas. The top markets were Netherlands and Italy in the group and in 2017 imported only 5 percent of total exports. They offered one of the highest prices for Paraguayan bovine meat and imported premium quality cuts, while Brazil and Chile bought bovine meat at average prices per ton.

On the contrary, frozen bovine meat variety (0202) was exported to mainly extraregional including Russia, South East Asian partners Vietnam and Hong Kong, and Middle Eastern partners Israel, Iran, Kuwait, Egypt and Iraq. Moreover, Paraguayan exports of the frozen boneless variety get preferential access in Taiwan and Israel. Russia occupied a share of 39 percent in 2017, while Middle Eastern markets constituted 27 percent in 2017. Recently in 2017 the UAE also authorized bovine meat imports from Paraguay.

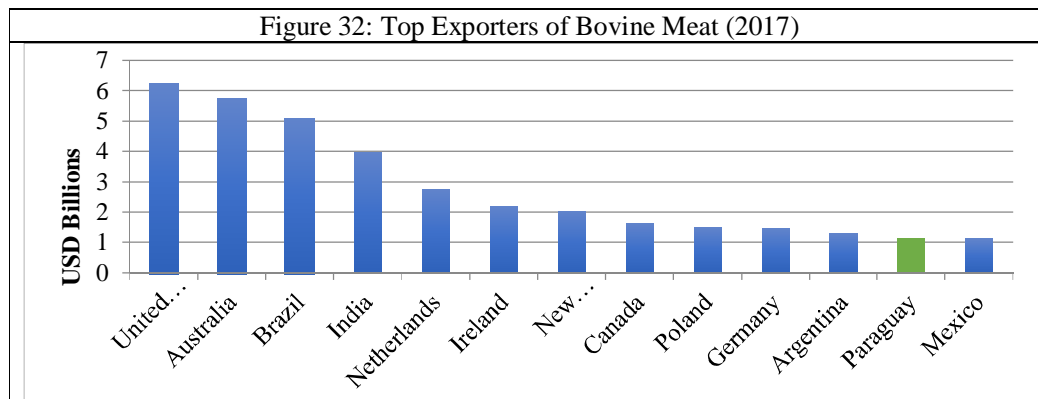
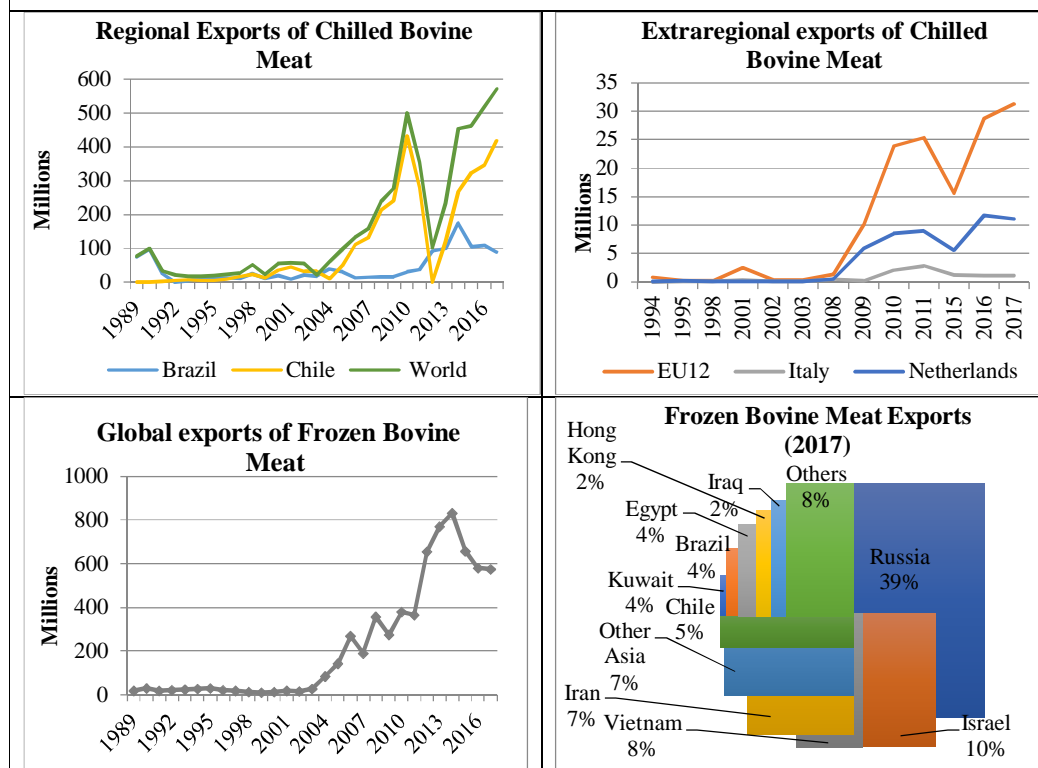


Figure 33: Exports of Chilled Bovine meat and Frozen Bovine meat



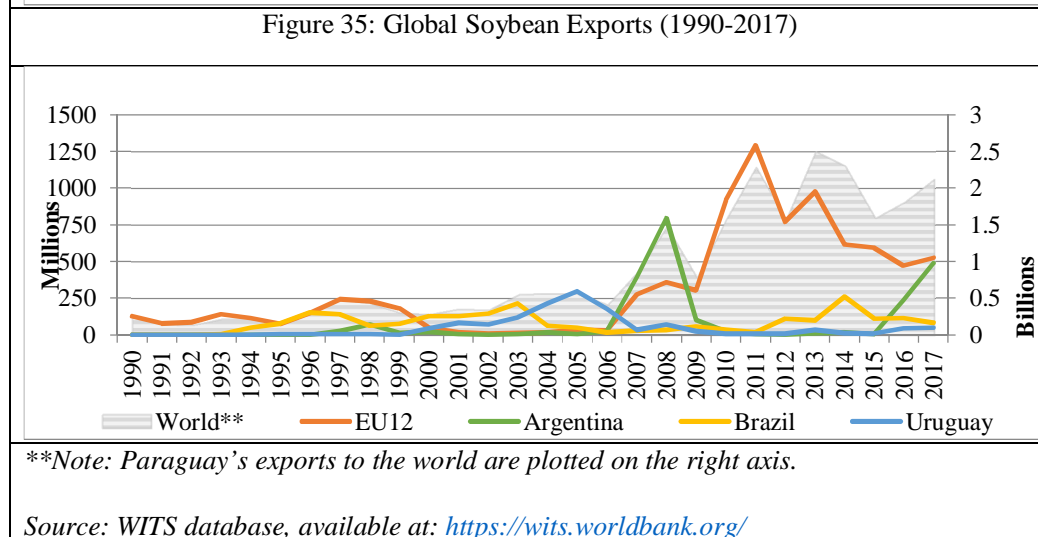
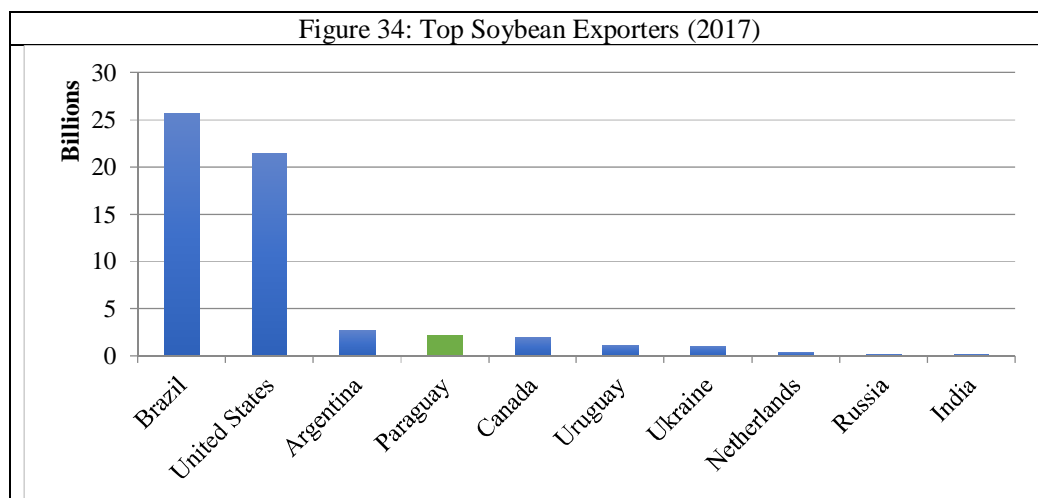
Source: WITS database, available at: <https://wits.worldbank.org/>

Such tremendous growth in bovine meat exports has been due to the efforts by the government since 2005. Supportive policies in the form of a *public-private partnerships* under the genesis of the Ministry of Industry and Commerce have supported the production and exports of bovine meat through upgradation of slaughter houses, maintaining better health of the cattle, greater marketing efforts through trade fairs in the European Union, and through establishment of a single window for exporters (*VUE*). As a result of these policies, Paraguay was not only declared *Foot and Mouth Disease* free in 2011, but has also been able to upgrade the quality of its exports and is now certified as 100% organic by international standards. New markets have thus opened up for bovine meat exports as a result of the robust government intervention in the industry, including Russia, European Union and others in South East Asia. Moreover, exports from adjunct industries such as leather and tanning have also increased in the last decade.

SOYBEAN

Paraguay was also the fourth largest exporter and sixth largest producer of Soybean in the world. It accounted for 3.7 percent of world exports (Fig 34). Exports boomed after 2007 as a result of the government impetus from US\$ 860 million to over US\$ 2.13 billion in 2017 (Fig 35), and exports specially grew by 17 percent in the year 2016-17. Soybean exports from Paraguay were the cheapest amongst the world's top 5 exporters of soybean at US\$ 348 per ton and were restricted only by the size of their produce. The top markets for soybean were regional neighbors Argentina and Uruguay, where most of the soybean was stored in export zones in other countries as Paraguay is a landlocked country; naturally, it depended on its neighbors to export to the rest of the world, especially to its top non-regional partners, the EU12 countries. Due to the severe drought and currency crisis in Argentina in 2016-2017, Paraguayan production of soybean surpassed that of Argentina for the first time ever in 2016. To compensate for the loss in Argentine harvest, most of the exports of whole grain found their way to Argentina for crushing and processing for re-exporting by the Argentine industry. Thus, exports of whole grain to other markets reduced in the same period. This also had a negative impact on the exports from complementary industries, including soybean cakes and soybean oil in the period 2015-2016. There has however, been a slight reversal of trend in 2017.

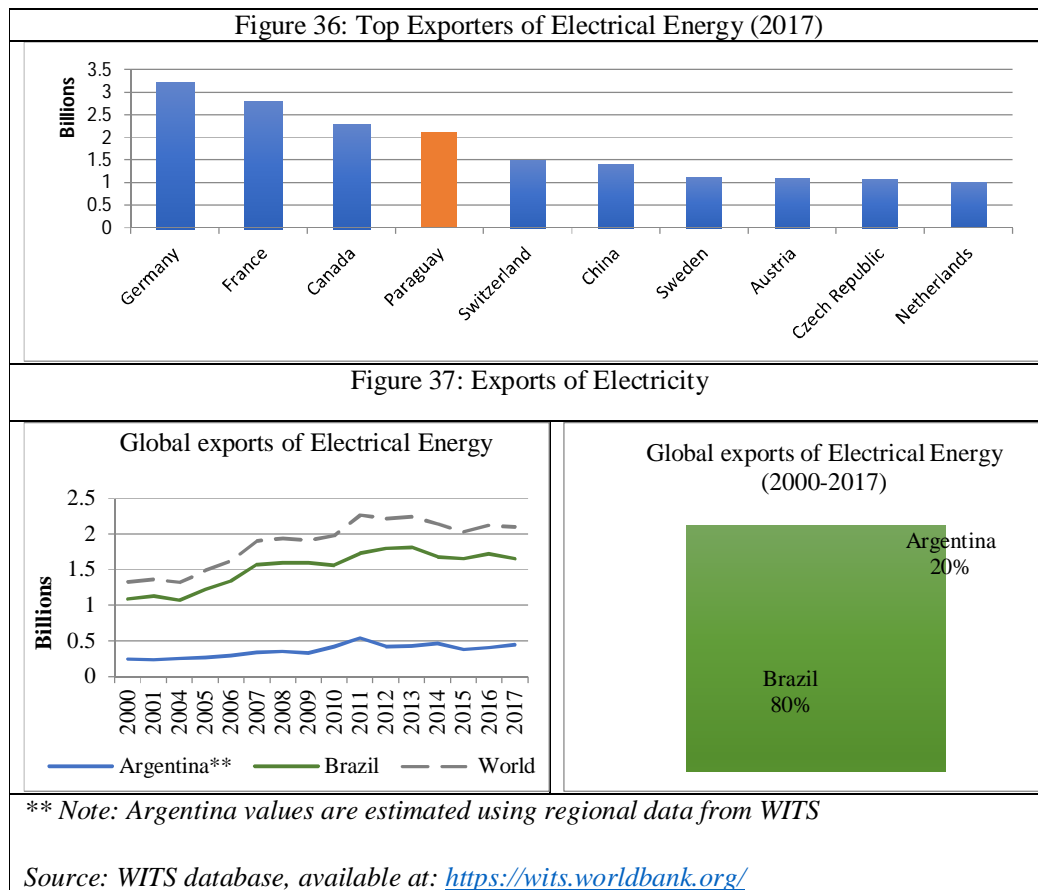
Comparison between export growth of whole soybean and processed soybean cakes and oils reveals that while exports of fresh soybean have grown six-fold since 2001, those of processed products have grown tenfold in the same period. Exporters of soybean in Paraguay also have a unique opportunity given the trade disputes between China and USA. China buys large quantities of American soybean and given the tariff war, Paraguay can capture the Chinese market with its competitive prices.



ELECTRICITY

Paraguay was the fourth largest exporter of electric energy (Fig 36) in 2017 and exported 75 percent of the hydroelectricity produced to its neighbors Argentina and Brazil through co-owned hydroelectric plants of Yacyretá (co-owned by ARG/PRY) and Itaipú (co-owned by BRA/PRY). Paraguay exported 400,000 megawatt hours

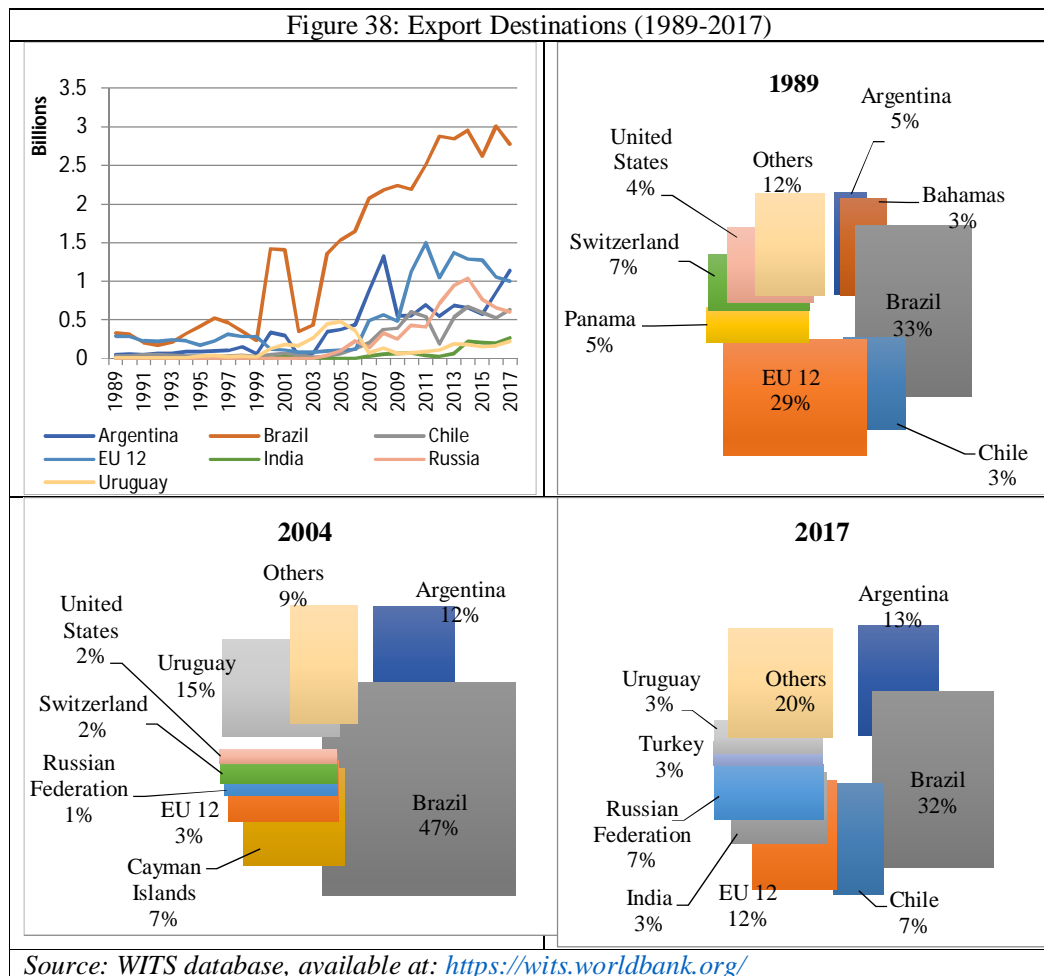
(MWH) of electricity in 2017-2018, valued at US\$ 2.1 billion, of which, 80 percent finds its way to Brazil and the rest to Argentina (Fig 37). However, technical and non-technical losses from the two plants have amounted to 25 percent of production according to a report by the WTO. In 2017, 98.9 percent of the country's population had access to electricity and accounted for 18.4 percent of the country's energy consumption, while biomass and imported hydrocarbons account for the rest.



EXPORT DESTINATIONS

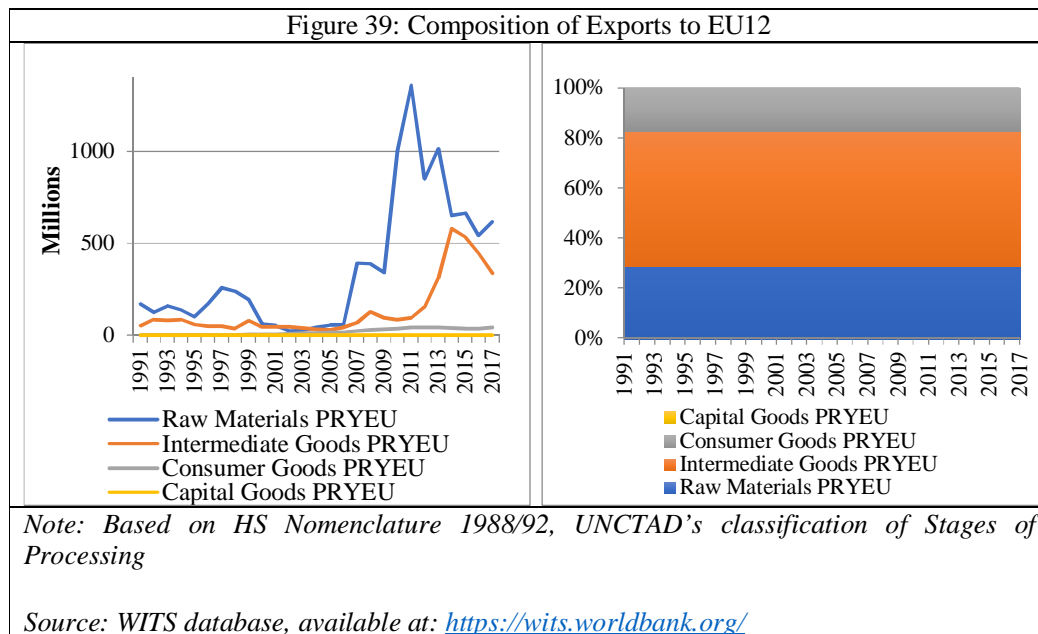
In the period 1989-2017, Paraguay mainly exported to Mercosur partners Brazil, Argentina, along with other regional partners such as Chile. Before the formation of Mercosur bloc, these regional partners constituted a share of 41 percent in 1989. This share grew to its peak of 75 percent in 2004, but dropped to 55 percent in 2017. Exports to Brazil have surpassed all other markets and touched US\$ 3 billion in 2016. Argentina was the next top destination, closely followed by the EU 12 members. Fig 38 shows

that the importance of EU12 as an export market has reduced since Mercosur market came into effect in 1995. EU12 members constituted a share of 29 percent of total exports in 1989, with a value of US\$ 288 million, but the share fell to only 3 percent of total in 2004, with a combined value of less than US\$ 95 million. This drop coincided with a simultaneous rise in share of regional partners in Paraguay's export basket in the same period.



Trade with the EU12 was almost negligible in 2001-2006 due to political instability in Paraguay. Following a series of structural reforms in 2003, trade picked up by 2007 and exports grew to US\$ 500 million. The reforms instilled confidence in the EU members and they soon recognized a potential trade partner in Paraguay. Ten years later, in 2017, exports had doubled to US\$ 1.015 billion to the EU12 members. Further, exports (in value) tripled between 2009-2011, but fell drastically to half their value between 2013

and 2017. Amongst the EU 12 members, the main export destinations were Italy, with a share of 24 percent in 2017, down from 30 percent in 2016; Spain with a share of 21 percent in 2017, followed by Germany, UK, Portugal and Netherlands, with a combined share of 45 percent in 2017. As expected, top exports to EU12 members comprised of 96 percent raw materials and intermediate goods in 2017 (Fig 39), including Soybeans (constituting a 50 percent share from 2016-2017), soybean factions including oilcakes (20 percent of total in 2016-2017) and soybean oil, chilled bovine meat and bovine leather. Soybean and bovine meat made up a 60 percent share by value. Their combined share peaked in 2010-2011, with a value of US\$ 1.35 billion. The composition of exports to the EU12 has remained unchanged since 1990s.

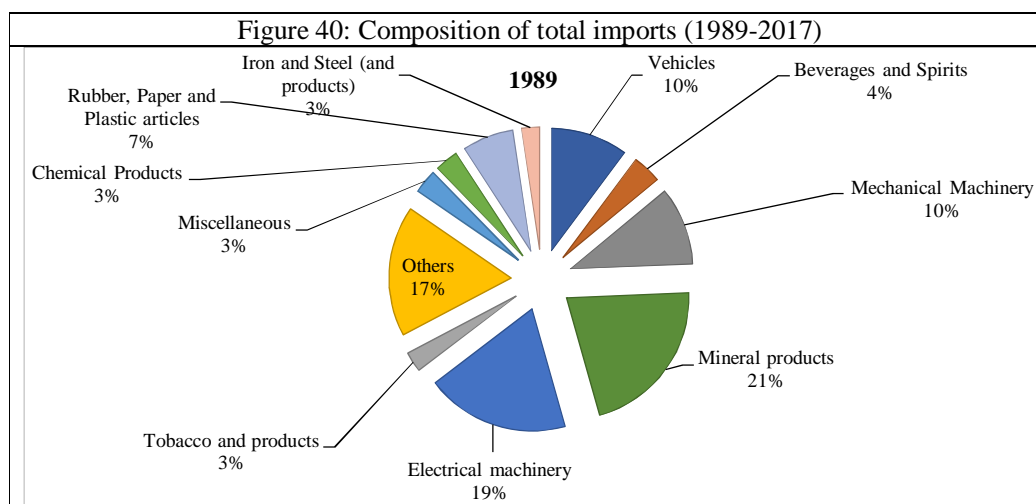


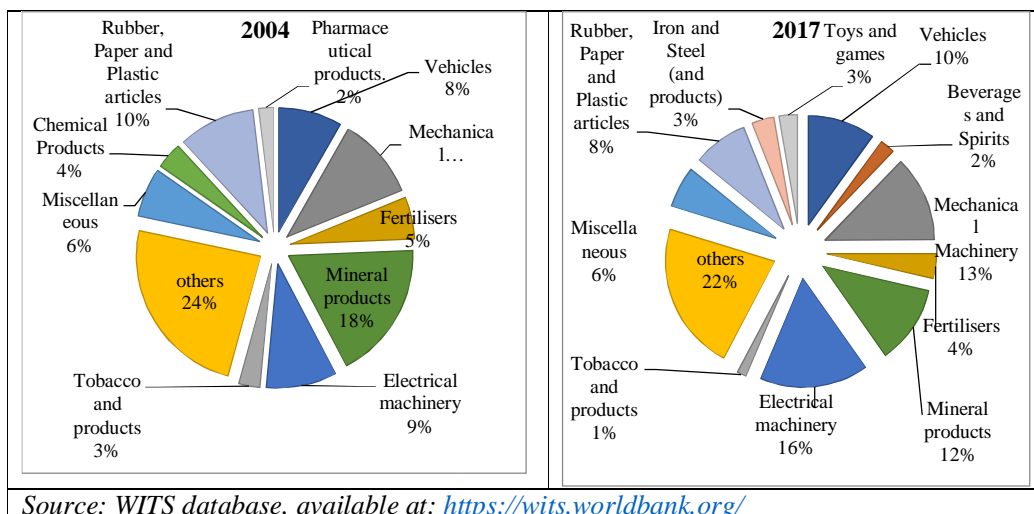
Since the commodity supercycle, new markets have opened up for Paraguay as it reduced its dependency on its neighbors. Though it continued to export 55 percent of all merchandise to the region, Paraguay managed to diversify its export destinations with the addition of Russia, India and Turkey to the mix. The relationship with Russia has improved dramatically since the turn of the century. Exports to Russia picked up in 2007 and grew from a mere US\$ 3 million in 2001 to US\$ 600 million in 2017, perhaps, due to improvement in diplomatic relations between the countries. Exports peaked between 2013-2014 to over US\$ 1 billion. The main exports to Russia included goods from the agriculture-food processing industry, notably frozen bovine meat, and soybean and factions. Moreover, exports to India have grown tenfold since 2001 and stood at

US\$ 266 million in 2017, mainly comprising of soybean oil and ferrous waste, while exports to Turkey picked up in 2010 in soybean.

IMPORTS

A temporal analysis of Paraguay's import basket in the period 1989-2017 reveals that Paraguay continued to import a similar set of products over time that comprised primarily of intermediate goods for domestic industrial use and finished capital goods to meet the domestic demand (Fig 40). An array of Mechanical machinery, electrical appliances and motor vehicles constituted a combined share of 39 percent of the total imports in 2017, with a value of US\$ 4.61 billion. These were accompanied by imports of refined petroleum with a share of 11.6 percent, fertilizers (4 percent) and rubber-plastic-paper products (8 percent) in 2017. Toys and games were the next top import with a value of US\$ 327 million in 2017, down from its peak of US\$ 566 million in 2010. They were mainly imported from China, among other consumer goods. The overall basket of goods imported by Paraguay was quite diversified, as seen from the large share of 'Others' category in Fig 40. Numerous goods were imported, with shares less than 1 percent and this is reflected in this category of imports.





The Paraguayan domestic market was heavily dependent on fuel imports. While mineral fuel imports comprised a share of 21 percent of the total in 1989, it was down to 18 percent in 2004, and in 2017, its relative share dropped to 12 percent due to the diversification of Paraguay's import basket. In terms of total value of fuel imported, Fig 41 shows that the value has declined in recent times. This is accompanied by intensified efforts by the Paraguayan government to promote the use of absolute-alcohol and fuel-alcohol for vehicles to encourage production of sugarcane, while reducing greenhouse emissions to contribute to climate change (MIC resolution No. 425/08).

Refined Petroleum was mainly imported from Argentina, Brazil, and Venezuela. Venezuela was the top source till 2009 and helped Paraguay meet 60 percent of its demand. Over 2009-2012 Argentina and Brazil supplied most of the oil. However, Paraguay's dependence on its regional partners declined thereafter and it began importing oil from the United States to meet 25 percent of its domestic demand (Fig 41). Subsequently, the value of fuel imports from EU12 surpassed that from the rest from the world. PETROPAR, a company established in 1981 and owned by the Paraguayan state plays an important role in the hydrocarbons sector. It imports and markets hydrocarbons. In 2016, PETROPAR took a 35 percent share of diesel imports market and 17 percent share in gasoline imports.

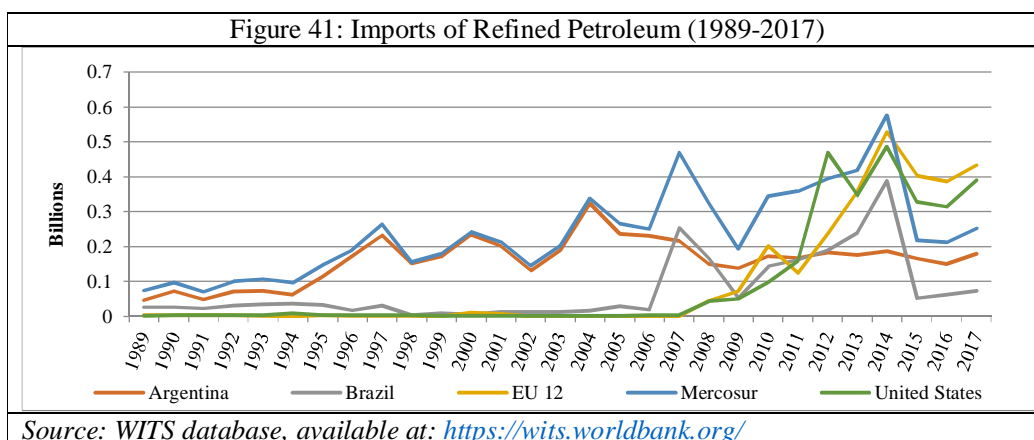
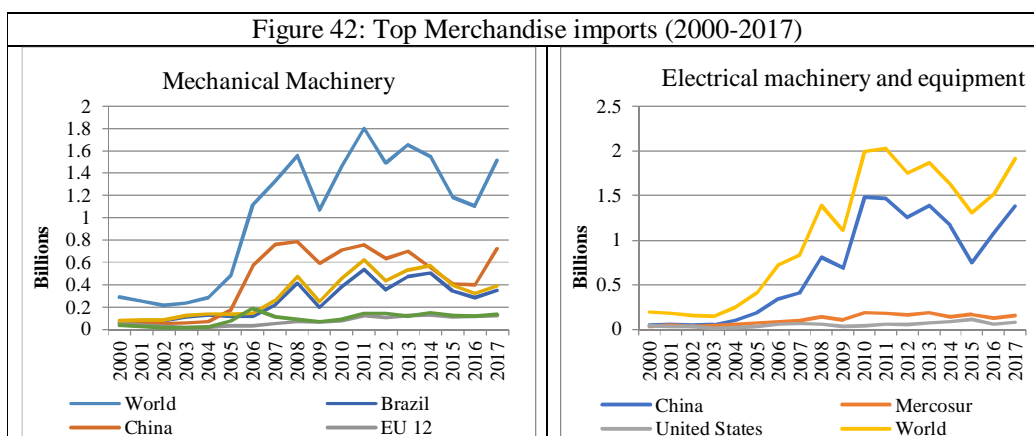
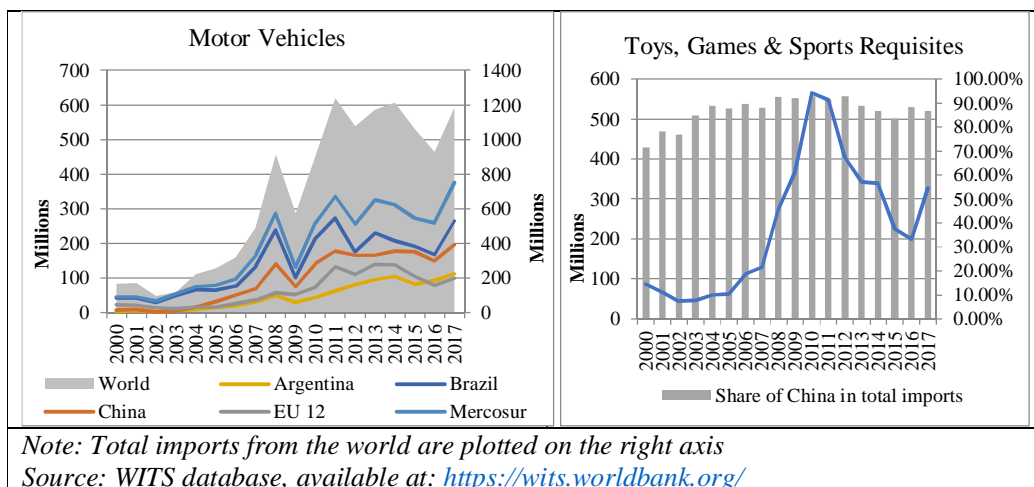


Fig 42 shows the top 4 imports by Paraguay in the period 2000-2017⁶⁷. As previously mentioned, mechanical and electrical machinery have been one of the largest imports, with a combined value of US\$ 3.42 billion in 2017, up from just US\$ 433 million in 2000. China and its Mercosur partners, especially Argentina and Brazil were the top sources, with an approximate share of 73 percent in total imports of mechanical machinery and 80 percent in the total imports of electrical equipment. Another major import from China in that has emerged in recent times is toys and games. In 2017, Paraguay imported toys and games worth US\$ 337 million, of which 87 percent originated from China. The importance of China as a supplier of capital goods to Paraguay only surfaced post 2004, however the dependence on Mercosur members remained strong in terms of motor vehicle imports. Paraguay imports large quantities of refurbished cars (HS code 8703) from Brazil, Argentina, Germany and South Korea. 30 percent of all motor vehicles (passenger and goods carriers) imported in 2017 originated from its Mercosur neighbors.



⁶⁷ Due to the paucity of accurate data, the period from 1989-1999 has been dropped.



IMPORT SOURCES

Overall, the main import sources for Paraguay were almost identical to the export markets for Paraguayan merchandise goods. Regional partners, Brazil and Argentina topped the list. The share of Mercosur partners in Paraguay’s total imports was 35 percent in 1989; it climbed in the decade after the signing of the Treaty of Asuncion in 1991 to 55 percent of total imports in 2004. This confirms the dependence of Paraguay on its Mercosur partners for imports of manufactured and capital goods. However, this share dropped to 35 percent in 2017 due to the growing importance of China. This trend in the Paraguayan analysis is similar to the trend displayed by both Argentina and Brazil in selection of trade partners after 2004.

The growing importance of China is apparent from Fig 43, as China overtook Brazil to be the top import source in 2016-17. Paraguay also imported goods north of US\$ 500 million from the United States in the period 2010-17. Refined Petroleum, along with perfumes, cars and beer made up 65 percent of total imports from the United States in 2017-18. The rest of the basket comprised of electronics, with a particular hike in 2006 due to large imports of computers. Moreover, the combined contribution of China and the United States to Paraguay’s import basket stood at 40 percent of the total in 2017.

The EU12 also remained an important partner post 2003 national reforms in Paraguay. Together, they accounted for a 10 percent share in 2017 of total imports. Fuel was also the top import from the EU12 members till 2017, with a share of 30 percent in total imports, followed by mechanical machinery with a 10.5 percent share, and motor

vehicles including used/refurbished cars with a 10.3 percent share in 2017. On an average, total imports from EU12 remained close to US\$ 1 billion in the period 2013-2017. Netherlands was the top supplier of goods from the region, with total imports valued at US\$ 456 million in 2017. Moreover, Dutch imports grew by a factor of thirty-five between 2007 and 2014, reaching their peak of US\$ 520 million in 2014. Refined Petroleum was the top import in 2017 with a value of US\$ 411 million, followed by Beer valued at US\$ 15 million in 2017. Paraguay also continued to import German machinery, electrical equipment in the period between 2000-2017, with a combined contribution of 30 percent, in addition to and German made cars, with a share of 30 percent as well. Total imports from Germany were valued at US\$ 260 million in 2017.

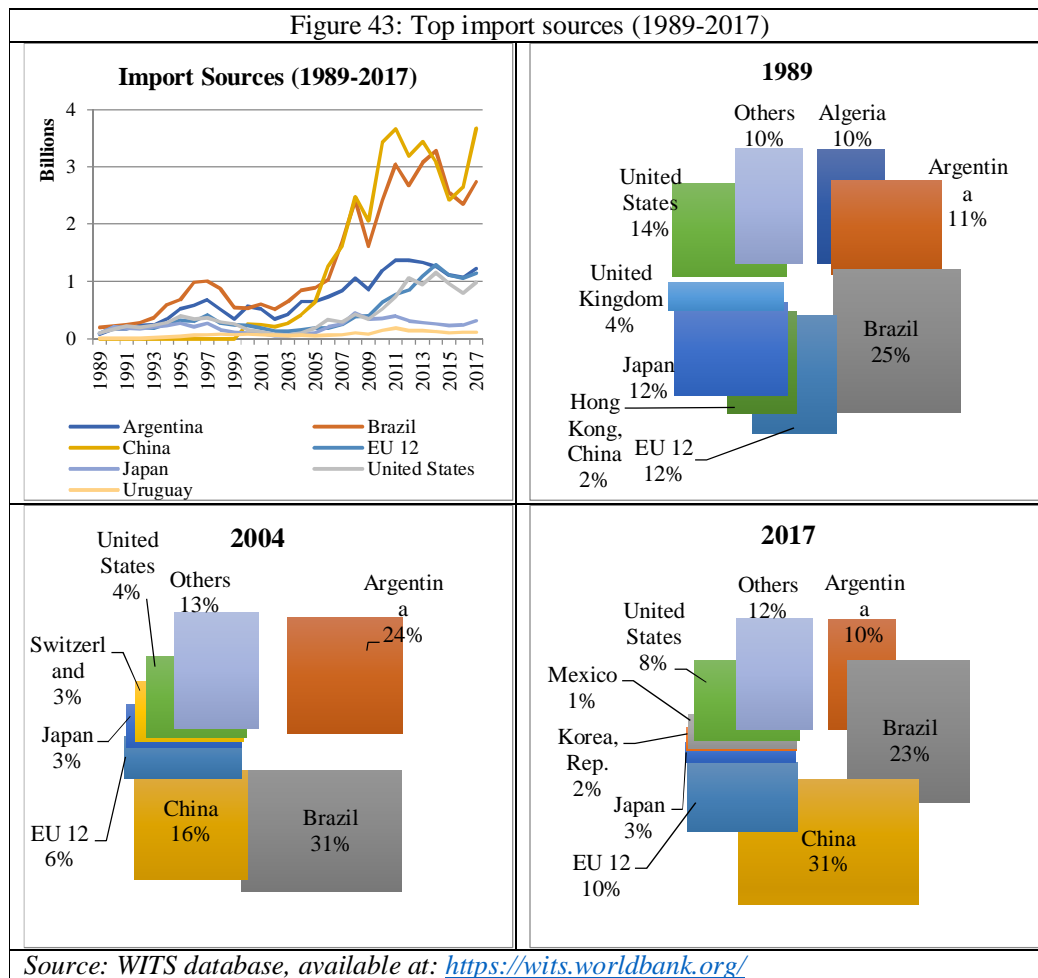
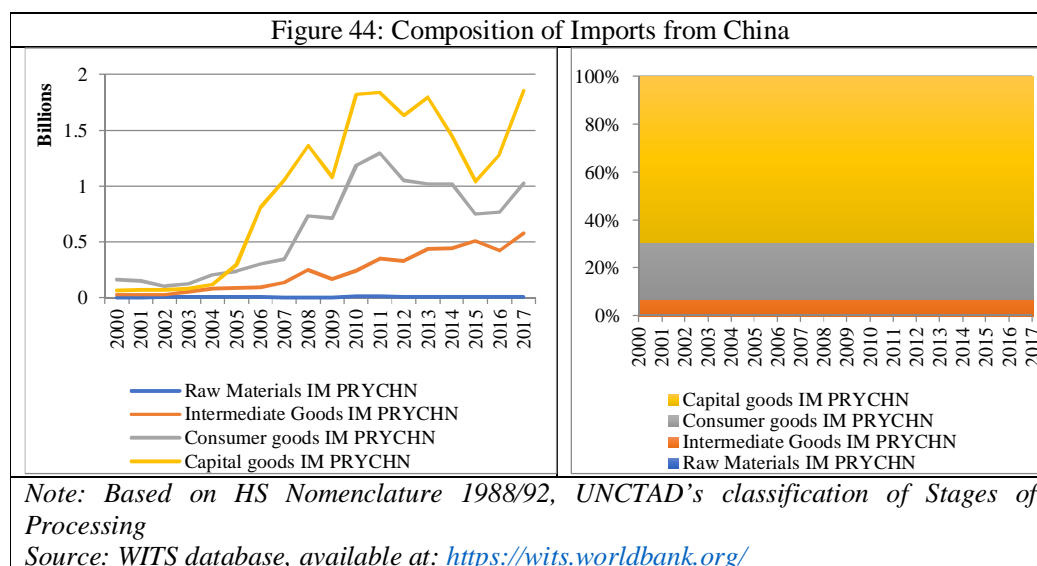


Fig 43 also clearly shows the expanding share of China, along with other Asian sources like Japan and South Korea. Imports from China surged after 2004, from US\$ 160 million to US\$ 3.6 billion in 2017. Paraguay imported mostly intermediate goods,

consumer and capital goods from China, with a combined share of 90 percent of total imports (Fig 44). Imports of capital goods peaked in the pre-financial crisis period under the HS chapters machinery, electrical equipment and motor vehicles, with the largest imports of mobile telephones. Together, they comprised of 63 percent of total imports in 2017, up from a 25 percent share in early 2000s. Consumer goods also occupied a share of 35 percent in 2017, with a value of US\$ 700 million and consisted of footwear, runner tires, plastic products, metal watches, video games and toys, with a combined value of US\$ 284 million in 2017. Rest of the imports consisted of intermediates for domestic industries like plastics, chemicals, fabrics and insecticides and pesticides in 2017. It is well known that Paraguay's relation with China is fairly new and their diplomatic relation is work in progress as Paraguay is a great sympathizer of Taiwan (also known as Chinese Taipei).

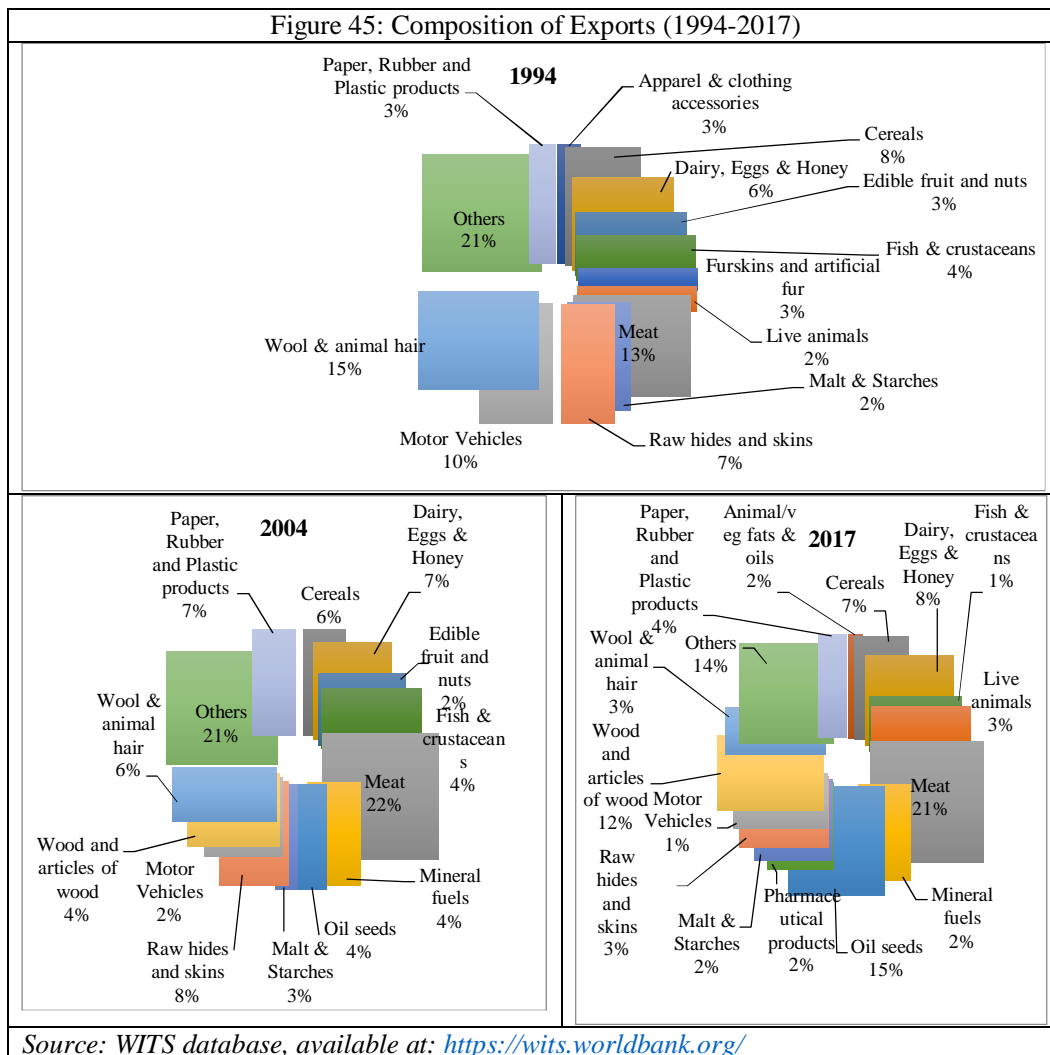


URUGUAY

EXPORTS

The previous chapter emphasized that Uruguay has been reliant on exports of agro-food based products, although the government has made efforts to diversify its export basket through export promotion incentives. Nevertheless, in the period 1994-2017, Uruguay's exported commodities chiefly of animal and plant origin, including food, wood and other agricultural raw materials. This export basket comprised of bovine meat (fresh,

chilled or frozen), soybean, wood pulp and other wood products, rice, live animals, skins, hides, fur, dairy, oils of plant or animal origin, malts and crustaceans. These products alone accounted for 77 percent of all exports in 2017, valued together at US\$ 6.1 billion, up from a value US\$ 1.9 billion and share of 59 percent in 2004 (Fig 45). In 2017, while China was the top destination for soybean and frozen bovine meat, EU12 was the main market for fresh bovine meat, Brazil for hides and skins, Peru for rice, and Turkey for live bovine animals. The value of bovine meat exported has more than doubled between 2004 and 2017 even though the share has remained constant, while total export value of soybean has increased nine-fold in the same period. Similar growth in value was also experienced by the timber and wooden products industry.



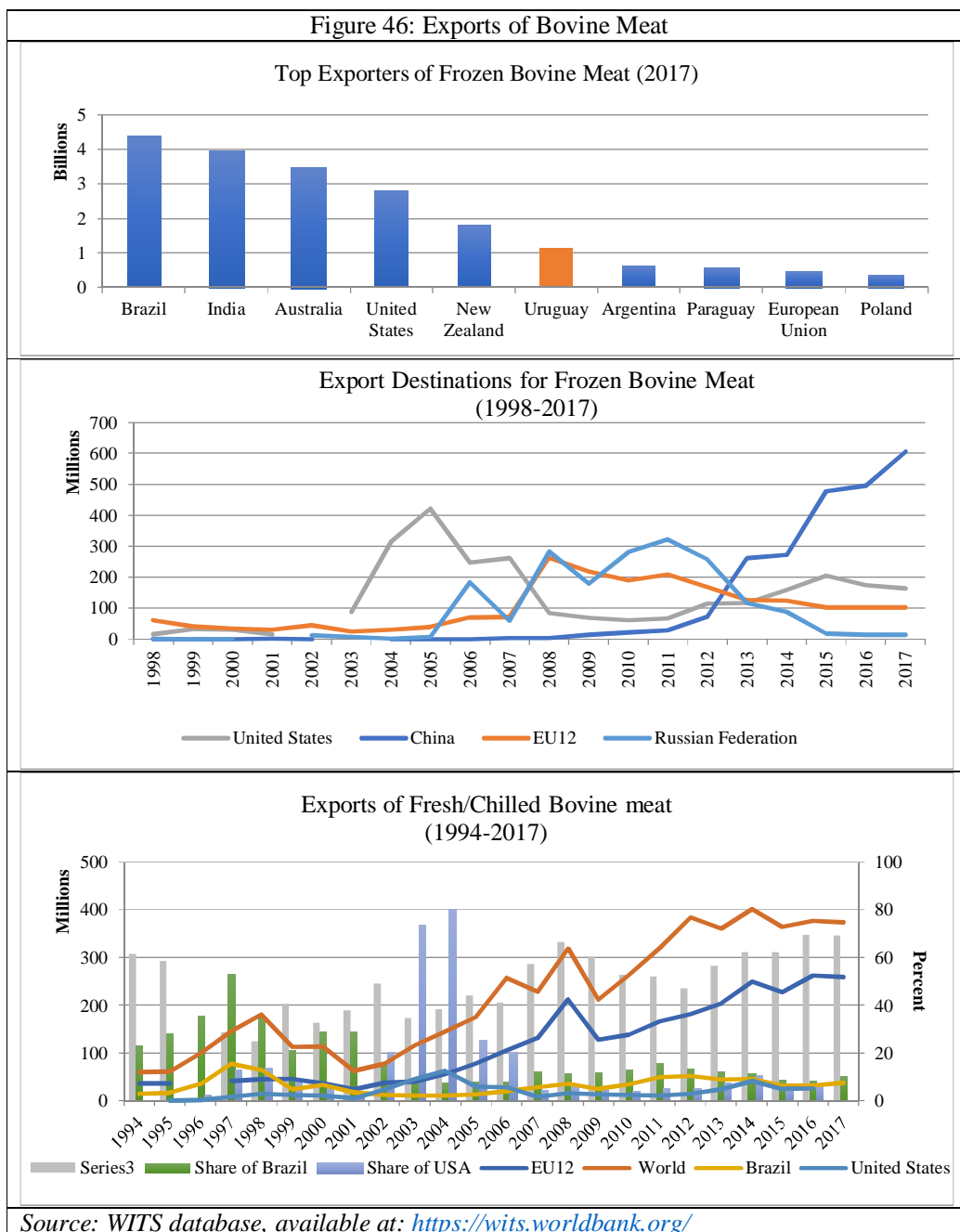
A poor harvest in 2015 had depressed the production and exports of Soybean, but it experienced a swing back in early 2017. Prudent policies through monetary tightening

and strong investor interest in Uruguay led to nominal appreciation in the Uruguayan Peso vis-à-vis the US dollar, but a slight depreciation against the Argentine peso. On one hand, the appreciation weakened export competitiveness in agriculture and manufacturing products though output remained strong due to the good harvest in early 2017; on the other, the depreciation vis-à-vis Argentina gave Uruguay a boost within the region.

Given the active policies aimed at diversification, Uruguay has managed to diversify its export markets over the past decade. Notably Uruguay began exporting Pharmaceutical products, paper-rubber-plastic products, and mineral fuels in recent time that replaced previous exports of motor vehicles in 1994. Export diversification has decreased vulnerability to recurrent shocks in the neighboring countries and in international commodity prices.

BOVINE MEAT

Uruguay is the sixth largest exporter of frozen bovine meat in the world, with a share of 5.1 percent in global exports. Uruguay exports frozen bovine meat to China, EU12, USA and Russia (Fig 46), with a total value of US\$ 1.13 billion in 2017, up from US\$ 567 million in 2007. China bought a variety of cuts, including short ribs bone in, round cuts, chuck and blade, trimmings and shin shank, totaling 160,000 tons in quantity in 2017. Hence, China was the top destination for frozen bovine meat in 2017, with a value of US\$ 606 million and a share of 53.7 percent of total exports. Uruguay also exports high quantities of fresh/chilled bovine meat to EU12 and Brazil. EU12 members, notably Netherlands, are the top destination for high value fresh cuts under the Hilton quota. 69 percent of total fresh bovine meat reached the EU 12 markets. Uruguay bovine meat exporters have also developed a niche in the US markets and exports organic- chemical free products. It competes with New Zealand and Australia for the US market but manages to export 5,000-6,000 tons of bovine meat annually. The share of the United States in total exports of fresh bovine meat peaked in 2003-2004. Uruguay also exported Kosher certified bovine meat to Israel, notably since 2011, with an average value of US\$ 125 million between 2011 and 2017.

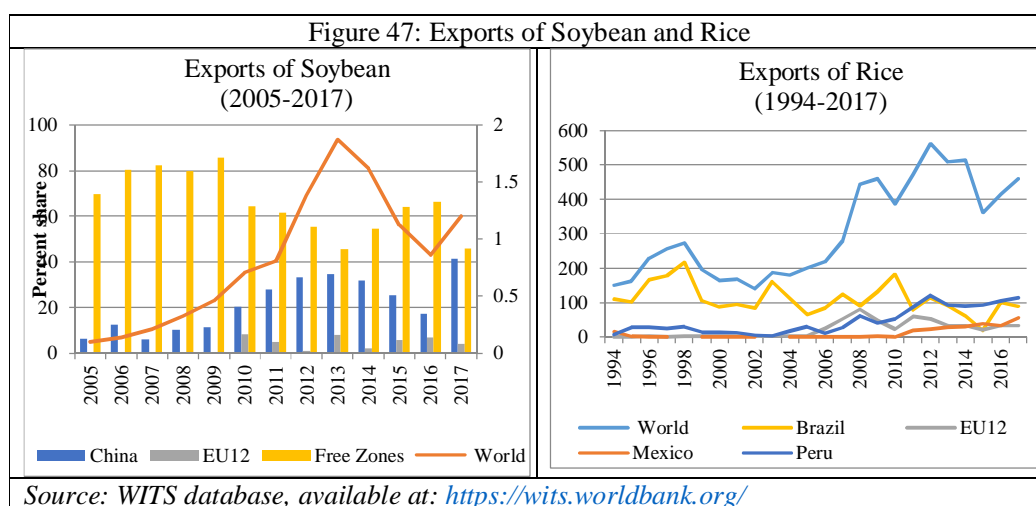


SOYBEAN and RICE

Uruguay was also the sixth largest exporter of Soybean (2.1 percent share in global exports) and ninth largest exporter of Rice in the world in 2017 (2 percent share in global exports). The growth of Soybean exports can be seen in Fig 47, as total exports increased from US\$ 137 million to US\$ 1.8 billion towards the end of international commodity supercycle in 2012-13. Exports dipped to just under US\$ 900million in 2016 but experienced an upswing in 2016-2017 due to a good harvest. Of the total

soybean exported worth US\$ 1.2 billion in 2017, 45.8 percent ended up in Free Zones to reap the benefits of such a scheme. China was the next top destination, with a share of 41.3 percent of total soybean exports in 2017.

Another top export from Uruguay was Rice in the period 2002-2017, with a peak value of US\$ 560 million in 2012. Peru was the top buyer of Uruguayan Rice in 2017, closely followed by its fellow Mercosur member Brazil. Peru bought 207,435 tons of rice, valued at US\$ 460 million and occupied a share of 24.7 percent in total rice exports. On the other hand, Brazil comprised a share of 19.5 percent of total in 2017. From 2011, exporters of rice in Uruguay are required to obtain *Rice Export Authorization* as per Decree 439/011 dated Dec 12, 2011 (WTO, 2012).



EXPORT DESTINATIONS

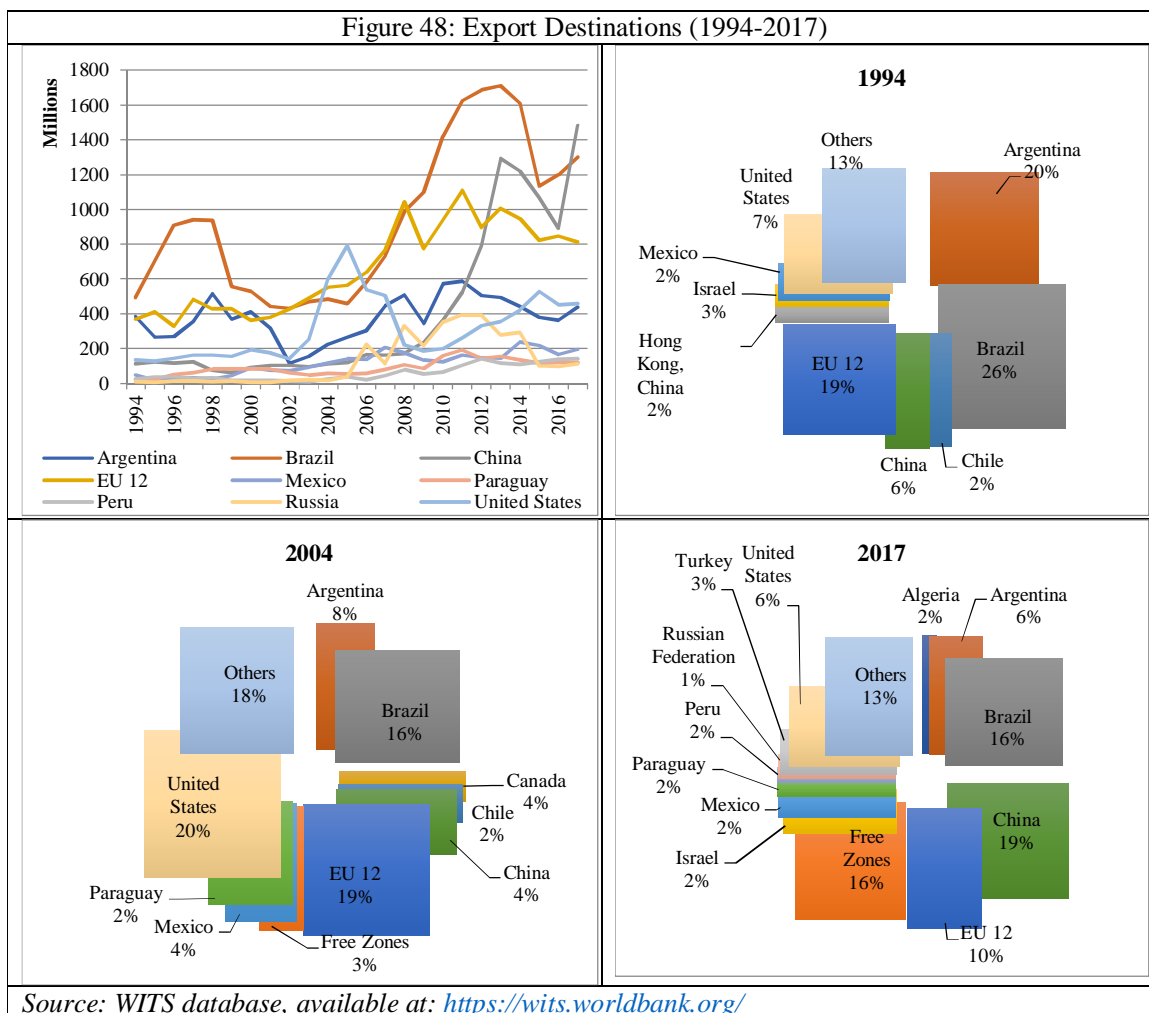
One of the key objectives of Uruguay’s trade policy has been to ensure stable market access around the world. (WTO, 2018) The government has made several efforts to increase Uruguay’s integration in the global market through bilateral, regional and multilateral efforts. These efforts have helped diversify its export destinations over time, as seen in Fig 48. Over time, Brazil, China and EU 12 continued to be the top three destinations for Uruguayan merchandise exports. Right after the adoption of the CET in 1994, Mercosur partners, Brazil and Argentina comprised a share of 46 percent in Uruguay’s export basket. However, as we have seen earlier in the case of Paraguay, the dominance of China began in 2004 as it started to buy larger quantities of Uruguayan food and agricultural products and by 2017, China had surpassed Brazil to occupy the

top position, with a value of US\$ 1.48 billion and a share of 19 percent in total exports. Nonetheless, the regional partners, Brazil, Argentina, and Paraguay that occupied a collective share of 48 percent in 1994, halved their share to just 24 percent in 2017. Notably, exports to Brazil fell drastically from US\$ 1.7 billion in 2012-2013 to only 60 percent of their value in 2017 due to the political and economic crisis in Brazil.

Apart from China and the EU12, the next top extraregional destination was the United States. Their collective share grew from 32 percent in 1994 to 43 percent in the next decade in 2004 and finally dropped to 35 percent in 2017 with prominence of China. The burgeoning of their collective share in 2004 was attributed to the rising importance of the United States. This coincided with the FTAA negotiations and as mentioned earlier, Uruguay was inclined towards concluding the FTAA negotiations, however they lost momentum by 2004 due to difference in opinion of Brazil and Argentina. These dynamics have been explored at length in Chapter on Political economy of Mercosur. Notably, in the period 1994-2004, the share of USA improved from 7 percent in 1994 to 20 percent in 2004. Exports to the US consisted chiefly of meat, hides and skins, fresh fruits, dairy products and wooden articles. This export basket has largely remained unchanged since the turn of the century. Food based products comprised of over 80 percent share in total export to the United States, while the share of USA in total exports by Uruguay fell from its 2004 peak to just 6 percent in 2017.

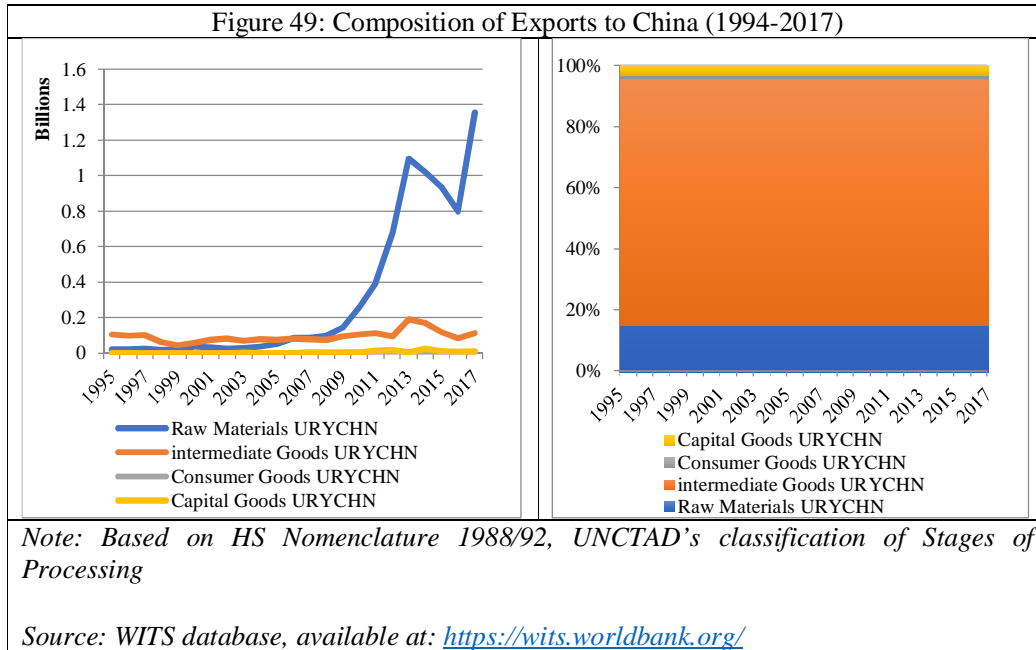
Canada, Paraguay and Free Zones also emerged as important destinations for Uruguayan exports in the period 1994-2004. However, Hong Kong and Israel lost out on their share in the same period. Between 2004 and 2017, the share of exports reaching *Free Zones* grew from 3 percent in 2004 to 16 percent in 2017, such that *Free Zones* were the third top destination after Brazil and China in 2017. This was a direct consequence of the export promotion policies by the government that led to the establishment of free zones in the country. Another positive consequence was the diversification of markets in this period. Thus, Turkey, Russia, Peru and Algeria emerged as important destinations for exports, with an average share of 2 percent in 2017. Uruguay, under the Mercosur banner also signed an FTA with Israel in 2007, Egypt in 2010, SACU in 2008 and a framework agreement with Turkey in 2008. Through these efforts, Uruguay has been able to integrate itself in the world market.

Figure 48: Export Destinations (1994-2017)



CHINA

China began importing bovine meat from Uruguay in 2009 and exports have only increased in terms of value and quantity in the following period. In 2017, China was the biggest importer of Uruguayan products including raw materials like soybean, and frozen bovine meat, and intermediary goods like Woodpulp and animal hides. The share of raw materials has increased from 20 percent in 1995 to 90 percent in 2017, replacing intermediary products from the basket of goods (Fig 49). Soybean exports peaked in the period 2010-2015, and were valued at US\$ 495 million in 2017. China imports 41.4 percent of all soybeans exported by Uruguay. China also accounted for 53.7 percent of bovine meat exports (0202).



Bovine meat exports increased from US\$ 0.8 million in 2001, to US\$ 606 million in 2017, with a peak period of 2012-2013. Bovine meat exporters in Uruguay also faced a 12 percent tariff on their exports when they reached the Chinese customs, while soybean exporters faced only a 3 percent tariff according to the 2017 tariff data⁶⁸. Overall exports to China grew from US\$ 102 million in 2001 to US\$ 1.48 billion in 2017, a 13-fold increase in less than two decades. The CAGR (2001-2017) for exports to China was 17 percent as compared to 5.77 percent for exports to the United States and 4.6 percent for exports to EU12.

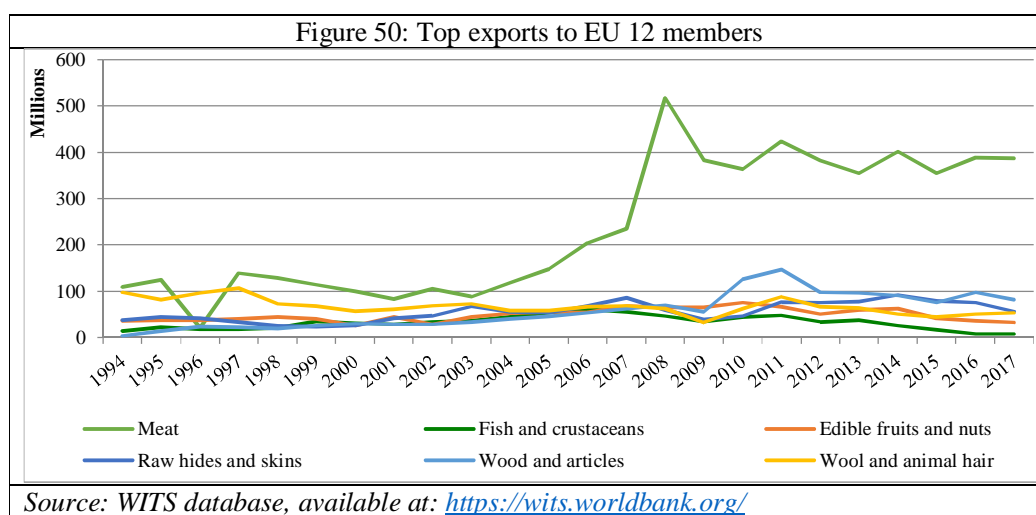
EU 12

EU 12 members had a share of 10 percent in Uruguay's export basket from 2012- 2017, a slight decrease from its share of 18 percent in the period 2001-2011. Exports to EU12 peaked in two distinct periods 2010-2012 and 2014-2016 (Fig 48). Netherlands was the top destination in Europe, followed closely by Germany, Italy and Spain. Exports to EU12 more than doubled between 2001-2017, from US\$ 378 million to US\$ 811

⁶⁸ WTO Trade Policy Review, 2018

million and included animal or agricultural origin goods like bovine meat, wood and articles of wood, mainly fuel wood, bovine hides and wool as seen in Fig 50.

Bovine meat exports witnessed the largest increase as they jumped from US\$ 101 million in 1994 to over five times their value of US\$ 517 million in 2008. Post 2008 financial crisis, bovine meat exports to EU 12 members have stabilized at an average of US\$ 400 million in the period 2009-2017. While EU 12 members mainly bought large quantities of frozen bovine meat from 2008-2012, but switched to fresh/chilled bovine meat from 2014, with a peaked value at US\$ 267 million in 2016. Moreover, exports of wood and wood products increased five times in value between 2001 and 2017 with a peak in 2011 at US\$ 147 million.

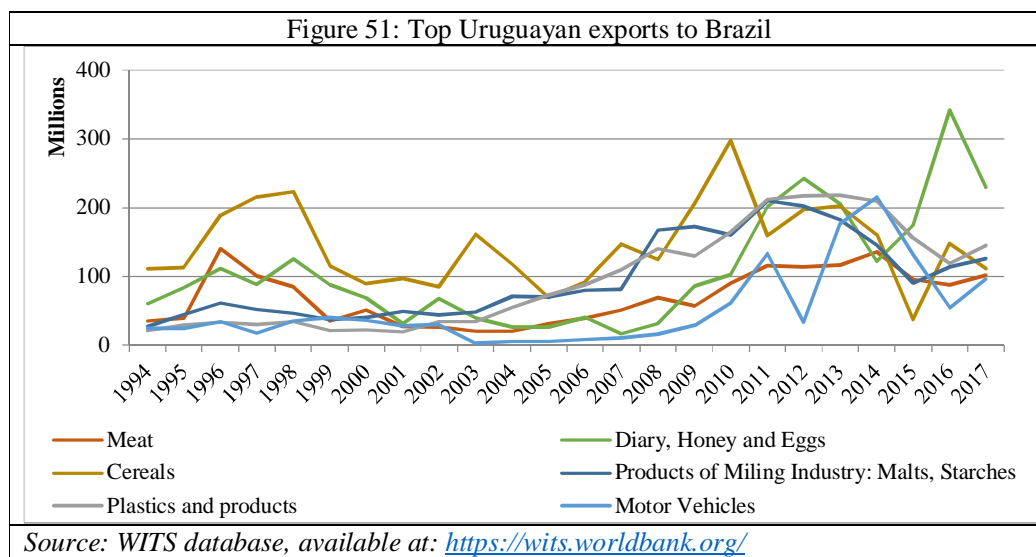


BRAZIL

Mercosur partner, Brazil continues to be one of the top destinations for Uruguayan merchandise exports within the region as well in the world, with a share of 16 percent of total export in 2017. In the period 1994-2017, products from the dairy industry, Milk and cream, cheese and curd and butter grew from US\$ 82 million in 1994 to their peak of US\$ 341 million in 2016, but dropped to US\$ 230 million in 2017 due to restrictive measures by the Brazilian dairy producers' association to control the importation of dairy products from Uruguay in September 2017 (FAO, 2017)⁶⁹. They expressed their concern over large imports from Uruguay at prices lower than Brazilian domestic dairy prices that caused distress to local producers. Such low costs made it impossible for

⁶⁹ More information at <http://www.fao.org/in-action/agronoticias/detail/en/c/1045720/>

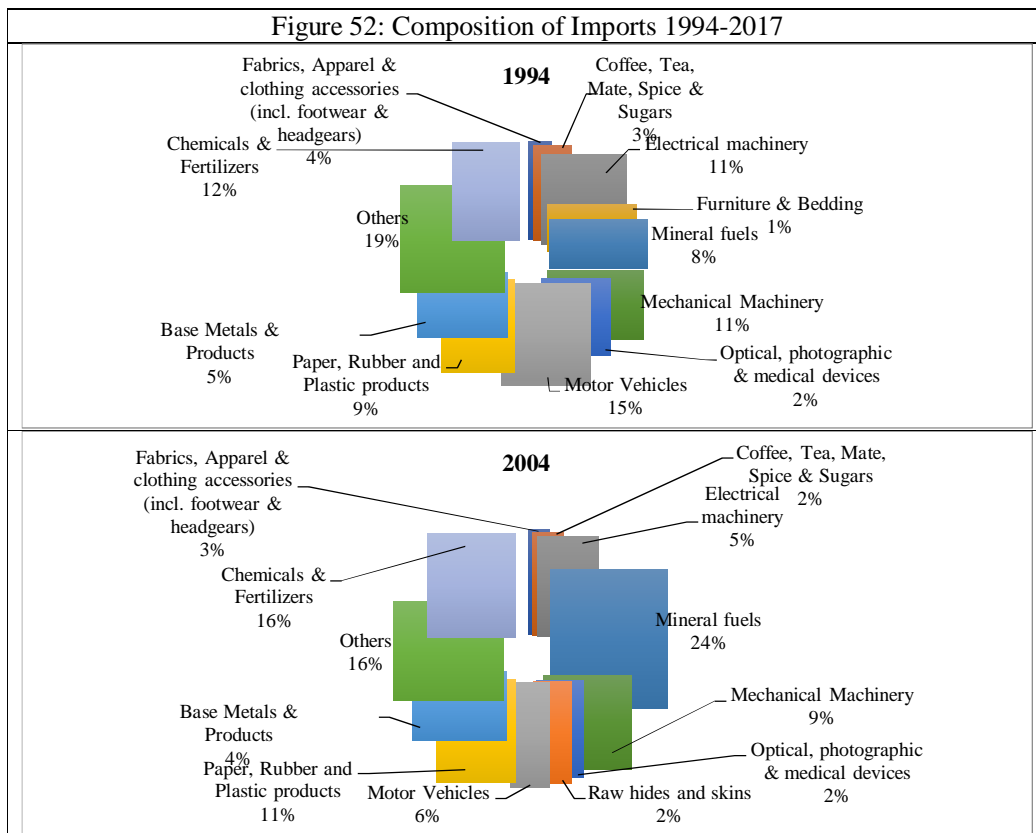
Brazilian local producers to compete with their Uruguayan counterparts. Further, Brazil questioned the origin of milk exported by Uruguay, following which; Brazil had completely suspended imports of Uruguayan dairy products in late 2017. This measure was reflected in the sudden drop in dairy imports as shown in Fig 51. The next top export from Uruguay to its fellow Mercosur member in 2017 was plastics primarily used for packaging of goods, followed by cereal in the form of malt, fresh bovine meat and parts and accessories of motor vehicles.

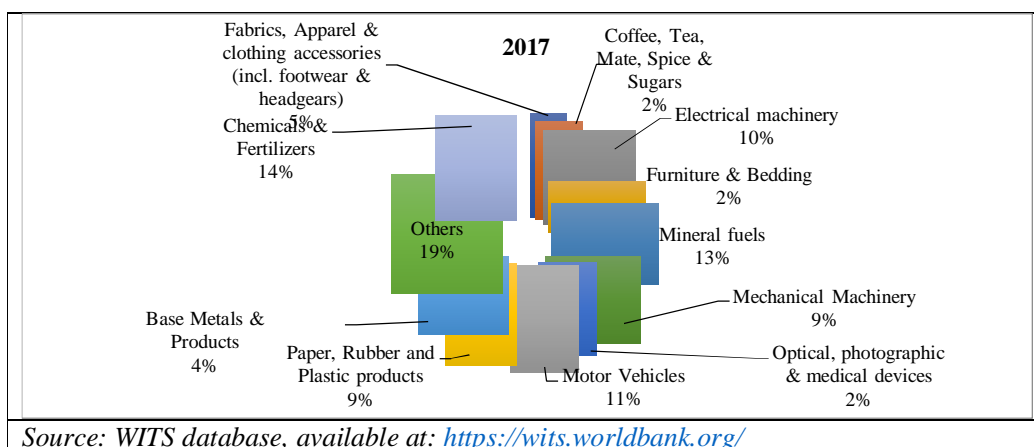


IMPORTS

Given the lack of a large-developed industrial sector in Uruguay, it mainly imported manufactured goods including electrical equipment, machinery, motor vehicles, chemicals and clothing and footwear in the period 1994-2017. This dependency on imported capital and consumer goods has already been explored at length in the previous chapter. In 2017, their combined share was 49 percent of total imports. Although this share has remained unchanged since 1994, the total value has tripled from US\$ 1.4 billion in 1994 to US\$ 4.1 billion in 2017. In the period 2015-2017, the prices of imported capital goods fell following Mercosur’s decision CMC/25/015, under which, Uruguay was permitted to apply a 0 percent tariff on capital goods till 2021 or 2 percent till 2023 (BK scheme) and 2 percent tariff on ICT goods imports till 2022. Moreover, machinery imported for agricultural purposes also attracted zero tariffs and taxes.

Mineral fuels were the top import in 2004 and held a share of 24 percent, with a value of US\$ 750 million. In 2017, despite the falling share of mineral fuels in the import basket, its value reached US\$ 1.06 billion. Uruguay imported both, crude and refined petroleum from its trade partners. The next important item in the basket was Plastic, Rubber and Paper goods. On average, they accounted for 9.6 percent of total imports in the period 1994-2017, with the shared value growing from US\$234 million to US\$746 million in the same period. Although Optical, medical and photographic devices occupied a small and consistent share of 2 percent in total imports, their value has tripled in the same period from US\$ 55 million to US\$ 143 million in 2017. Thus, overall, Fig 52 shows that the total basket of imported goods remained fairly unchanged in the period 1994-2017, however, their relative importance changed within the basket over time.

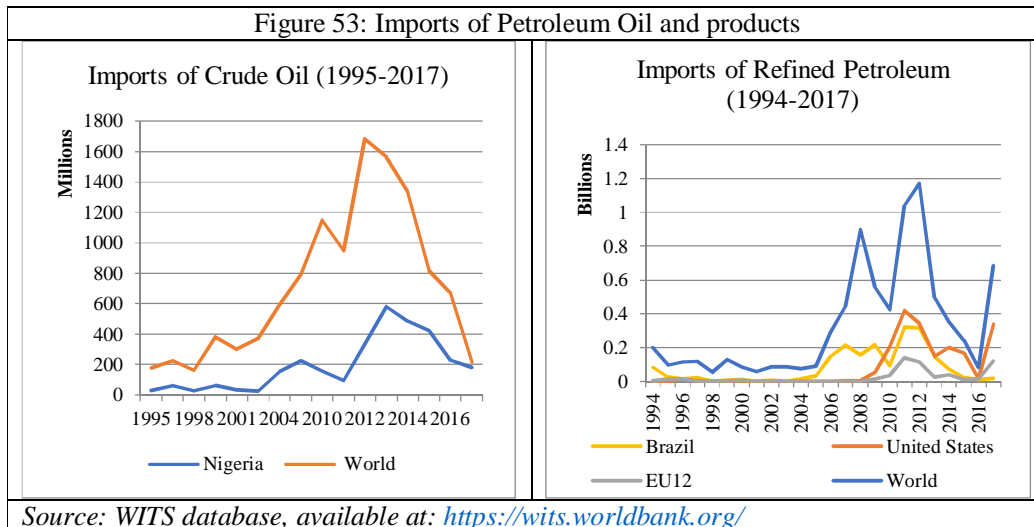




PETROLEUM OIL AND PRODUCTS

Historically, Uruguay extensively imported refined oil from the United States and Brazil in the period 2005-2012, with a dip in 2009 due to the financial crisis; while it began importing crude oil from Nigeria in period 2010-2013 (Fig 53). Together, total imports of petroleum products increased from US\$ 275 million in 1995 to its peak of US\$ 2.86 billion in 2012. The shift from refined to crude petroleum occurred because of increased domestic refining activity in Uruguay from 2010, possibly to reap the benefits of VAT-exempted crude imports from Nigeria. However, from 2013-2016, oil imports reduced considerably due to lower demands and increased efficiency of usage at home. Uruguay's economy also moved onto cleaner energies like solar and wind energy and imported equipment to produce clean energy that was exempted from tariffs and taxes. This is a clear consequence of the domestic policies to reduce reliance on imported petroleum products to meet energy needs at home. Despite these measures, imports of refined oil witnessed an upswing in the late 2016 owing to the appreciation of the Uruguayan peso in the period 2015-2017 that meant cheaper oil imports. According to the latest data from 2017, Uruguay continued to import 650,000 tons of refined oil valued at US\$ 337 million from the United States. Uruguay also imported US\$ 183 million worth of Nigerian crude (approximately 395,000 tons) that made up 83.8 percent of total crude imports in 2017.

Figure 53: Imports of Petroleum Oil and products



Source: WITS database, available at: <https://wits.worldbank.org/>

MOTOR VEHICLES

Uruguay's dependency on its regional neighbors extended to include imports of motor vehicles. Uruguay imported motor vehicles from Brazil and Mexico to take advantage of the special preferences in place as per the automotive agreements signed by the Mercosur members and Mexico. According to Decree 246/012 of the Ministry of Economy and Finance, automobiles imported from outside the region attract 0 to 23 percent tariff, with a national average of 15.7 percent, as well as the internal tax (IMESI) that varies across fuel consumption. Diesel automobiles attracted the highest IMESI rate, while hybrid and electrical vehicles attracted the least. As per the 2015 report by the US Department of Commerce⁷⁰, Table 2 lists the special import taxes and restrictions on imports of motor vehicles in Uruguay. The trade agreement for automotive sector between Mercosur and Mexico (ACE no. 55) allowed Uruguay to continue to import motor vehicles from Mexico despite the taxes in place. However, Brazil remained the top import source for motor vehicles in the period 2003-2107 and in 2017, Uruguay imported 50 percent of all vehicles (for transportation of persons and goods) from Brazil, valued at US\$ 400 million. The top foreign owned automobile brands sold in Uruguay in 2017 included Volkswagen, Chevrolet, Fiat and Renault (ASCOM, 2019).⁷¹ Apart from regional imports, Uruguay also imported Vehicles from China, South Korea, EU 12 members and the United States. In particular, Uruguay

⁷⁰ For more information, see: <https://www.trade.gov/td/otm/assets/auto/TBR2015Final.pdf>

⁷¹ Statistics available at: <https://www.ascoma.com.uy/index.php/documentos-ascoma/download/11-estadisticas-de-ventas-de-autos-y-comerciales-livianos/1131-ventas-automoviles-0km-2017>

imported motorcars for transporting of passengers from Brazil, Mexico, India, China and Germany (in that order) in 2017 (Fig. 54).

Table 2: Specific tariff and tax information for imports of Motor Vehicles																																																																																																																																																																																																								
<p>Tariffs: • The tariff applied to cars is generally 23 percent. Lower tariffs and some exemptions within quotas apply to cars imported from regional (MERCOSUR) countries. • The tariff applied to trucks is 7 to 8 percent. • The tariff for auto parts is 22 percent</p>																																																																																																																																																																																																								
<p>Taxes: • Value Added Tax is 22 percent • Special tax depending on fuel type: IMESI 46.7% • Special Consumption tax: (< 1000 cc) 23% between (1000 and 1500 cc): 28.75% between 1500 and 2000 cc: 34.5% (> 3000 cc): 46% • A transfer tax is applicable on all auto sales. Note: Because of taxes, in the best of cases a vehicle that costs \$10,000 CIF, is sold to the public at \$20,000 and in the worst of cases, at \$40,000.</p>																																																																																																																																																																																																								
<p>Import Restrictions: • Imports ban on used vehicles.</p>																																																																																																																																																																																																								
<p>Local/Regional Content Requirements: • Regional Content Requirements: For the MERCOSUR countries (Brazil, Argentina, Uruguay and Paraguay) all products that have at least 60 percent regional content (30 percent of which must be from Argentina) to be traded duty free.</p>																																																																																																																																																																																																								
<p>Figure 54: Imports of Motor Vehicles</p>																																																																																																																																																																																																								
<p>Imports of Vehicles (Chapter 87) 1994-2017</p> <table border="1"> <caption>Estimated data for Figure 54: Imports of Motor Vehicles (Millions)</caption> <thead> <tr> <th>Year</th> <th>Argentina</th> <th>Brazil</th> <th>China</th> <th>EU 12</th> <th>Korea, Rep.</th> <th>Mexico</th> <th>United States</th> </tr> </thead> <tbody> <tr><td>1994</td><td>10</td><td>120</td><td>10</td><td>80</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>1995</td><td>10</td><td>130</td><td>10</td><td>90</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>1996</td><td>10</td><td>140</td><td>10</td><td>100</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>1997</td><td>10</td><td>150</td><td>10</td><td>110</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>1998</td><td>10</td><td>160</td><td>10</td><td>120</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>1999</td><td>10</td><td>170</td><td>10</td><td>130</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2000</td><td>10</td><td>180</td><td>10</td><td>140</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2001</td><td>10</td><td>190</td><td>10</td><td>150</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2002</td><td>10</td><td>200</td><td>10</td><td>160</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2003</td><td>10</td><td>210</td><td>10</td><td>170</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2004</td><td>10</td><td>220</td><td>10</td><td>180</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2005</td><td>10</td><td>230</td><td>10</td><td>190</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2006</td><td>10</td><td>240</td><td>10</td><td>200</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2007</td><td>10</td><td>250</td><td>10</td><td>210</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2008</td><td>10</td><td>260</td><td>10</td><td>220</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2009</td><td>10</td><td>270</td><td>10</td><td>230</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2010</td><td>10</td><td>280</td><td>10</td><td>240</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2011</td><td>10</td><td>290</td><td>10</td><td>250</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2012</td><td>10</td><td>300</td><td>10</td><td>260</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2013</td><td>10</td><td>310</td><td>10</td><td>270</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2014</td><td>10</td><td>320</td><td>10</td><td>280</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2015</td><td>10</td><td>330</td><td>10</td><td>290</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2016</td><td>10</td><td>340</td><td>10</td><td>300</td><td>10</td><td>10</td><td>10</td></tr> <tr><td>2017</td><td>10</td><td>410</td><td>10</td><td>310</td><td>10</td><td>10</td><td>10</td></tr> </tbody> </table>	Year	Argentina	Brazil	China	EU 12	Korea, Rep.	Mexico	United States	1994	10	120	10	80	10	10	10	1995	10	130	10	90	10	10	10	1996	10	140	10	100	10	10	10	1997	10	150	10	110	10	10	10	1998	10	160	10	120	10	10	10	1999	10	170	10	130	10	10	10	2000	10	180	10	140	10	10	10	2001	10	190	10	150	10	10	10	2002	10	200	10	160	10	10	10	2003	10	210	10	170	10	10	10	2004	10	220	10	180	10	10	10	2005	10	230	10	190	10	10	10	2006	10	240	10	200	10	10	10	2007	10	250	10	210	10	10	10	2008	10	260	10	220	10	10	10	2009	10	270	10	230	10	10	10	2010	10	280	10	240	10	10	10	2011	10	290	10	250	10	10	10	2012	10	300	10	260	10	10	10	2013	10	310	10	270	10	10	10	2014	10	320	10	280	10	10	10	2015	10	330	10	290	10	10	10	2016	10	340	10	300	10	10	10	2017	10	410	10	310	10	10	10
Year	Argentina	Brazil	China	EU 12	Korea, Rep.	Mexico	United States																																																																																																																																																																																																	
1994	10	120	10	80	10	10	10																																																																																																																																																																																																	
1995	10	130	10	90	10	10	10																																																																																																																																																																																																	
1996	10	140	10	100	10	10	10																																																																																																																																																																																																	
1997	10	150	10	110	10	10	10																																																																																																																																																																																																	
1998	10	160	10	120	10	10	10																																																																																																																																																																																																	
1999	10	170	10	130	10	10	10																																																																																																																																																																																																	
2000	10	180	10	140	10	10	10																																																																																																																																																																																																	
2001	10	190	10	150	10	10	10																																																																																																																																																																																																	
2002	10	200	10	160	10	10	10																																																																																																																																																																																																	
2003	10	210	10	170	10	10	10																																																																																																																																																																																																	
2004	10	220	10	180	10	10	10																																																																																																																																																																																																	
2005	10	230	10	190	10	10	10																																																																																																																																																																																																	
2006	10	240	10	200	10	10	10																																																																																																																																																																																																	
2007	10	250	10	210	10	10	10																																																																																																																																																																																																	
2008	10	260	10	220	10	10	10																																																																																																																																																																																																	
2009	10	270	10	230	10	10	10																																																																																																																																																																																																	
2010	10	280	10	240	10	10	10																																																																																																																																																																																																	
2011	10	290	10	250	10	10	10																																																																																																																																																																																																	
2012	10	300	10	260	10	10	10																																																																																																																																																																																																	
2013	10	310	10	270	10	10	10																																																																																																																																																																																																	
2014	10	320	10	280	10	10	10																																																																																																																																																																																																	
2015	10	330	10	290	10	10	10																																																																																																																																																																																																	
2016	10	340	10	300	10	10	10																																																																																																																																																																																																	
2017	10	410	10	310	10	10	10																																																																																																																																																																																																	
<p>Source (Table): United States Department of Commerce, Office of Transportation and Machinery. Available here: https://www.trade.gov/td/otm/assets/auto/TBR2015Final.pdf</p> <p>Source (Graph): WITS database, available at: https://wits.worldbank.org/</p>																																																																																																																																																																																																								

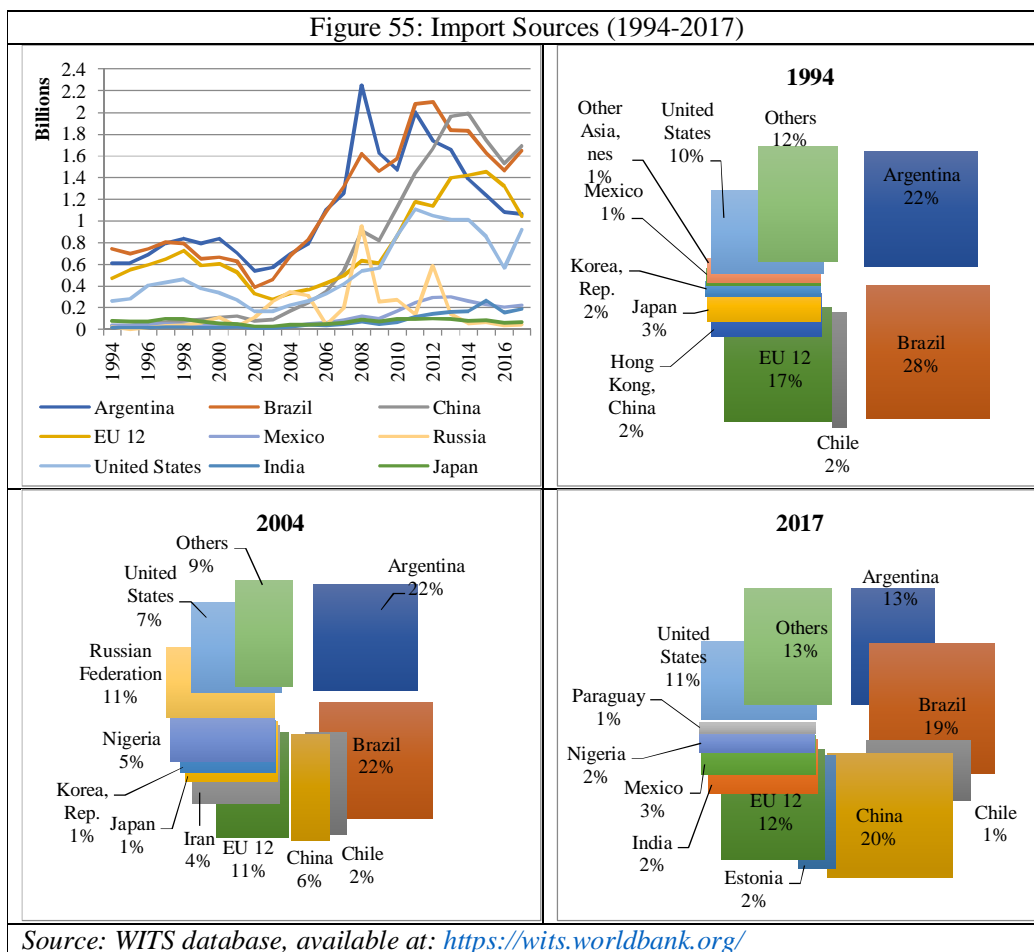
IMPORT SOURCES

Uruguay imported merchandise goods from a variety of regional and extraregional sources in the period 1994-2017. Imports particularly picked up especially after the commodity price boom in 2002, following which, imports from Argentina, Brazil, China and EU 12 members increased rapidly and crossed US\$ 1 billion in value. They were closely followed by the United States and Russia, while India, Japan and Mexico remained small import partners (Fig 55) throughout the period. In terms of regional partners, the combined share of Mercosur members, Brazil and Argentina was 50

percent of total imports in 1994, just before the CET came into effect. Following which, by 2004, the combined share had reduced to 44 percent with the emergence of extraregional partners China, Russia, Nigeria and Iran. Imports from Russia peaked in 2008 but declined drastically thereafter and were unable to recover to peak value. On the contrary, imports from China grew post the 2009 plunge such that China overtook Brazil in 2013 to be the top import source for Uruguay. Total imports from China rose from US\$ 121 million in 2001 to over US\$ 1.7 billion in 2017, with a rise in share from 4 percent to 20 percent in total imports in the same period. China thus became the top non-regional import source for Uruguay in the last 10 years.

Despite the exponential growth of China in the total imports by Uruguay, regional partners, Argentina, Brazil, Chile, Paraguay and Mexico were able to maintain their relative importance with a 37 percent share in total imports in 2017, with a combined value of US\$ 2.12 billion. Apart from regional partners and China, Uruguay's next top import source were the EU12 members, with leading imports from Germany, Spain, Denmark and the United Kingdom. Total imports from EU 12 members increased by 200 percent between 2001 and 2015, from US\$ 556 million to over US\$ 1.5 billion in 2015. The period from 2016-2017 saw a slight decline in value to US\$ 1.04 billion, with a share of 12 percent in total imports in 2017. Uruguay mainly imported an array of capital goods like machinery and mechanical appliances, vehicles and parts, pharmaceutical products and electrical equipment from the EU12 members, with a combined value of US\$ 440 million in 2017.

In terms of its relations with the United States, imports grew between 2008-2012 from US\$ 539 million to US\$ 1.01 billion. However, due to the recession in its neighbor Argentina, imports from the US declined till 2016. Nonetheless, 2017 was a recovery period for imports from the US as they reached US\$ 923 million in 2017. The share of the US in total imports also rose from 7 percent in 2004 to 11 percent in 2017. Uruguay mainly imported chemicals, polyacetals, plastics, fertilizers and medical equipment along with refined petroleum (only 2008 onwards) from them. The United States also signed the Trade and Investment Framework Agreement (TIFA) with Uruguay in 2007 to foster deeper trade relations between the countries.

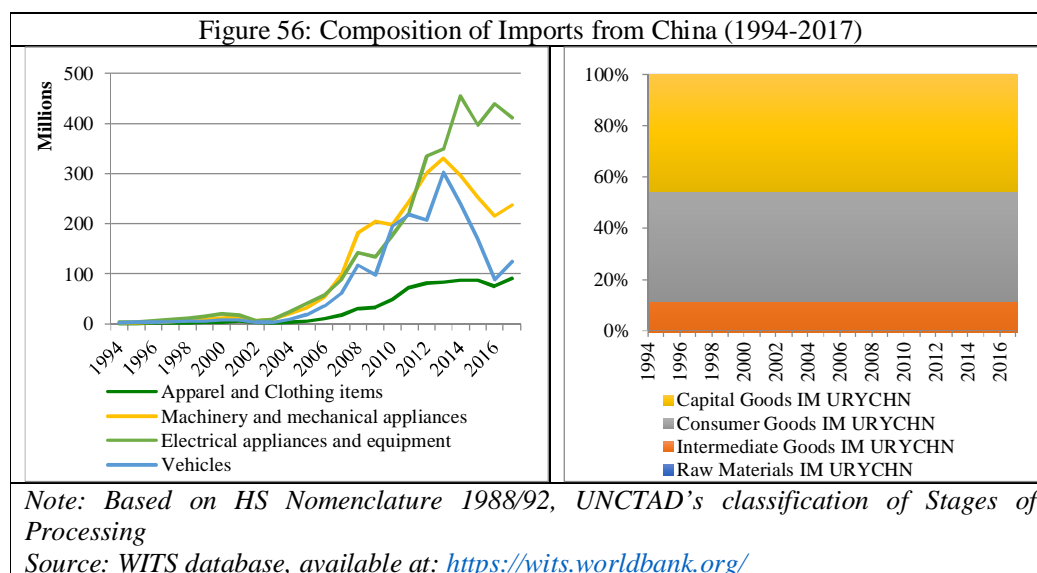


CHINA

China is indisputably a leader in production and exports of manufactured-consumer goods. These consumer goods held a share of 70 percent in Uruguay's Chinese import basket in 1994. This share dropped to 40 percent in 2017 due to increasing imports of capital goods such as electrical and mechanical equipment and motor vehicles from China (Fig 56). Among the largest imports of manufactured goods from China were telephones and mobile phones. Uruguay imported telephones worth US\$ 180 million from China in 2017. Other imports from China included consumer products such as clothing and footwear items. Imports of apparel and clothing items grew from US\$ 10 million to US\$ 90 million between 2006 and 2017. Moreover, 66 percent of all clothing items imported by Uruguay originated in China in 2017 (WTO, 2018).

Chinese exporters paid a 20 percent tariff on clothing, 16.1 percent on textiles, 15.3 percent on footwear, 8 percent on electrical machinery and 5 percent on mechanical

appliances in 2017 when they entered Uruguayan customs. Automatic licensing requirements have also been put in place on all textiles and clothing items entering Uruguay from non-Mercosur countries and on footwear and vehicles entering from all countries, and China is no exception to the rule.⁷² Electrical appliances and mechanical machinery together constituted a share of 38.38 percent in total imports from China in 2017. On 20th June 2010, Uruguay filed a complaint on anti-dumping measures on the product 851610 from China. This led to application of ad valorem duty from 2012-2015.



CONCLUSIONS

This chapter analyzed the evolution of trade relations in the four members of the bloc Argentina, Brazil, Uruguay and Paraguay in the period 1989 to 2017. It focused on the composition of export and import baskets of goods, export markets and import sources, while presenting an in-depth analysis of some of the largest goods traded globally by the four members. It is clear from the analysis that trade relations have been substantially affected by intra-bloc asymmetries, changes in domestic trade policy and

⁷² For more information, see WTO documents G/LIC/N13/URY/7 and G/LIC/N13/URY/9

external pressures such as the rise in Chinese demand for food and other commodities starting in 2002.

It is well documented in the previous chapters that all four members of Mercosur are large exporters of agro-based goods such as soybean, oilcakes, cereal, cane sugar, bovine meat, poultry, rice, oils of animal and vegetable origin and biofuels. This was confirmed through this analysis. For example, in 2017, Brazil was the largest exporter of soybean in the world, Argentina was the third largest and Paraguay was the fourth; Brazil was also the largest exporter of frozen bovine meat followed by all other members within top-ten exporters of the world, Brazil was also the largest exporter of poultry and cane sugar, Argentina was the fifth largest exporter of cereal, fourth largest of oils and biofuels, and second largest of oilcakes, while Uruguay was the ninth largest exporter of rice in the world. This resulted in a large dependency on various exogenous factors such as weather, movement of international prices and external demand for food. Fortunately, the rise in Chinese demand for these products since the turn of the century led to an upswing in international prices of such products for the benefit of agricultural exporters in Mercosur members and their overall growth trend.

Although the rise of Chinese demand for food and agricultural products led to impressive growth in the agricultural sectors of all the members, it came at the expense of the industrial sectors in Brazil and Argentina the ten-year period from 2002-2012. The simultaneous expansion of Chinese exports of manufactured goods flooded the markets such that China was of the top import source as well as the top export destinations for the Mercosur members. All the members imported a myriad of products from China including electrical and mechanical equipment, chemical products such as pharmaceuticals, fertilizers, some plastics, and organic chemicals. The slackening of demand from China led to a slowdown in the supercycle as global commodities prices fell for mineral and food products. The subsequent deceleration in export growth in the member economies coincided with political crises in Brazil and Argentina in 2013-14 that continued to depress growth and trade. Despite the slowdown, China remained one of the top trade partners, followed by EU members, the United States and the Mercosur common market.

The composition of export baskets reveals a clear distinction between the small and large members of the bloc. For example, although all four members are large exporters

of food-based products such that these goods comprise a sizeable share in total exports, the large members Brazil and Argentina have diversified their export baskets presumably due to decades of import-substitution industrialization policies followed by then till the eighties. Both the manufacturing bases remain diversified, although the Brazilian industrial production is more diversified than the Argentine counterpart. Uruguay has also implemented a more robust trade policy aimed at promoting diversification of export basket and grants special tax exemptions to exportable goods in Free Zones. Yet, all three countries continue to be the largest exporters of food and agricultural products such as soybean and bovine meat in the world. Perhaps, the diversified industrial base is unable to compete in the international market for manufactured goods due to low competitiveness as a result of years of import-substituting industrialization policy that discriminated against competitive imports. As highlighted earlier, this policy created severe inefficiencies that continue to hinder a rise in global competitiveness.

However, the industrial exports have found a substantial market in the regional partners. One of the most prominent industrial exports for Brazil and Argentina have been passenger cars, motor vehicles for transporting goods and their parts; although the domestic producers are not globally competitive, they have found large markets in the region, notably in the other Mercosur members. Trade patterns revealed that imports of automobiles by Mercosur members rose dramatically during the commodity supercycle due to increased export earnings and greater demand for luxury goods such as cars. As a result, automobiles were the largest regionally traded product. This trade in case of Brazil and Argentina constitutes intra-industry trade that has been explored further in the chapter 6. One noteworthy observation is that the Government of Uruguay has banned the imports of used vehicles and imposes special fuel-based tax on all automobiles; despite these taxes, imports growth has been robust in our period of analysis.

Another consequence of the asymmetry in size of the four members is the reliance displayed by Paraguay and Uruguay on their neighboring markets in Argentina and Brazil. Given Paraguay is a landlocked country, this dependency on its neighbors, especially Brazil and Argentina is greater due to the need for access to their port facilities. In 2004, a decade after the application of the CET, share of Mercosur markets

in Paraguay's exports was 74 percent, the highest among the members. By 2017, although this share had declined, fifty percent of all Paraguayan exports reached the internal Mercosur market, perhaps due to its geographical limitations. Uruguay was less dependent on the Mercosur market, yet almost fifty percent of all goods were exported to Brazil and Argentina in 1994 and a quarter were exported in the period from 2004-2017. In terms of imports, one-third of total imports originated in Brazil and Argentina mainly in the form of motor vehicles, machinery and electrical equipment for both Paraguay and Uruguay in 2017, down from almost fifty percent share in 1991-2004.

This analysis has revealed that intra-Mercosur trade rose not only for the smaller members but also for the larger countries Argentina and Brazil in the nineties before the arrival of China. About one-fifth of all Argentine exports and one-tenth of all Brazilian exports reached the Mercosur members in 2004, while over one-third of all imports by Argentina and one-tenth of all Brazilian imports originated in Mercosur members in 2004. However, these shares slightly decreased in the next decade following the pattern of other two bloc members. Despite the rise of China in the new millennium, other extraregional partners such as the EU12 and the United States remained significant for all four members of the bloc, emphasizing the importance of traditional yet strategic partners. For example, despite the failure in the negotiations for the FTAA with the United States and the FTA with the EU, their relative importance did not plummet in the subsequent period. This proves that Mercosur members have maintained their extraregional trade relations independent of political aberrations. However, the downturn in 1999-2002 due to Brazilian currency and Argentine debt crises, in 2009 due to the global financial crisis and again in 2014-2016 due to the Brazilian crisis, have severely impacted trade patterns of Mercosur members and this is evident from the dip in export and import values during these adverse periods.

It was evident that, although the signing of the Treaty of Asuncion had a positive impact on intra-bloc trade in the decade that followed, its benefits slowly evaporated. This coincided with the shift in trade preferences to meet Chinese demand of commodities and to import Chinese products due to a significant cost advantage. The shares of other extraregional partners remained constant despite the growing trade with China, unmistakably at the cost of regional partners. Although policies aimed at export diversification were fairly successful, members continued to be large exporters of agro-

based products. This dependency on exports of food-based products has exposed the economies to the fluctuations in international commodity prices. The governments have recognized this as an economic concern and felt the need to diversify their export baskets. Moreover, policies directed at setting-up of free zones have been implemented to incentivize the manufacturing sector as well. Another aspect of the trade dependency is the historical reliance on imports of crude and refined petroleum by all four members, however, efforts have been made to shift to other renewable sources of energy, especially to biodiesel, ethanol, wind and solar energies. Paraguay is the largest producer and exporter of hydroelectricity to its neighbors and has been assisting in reducing the dependency on petroleum products.

Thus, in conclusion, there exists a similarity in the composition of export and import baskets, as well as the choice of trade partners in all four members of the bloc analyzed in this chapter. Moreover, the reliance on the bloc's internal market, especially for Uruguay and Paraguay, but also for Argentina and Brazil, proves that the choice to join Mercosur in 1991 through the Treaty of Asuncion was an active policy decision that continues to influence their current trade patterns and choices, in all variations of trade-intra-bloc, regional and extraregional. Despite the similarity in trade patterns, several asymmetries continue to exist between members and this chapter has provided ample evidence to highlight their impact on trade trends. The next, Chapter 5 further analyzes the nature of the three levels of trade relations, intra-bloc, regional and extraregional by employing various statistical tools and modeling methods.

CHAPTER 5: EMPIRICAL ANALYSIS OF MERCOSUR'S TRADE RELATIONS: GRAVITY MODEL AND OTHER TOOLS

This chapter analyzes the economic determinants of Mercosur's trade relations by employing traditional econometric trade tools including the classical gravity model, trade complementarity index and Grubel-Lloyd index. This chapter is further divided into three sub-sections. Section 1 presents the *Gravity Model* results to quantitatively establish the determinants of trade between the Mercosur members, their trade with regional and extraregional partners. This Gravity Model complements the study presented in the previous chapters (Chapter 3 and 4) that focused on country-policy studies and analyzed the nature of recent trade trends.

In Section 2, the Gravity Model results are followed by other indices that complement these results, such as, top bilateral export baskets among members and the *Revealed Comparative Advantage* in these goods; the extent of *intra-Mercosur trade* as compared to other regional blocs comprising of only developing countries; *level of dependency* between Mercosur members (for example: what is the share of each member in others' total trade); *Trade Complementarity Index* (bilaterally) to show how well suited they are for intra-industry trade and inter-industry trade; and *Preference Margins* due to the CET vis-à-vis the MFN tariff rates.

Section 1: Gravity Model Analysis

Almost sixty years ago, Tinbergen (1962) used the gravity model of trade to describe bilateral patterns of trade between two partner countries. According to theory, bilateral trade is directly proportional to the size of the countries and inversely proportional to the distance between the two countries. Later, Krugman (1980) also emphasized on the role of a large domestic market in encouraging exports based on the assumption that due to increasing economies of scale, a country will tend to export products which also have a sufficiently large domestic demand. He termed this as "home effects". In contemporary gravity models, the size of the exporter country determines bilateral trade patterns as well. Moreover, he also highlighted that a positive transport cost will not

alter production patterns of firm, but will have an impact on the price and demand for such a product in a partner country; hence, it is economically beneficial to locate production close to the main export destination to minimize transportation costs.

This section employs a gravity model to analyze bilateral trade on three distinct levels of trade: intra-Mercosur trade among members, bilateral trade of each members with top seven regional partners including Bolivia, Colombia, Chile, Ecuador, Mexico, Peru and Venezuela, and bilateral trade of each member with their biggest extra-regional partners China, EU12 and the United States. In this model, the size of the country has been captured through the Gross Domestic product, population and GDP per capita of origin and destination country, distance between the countries and other enabling factors such as a possible preferential trade agreement. The time period chosen for the analysis is 1991-2017.

Traditionally, a large country in terms of GDP and population would have a higher capacity to export. On the contrary, a large country could also translate into a large internal market and self-sufficiency; such a country would have a lower trade to GDP ratio, hence low value of exports. Similarly, a small country in terms of both GDP and population would traditionally mean low capacity to export but a small population could also have a small internal market and low absorption of national production; such a country would be largely dependent on the external market through greater exports. Thus, size of a country can be interpreted in different ways and may necessarily not have positive relationship with trade. However, if we include GDP per capita in our analysis, a higher value would reflect a higher purchasing power for both domestically produced goods and imports.

Another important variable in the model is distance between partners. Traditionally, distance is inversely proportional to bilateral exports, i.e.; an increase in distance will hinder trade between two countries due to an increase in transportation costs and overall trade costs. This distance variable can however take various forms. For example, distance can represent geographical distance between the capital cities of partner countries, or it can be interpreted as a language barrier or it can represent trade barriers in the modern sense such as, tariffs and non-tariff measures faced by exporters that can hinder bilateral trade. Historically, countries may even trade more with each other in case of common colonial legacies, linguistic ties and regional integration. Today, the

distance between two countries can also be reduced through trade liberalization, preferential trade agreements, and trade facilitation efforts.

For our analysis, a standard Gravity equation was used to determine the effect of both quantitative and qualitative variables. The equation is given as follows:

$$\begin{aligned} \ln (Ex_{ij}) = & \beta_1 \ln Distance_{ij} + \beta_2 Contiguity_{ij} + \\ & \beta_3 Language_{ij} + \beta_4 PTA_{ij} + \\ & \beta_5 \ln GDP_{pc_{it}} + \beta_6 \ln GDP_{pc_{jt}} + \beta_7 \ln GDP_{it} + \beta_8 \ln GDP_{jt} + \\ & \beta_9 \ln Pop_{it} + \beta_{10} \ln Pop_{jt} + u_t + \varepsilon_{ij} \end{aligned}$$

where,

Ex: Bilateral Exports (in USD)

Distance: geographical distance between capital cities of the partners (time invariant, continuous) (in kilometers)

Contiguity: whether the two countries share a common border (dummy with value 0 or 1)

Language: whether they speak a common language (dummy with value 0 or 1)

PTA: whether they are a part of a preferential trade agreement; in case of the regional gravity equation, this would reflect the existence of a free trade agreement between partner countries (dummy with value 0 or 1)

GDP_pc: GDP per capita (time variant) (in USD)

GDP: Gross domestic product (time variant) (in USD)

Pop: Population (time variant)

ε: Error term

u: Fixed effects

Here, null hypothesis H_0 is that all coefficients (β_i) are simultaneously equal to zero.

The variables used in our gravity equation as described in Table 3 below⁷³:

Table 3: Variable Description for Gravity Model Analysis	
Variable	Description
ISO3_o	Origin country code
ISO3_d	Partner country code
year	Year of data
Exports	Exports in US \$ from origin country to destination country
POP_o	Population of origin country
POP_d	Population of destination country
GDP_cur_o	GDP at current prices in US \$ of Origin country
GDP_cur_d	GDP at current prices in US \$ of Destination country

⁷³ See **Annexure 1** for description of the variables used in the three gravity equations.

GDP_pc_o	GDP per capita at current prices in US \$ for Origin country
GDP_pc_d	GDP per capita at current prices in US \$ for destination country
Area	Area in square kilometers of origin country
Dist_cap	Distance between the capitals of the origin and destination country in kilometers
FTA	A dummy that takes the value 1 if an FTA is in place between the origin and destination country, 0 otherwise
Contiguity	A dummy that takes a value 1 if the origin and destination countries share a common border
Landlocked_o	A dummy that takes the value 1 if the origin country is landlocked
com_lang_off	A dummy that takes a value 1 if the set of countries share a common official language
lexport	Defined as the log of the variable Exports
lpop_o	Defined as the log of the variable POP_o
lpop_d	Defined as the log of the variable POP_d
lgdp_o	Defined as the log of the variable GDP_cur_o
lgdp_d	Defined as the log of the variable GDP_cur_d
lgdp_pc_o	Defined as the log of the variable GDP_pc_o
lgdp_pc_d	Defined as the log of the variable GDP_pc_d
larea	Defined as the log of the variable Area
ldist	Defined as the log of the variable Dist_cap
<i>Source: Self-computed</i>	

The data for bilateral exports was taken from UN COMTRADE database, while the rest of the data was taken from CEPII database and World Bank. During the compilation of the data, a few missing values were found in the quantitative variable. These missing values were replaced by a trend estimate using the rate of growth of the last three years. As mentioned earlier, this model is restricted to the inclusion of three dummy variables to account for descriptive factors that affect trade including common border, common language and existence of a PTA. These datasets were compiled using CEPII database that was updated with recent events that may influence the value taken by the variable PTA_{ij} . This is a panel dataset with country-wise pairs over 27 years from 1991 to 2017. Hence, the regression model used for this analysis was the *Fixed Effects model* that captures the ‘within cluster effects’, with time dummies to capture the time-specific effects pertaining to a specific year. This model has been compared with a *Random*

Effects Hybrid model using similar variables that captures both ‘within and between cluster effects’.

Extraregional Gravity Model

A total of 324 entries are present in this dataset that includes 12 county pairs, of each Mercosur member with three extraregional partners: China, United States and EU12 taken collectively (Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and the United Kingdom). We have used *GDP at constant prices* rather than GDP at current prices to account for high inflationary rates in Mercosur countries during the nineties as opposed to a more stable inflation rate in its extraregional partners during the same period. We also found that a *hybrid RE model* was well-suited to this analysis as Mercosur members have had quite diverse relationships with the extraregional partners. For example, Paraguay has had a historically unfriendly past with China and this affected their trade relationship as well. Hence, we have considered both within and between effects by using the hybrid random effects model; i.e. factors that affect specific country-pair relationships and factors that explain dynamic trade patterns that vary between country-pairs. Therefore, time-invariant independent variables such as Distance and Common language are significant in our Hybrid RE Models.

The STATA results are summarized in the following table 4. It compares multiple relevant gravity models based on varying combinations of variables. For example, Model 1 is a FE model with GDP at constant prices of 2010, Model 2 is a RE Hybrid model with GDP constant at 2010 as well, while Model 3 considers using time dummies with Model 2.

On comparing Model 1 and Model 2, it was found that the specification of the model itself was important. It answers the question on why the RE hybrid model was chosen over a similarly identified FE model. Although within the FE model, the four time-variant explanatory variables are significant, the model fails to account for the time-invariant variables such as [comlang_off] and [ldist]. A positive coefficient for [lpop_d] means that the exports to the destination country increase with the size of the population of the destination country. Similarly, a positive relationship exists between the size of the population of the origin country as well its exports to a third country in any given

year, explained by the high and positive coefficient of [lpop_o]. The other two time-variant explanatory variables [lgdp_const_d] and [lgdp_const_o] also display a significant and positive relationship with the exports. As predicted, an increase in GDP increases the potential exports from a country and also increases the demand for imports from another country.

While the REH model maintains the significance of the coefficients of the time-variant variables, it also displayed significant values of the distance variable and dummy for official common language. As expected, [ldist] had a negative and high coefficient, confirming the theory that bilateral exports reduce significantly with an increase in distance that adds to higher transportation and logistical costs. On the contrary, the dummy [comlang_off] had a positive and significant coefficient that conforms with the traditional hypothesis that cultural ties in the form of common language heritage lead to greater trade between partners. In our model, Mercosur members shared an official common language with EU12 countries: Argentina, Paraguay and Uruguay share Spanish with Spain and Brazil shares Portuguese with Portugal in EU12. Results from the previous chapter also confirmed that the EU is a large and important trade partner for Mercosur countries. More specifically, this partnership is explained by its historic cultural and imperialistic ties that lend to the commonality of official languages in both partners.

Within the REH model, five out of six significant independent variables were significant at 1 % confidence interval. Moreover, the shift from FE to RE model also dropped the constant term that was in turn captured correctly by the significance of the time-invariant variables. The low and insignificant constant term can be interpreted in the following way: when the explanatory variables are simultaneously set to zero, bilateral exports will be zero as well. This seems like a reasonable assumption in the real world as well. Moreover, the low R^2 value of 0.37 for the FE model calls for the addition of more explanatory variables to the model because the specified independent variables do not explain the nature of bilateral trade. Hence, when we shifted to the REH model by adding the time-invariant variables, the R^2 increased to 0.78 confirming the basis for this addition.

In the next step, the REH model was expanded to include time dummies in Model 3. The time dummies for the years 1995 through 2017 are significant suggesting that there

were year-specific factors or shocks that affected bilateral trade and were not included in our model. However, this complicated the model as all the time-variant variables such as population and GDP turned insignificant. Hence it is safe to avoid the addition of the time dummies and consider it as a part of the estimation error. Finally, we can accept that Model 2 is the best fit for our analysis of Mercosur's extraregional trade with China, the United States and EU12 members, as it conforms to our conclusions from Chapter 4.

<u>Extraregional Trade with Mercosur Countries</u> [Lexports]	Model 1: FE Model with GDP_ constant at 2010	Model 2: RE Hybrid Model with GDP- constant at 2010	Model 3: RE Hybrid Model with GDP_ constant at 2010 and Time Dummies
lpop_d	3.605***	3.605***	-0.246
(t- value)	(6.2)	(6.13)	(-0.33)
lpop_o	3.199***	3.197***	0.0454
(t- value)	(5.04)	(4.98)	(0.06)
lgdp_const_o	0.553***	0.554***	0.0839
(t- value)	(4.49)	(4.45)	(0.67)
lgdp_const_d	0.380**	0.382**	-0.221
(t- value)	(3.19)	(3.18)	(-1.72)
ldist	0	-2.776***	-2.797***
(t- value)	(.)	(-5.18)	(-5.00)
comlang_off	0	0.938**	0.935**
(t- value)	(.)	(2.83)	(2.7)
Effect of Time Dummies (Significant Years)	N	N	Y (1994-2017)
Constant	130.2***	6.892	5.561
(t- value)	(-13.68)	(0.77)	(0.6)
N	629	629	629
R square within	0.5617	0.5617	0.6418
R square between	0.4175	0.8378	0.8429
R square overall	0.3742	0.7804	0.8013
t statistics in parentheses			
* p<0.05, **p<0.01, *** p<0.001			

Regional Gravity Model

A total of 1,512 entries are present in the dataset, with 11 countries from South America, including Mercosur countries, Pacific Alliance countries (Peru, Chile, Mexico and Colombia), and others like Bolivia, Ecuador and ex-Mercosur member Venezuela. There were 56 country-wise pairs that included bilateral trade between four Mercosur members and its seven regional partners. For this gravity model, the dummy FTA_{ij} takes the value 1 if the partners have a free trade agreement since 1991. The model attempted to use both GDP at current prices as well as GDP at 2010 constant prices. The countries in the region faced similar inflationary rates, hence, GDP at current prices can be used for this analysis of Mercosur's regional trade dynamics. This study uses additional variables to those used in the previous extraregional analysis, namely: Geographical area of the origin country- theory predicts that an increase in area would lead to higher exports due to availability of land; Dummy for Landlocked countries in the region that takes a value 1 if the country is landlocked and 0 otherwise; and a Dummy for Contiguity that takes a value 1 if partner countries share a common border and 0 otherwise.

There were four main regressions that were significant for our analysis and they have been presented in the table below. Model 1 was a Fixed-Effects model with GDP_Current, Model 2 was a REH model with GDP_Current, while Model 3 used GDP_Constant instead; and Model 4 added time dummies to Model 2.

Within Model 1, although all the explanatory variables included [$lgdp_d$, $lgdp_o$, $lpop_d$, $lpop_o$] were significant, however, the overall R^2 was very low at only 0.4091 indicating a poor fit of the model in the data. Model 2 was an improvement over Model 1 as it preserved the significance level of all time-variant factors, and also introduced other significant time-invariant factors [$ldist$] and [$landlocked_o$] in the regression analysis. Distance does play an important role in the determination of bilateral exports over time in South America; and the sign of [$ldist$] is consistent with theory that an increase in distance reduces trade between two countries. Moreover, a landlocked country is expected to be trade dependent on its regional neighbors due to its geographical backwardness, and the model confirmed this as [$landlocked_o$] was significant at 1 % confidence level.

An important observation can be made based on the signs of the coefficients of the variables. In theory, GDP and population have a positive correlation with bilateral exports. However, in model 2, the coefficient of [lgdp_o] carried a negative sign, i.e.; an increase in GDP of the exporting country had a negative impact on regional exports. This could be explained by the fact that a large country would be inclined towards extra-regional trade and will thus be less dependent on its regional neighbors. Chapters 3 and 4 showcased this behavior in case of the two big Mercosur members: Brazil and Argentina; their biggest trade partners lie outside the South American region, while the opposite is true for the small members Paraguay and Uruguay. This pattern will also be confirmed in the next section that traces the dependency of the members on each. The larger countries are thus less-dependent on its regional partners as they seek larger markets for their globally competitive products. Another plausible explanation of the negative coefficient could be that a large country will relatively have low trade to GDP ratio as it would be highly dependent on its internal market. Hence the sign of the coefficient of [lgdp_o] is justified.

Another interesting observation is the increased significance of the [FTA] variable. It has a clear positive correlation with bilateral exports and this is consistent with theory as well: countries sign a Free Trade Agreement with the primary aim of boosting bilateral trade through reductions in tariff and non-tariff barriers. The positive and significant coefficient of [FTA] confirms that bilateral exports increased between regional partners after signing of an FTA. For example, Argentina, Brazil, Uruguay and Paraguay signed an FTA with Chile and Bolivia in 1996, and with Peru in 2005; while Uruguay signed an FTA with Mexico in 2002 and evidently, trade has prospered between these partners as a result. The move from Model 1 to Model 2 increased the significance of [FTA] from 5% to 1% confidence level.

An addition was made to Model 2 by the introduction of Time Dummies for the years 1991-2017 and the results are reflected in Model 4. It preserves the significance and signs of all the variables from Model 2 and also introduces two significant years that had a negative effect on exports: year 2002 and 2003, significant at 1% confidence level. The negative coefficient shows the impact of an economic shock to regional trade. This could be explained in two ways. Perhaps the region-wide slowdown of 1999-2002 cumulated into a fall in regional trade. It is known that regional trade

integration was not a priority for the Mercosur countries after the crisis period of the late nineties and this resulted in a negative correlation. Another explanation could be that 2002-2003 witnessed the growth of Mercosur exports to China, particularly concentrated in primary products and it is possible these extra-regional exports diverted attention from regional trade.

The introduction of the time dummies also increased the significance of the [FTA] variable to 0.1 % confidence level. Given the importance of the effect of signing an FTA, Model 4 is preferred over Model 2 for this reason. Moreover, Model 4 also improves the overall fit of the regression with the data with an increase of R^2 from 0.8195 to 0.8253. Although it is a slight increase, Model 4 is an improvement to Model 2 due to the shock variables of 2002 and 2003 that is consistent with reality.

A second attempt was made to improve the fit and significance of Model 2 by replacing [GDP_Current] with [GDP_Constant]. This slight tweak completely changed the set of significant explanatory variables in the new Model 3. Not only did [FTA], [Landlocked_o] and [lpop_o] drop out, time-invariant factors such as geographical area [larea] and [comlang_off] become statistically significant at 1% confidence level. The debate between Model 2 and Model 3 is about choosing the priority level of our explanatory variables in the regression equation. Although [larea] could be an important determinant of bilateral trade as an increase in [larea] would possible increase exports, it is favorable only to Brazil and Argentina in this regional analysis. The other significant factor introduced was [comlang_off]: given ten out of 11 countries in this study speak Spanish with the exception of Brazil, the importance of this variable is limited to analyzing Brazil's bilateral relations. Notably, by controlling for inflation, Model 3 reveals the importance of [comlang_off] for Brazil's case. *Ceteris Paribus*, a common language increases regional exports for all countries except Brazil i.e.; it significantly reduces the Portuguese-speaking country's trade with the rest of them in the region.

As mentioned earlier, Model 3 drops [FTA], [Landlocked_o] and [lpop_o]. Although the dummy for a landlocked country in the region is not an important variable for the analysis, the exclusion of [FTA] in Model 3 is not acceptable as it is a priority explanatory variable in our regression equation. The dropping of [lpop_o] along with the inclusion of [comlang_off] reveals an important observation for Brazil as it has the

largest population in the region. While the population size of Brazil had a positive impact on its extraregional trade (with [GDP_Constant]), it does not have a significant impact on its bilateral exports to its regional partners; moreover, trade is also reduced because Brazil is the only Portuguese-speaking country in the region. However, these factors are replaced by the positive, yet small impact of Brazil's large geographical area. After weighing the pros and cons of the four models, Model 4 was accepted to be the best fit for our conclusions from Chapters 3 and 4.

<u>Regional Trade of Mercosur Members</u> [lexports]	<u>Model 1:</u> FE Model with GDP_Current	<u>Model 2:</u> RE Hybrid Model with GDP_Current	<u>Model 3:</u> RE Hybrid Model with GDP_Constant	<u>Model 4:</u> RE Hybrid Model with GDP_Current and Time Dummies
ldist		-1.389***	-1.498***	-1.359***
(t-values)		(-6.24)	(-5.92)	(-6.27)
larea		0.337	0.789**	0.338
(t-values)		(1.42)	(3.09)	(1.48)
lgdp_d	1.113***	1.116***		0.807***
(t-values)	(13.83)	(13.71)		(6.81)
lgdp_o	-0.287***	-0.291***		-0.611***
(t-values)	(-3.54)	(-3.56)		(-5.07)
lpop_d	1.638***	1.566***	2.406***	3.088***
(t-values)	(3.66)	(3.46)	(5.12)	(5.16)
lpop_o	1.172**	1.176**	-0.556	2.722***
(t-values)	(2.63)	(2.61)	(-1.18)	(4.54)
comlang_off		0.289	0.903**	0.289
(t-values)		(0.94)	(2.61)	
landlocked_o		1.231**	-0.38	1.211**
(t-values)		(2.77)	(-0.94)	(2.81)
Contiguity		0.387	0.225	0.391
(t-values)		(1.52)	(0.78)	(1.59)
FTA	0.194*	0.270**	0.0757	0.320***
(t-values)	(2.25)	(3.18)	-0.83	(3.51)
lgdp_const_o			1.030***	
(t-values)			(4.39)	

lgdp_const_d			1.276***	
(t-values)			(5.23)	
constant	-50.40***	-28.00***	-19.46***	-27.99***
(t-values)	(-5.48)	(-9.05)	(-6.02)	(-9.33)
Time Dummies (Significant Years)	N	N	N	Y (negative effect) (2002-2003)
N	1503	1503	1487	1503
R square within	0.5131	0.5126	0.5008	0.5340
R square between	0.4383	0.9028	0.8527	0.9044
R square overall	0.4091	0.8195	0.7790	0.8253
t statistics in parentheses				
* p<0.05, **p<0.01, *** p<0.001				

Intra-Mercosur Gravity Model

A total of 432 entries are present in the dataset with 16 country pairs (4X4) of members of Mercosur including Argentina, Brazil, Paraguay and Uruguay. The dataset was collected for the period 1991-2017. This statistical determination of intra-bloc trade has experimented with various models with an array of differentiated time-variant and invariant factors. In comparison to the previous analysis, [landlocked_o] was dropped as it remained insignificant in all 16 regressions and [FTA] was dropped because the dataset begins from 1991 and that was the year Mercosur countries signed the Treaty of Asuncion that established Mercosur.

This analysis of intra-bloc trade was based on various regressions through STATA, of which, only four were chosen and they are summarized in the table below. Model 1 is a simple FE model with GDP Constant at 2010 prices. A similar regression with GDP at Current prices displayed similar results and was not chosen for the purpose of this analysis. Model 2 convert Model 1 into a REH model, Model 3 adds the dummy variable [contiguity] that takes a value 1 if partners share a border and 0 otherwise;

[contiguity] is important as it explains the low values of trade between Uruguay and Paraguay due to lack of a common border; both Brazil and Argentina share a common border with the other three members respectively. A similar regression to Model 3 that replaced GDP at Constant 2010 prices with GDP at current prices was run that did not change the significance of any of the explanatory variables. Thus, in this study, bilateral trade does not depend on inflationary tendencies, perhaps because Mercosur members experienced high inflation rate at the same time- in early nineties and late nineties. Later, Model 4 used GDP at current prices along with time dummies.

In all the regressions, [lgdp_o], [lgdp_d], [lgdp_const_o] and [lgdp_const_d] were not significant to determining bilateral trade in Mercosur bloc. This is consistent with the literature presented in Chapter 2 that emphasized the importance of non-economic factors to understand intra-bloc trade relations. Model 1 is very weak as it fails to explain the pattern of trade with an R^2 of 0.019. Model 2 is an obvious improvement with the introduction of significant coefficients of [ldist], [larea] and [comlang_off]. These explanatory variables are consistent with the literature and confirm that first, Mercosur members trade due to their close proximity to one another, second, Brazil's bilateral trade with the other three members is the highest in the bloc and third, the historical cultural ties-initiated trade links that are alive even today. Results from the previous chapters showed that Brazil is the largest regional trade partners for all other Mercosur members. Hence, the prediction made by the highly positive coefficient of [comlang_off] cannot be accepted as it debases the previous results; per this model prediction, the Spanish-speaking countries in the bloc would have greater trade among themselves, but as we have seen, this is not true.

However, the R^2 for Model 2 still remained low at .5164 making it unfit in explaining intra-bloc trade. A low r-square could also be explained by either the inclusion of an incorrect array of explanatory variables or due to missing independent variables in the regression analysis. For this purpose, Model 3 included the dummy [contiguity] that preserved the significance of other variables and also displayed a positive correlation between shared border and bilateral trade. The model predicted that a shared border led to a significant increase in trade between Brazil-Argentina, Brazil-Paraguay, Brazil-Uruguay, Argentina-Paraguay and Argentina-Uruguay. Conversely, this dummy variable is useful in explaining the lack of bilateral exports between Paraguay and

Uruguay. Although inclusion of [contiguity] led to the loss in significance of [lpop_o], the overall fit increased to an R-square of 0.6803.

As mentioned earlier, the conversion of GDP at constant 2010 prices to GDP at current prices (interim model) within Model 3 did not have a significant impact on the explanatory variables or the fit of the model; thus, they can be considered to be similar. Model 4 added time dummies to this Interim Model 3 and the results show an increase in fit with R² of 0.721. However, this rise in r-square must be accepted with caution as 26 new time dummies were added to the model and according to regression theory, an increase in degrees of freedom can alone raise R² without an increased contribution from the explanatory variables in the model. In Model 4, the time dummies for the years 1992-2010 were highly negative and significant in explaining bilateral trade, i.e.; in the absence of non-economic shocks to the bloc and the members, they would have traded much more than they actually did. Moreover, the individual economic crises experienced by the members between 1991 and 2010 hindered trade patterns despite competitiveness and industrial complementarities.

Despite the advantages of including time dummies in Model 4, their actual significance remains to be verified. Hence, Model 3 and 4 can both be chosen to represent intra-bloc trade in Mercosur; although it can be said that the explanatory variables in the model do not sufficiently explain intra-bloc trade. There are non-economic factors at play and these have been discussed at length in Chapter 7.

<u>Intra-Bloc Trade in Mercosur</u> [Lexports]	Model 1: FE model with GDP_Constant	Model 2: Hybrid model with GDP_Constant	Model 3: Hybrid model with Contiguity Dummy and GDP_Constant	Model 4: Hybrid Model with Time Dummies
ldist	0	8.898***	8.250***	7.755***
(t-values)	(.)	(13.54)	(13.95)	12.76
larea	0	21.87***	19.17***	11.57***
(t-values)	(.)	(5.94)	(5.83)	4.42
lgdp_d				0.108
(t-values)				(0.46)

lgdp_o				0.232
(t-values)				(0.98)
lpop_d	-0.548	-0.65	-0.301	-0.218
(t-values)	(-1.16)	(-0.92)	(-0.41)	(-0.27)
lpop_o	2.599***	2.474***	1.734*	1.846*
(t-values)	(5.5)	(3.5)	(2.35)	2.24
comlang_off	0	9.551***	8.570***	7.521***
(t-values)	(.)	(5.5)	(5.54)	(4.92)
Contiguity			2.833***	2.397***
(t-values)			(6.97)	(5.96)
lgdp_const_o	0.523	0	0	
(t-values)	(1.3)	(.)	(.)	
lgdp_const_d	0	0.535	-0.0374	
(t-values)	(.)	(0.89)	(-0.06)	
Effect of Time Dummies (Significant Years)	N	N	N	Y (negative impact) (1992-2010)
Constant	-47.45***	-70.25***	-57.34***	-32.13**
(t-values)	(-9.19)	(-4.43)	(-4.04)	(-2.98)
N	432	432	432	432
R square within	0.5215	0.5079	0.4228	0.4747
R square between	0.0184	0.5165	0.6823	0.7231
R square overall	0.0195	0.5164	0.6803	0.721
t statistics in parentheses				
* p<0.05, **p<0.01, *** p<0.001				

Section 2: Other indices

The previous section emphasizes on the determinants of trade between Mercosur members (intra-bloc) and their trade with the rest of the world. This section highlights the top products exported and imported by the members to Mercosur and ROW. It then compares this trade basket with the industries in which members have revealed comparative advantage. It is predicted that member countries export products belonging to industries with an RCA greater than one. The rest of the section uses statistical indices to determine the degree of dependency within the bloc members, while

establishing the extent of intra-bloc trade and how well suited the members' industries are for intra-bloc trade. This is determined by employing the trade complementarity index. Last, the nature of intra-bloc trade must benefit from preference margins and these are analyzed in the last sub-section. Today, tariff preferences are not enough to explain patterns of trade between partners; the existence of non-tariff measures like technical standards, sanitary measures may hinder even in the presence of measurable preference margins.

Top bilateral export basket

Chapter 4 discussed the composition of trade baskets for Mercosur members and highlighted the top industries that contribute to exports and import in each of the members. This section further explores the top traded products on HS 6-digit classification that are trade within Mercosur and with the rest of the world. The top five products traded over the years by Mercosur members has been presented in the left-hand columns in the Table 7 below, while those traded with the rest of the world are presented in the right-hand columns. For the analysis, the years 1998, 2007 and 2017 were chosen for each of the four members.

Argentina's export and imports to Mercosur have remained unchanged from 1998 to 2017. It exported and imported vehicles and parts to its Mercosur partners; other exports mainly consisted of wheat and petro oils while imports comprised mainly of electrical energy and soybean from Paraguay and transmission apparatus from Brazil apart from vehicles and parts. Through the period, three out of Argentina's five biggest exports to the world consisted of soybean seeds, soybean oil and soybean residue cakes. Other top products exported also included natural resource-based goods such as crude and refined petro oils, corn and wheat. Only recently in 2017, were vehicle exports among the top Argentine exports to the world, most of which found its way to the regional markets. Argentina is actively engaged in value chains in the automobile industry as they are simultaneously exported and imported by the industry. The global imports also comprised in part of capital goods including vehicles transmission apparatus, airplanes and parts of telephonic devices as well as petroleum products. For example, Refined petroleum was the largest import in 2007 and by 2017, it was replaced by other petroleum oils and Natural Gas.

A similar analysis for Brazil revealed that vehicles remained the largest export and import from 1998-2017 in terms of intra-bloc trade, followed by imports of cereals like wheat and rice as well as trade in petroleum oils at various processing stages. Brazil also briefly exported tobacco cigarettes in the late nineties to its Mercosur partners and transmission devices directly to Argentina in 2007. This shows that Brazil continued to produce manufactured goods and exported them to the regional market although its overall exports to the rest of the world consisted of primary-food based goods. For example, the top Brazilian exports to the global market in 1998 comprised of soybean, orange juice, and coffee in addition to non-food primary goods such as iron ores and concentrates. By 2007, three out of the four food-based exports were replaced by crude and refined oil and aircrafts. The only unchanged top export was Soybean (whether broken or whole). Recently in 217, raw sugar and bleached wood pulp were added to the export basket. On the import side, the top basket over the years consisted of petroleum products at various stages of processing: crude, refined, and medium-light oils. However, it also imported other products in spurts owing to lack of domestic production such as transmission devices in 1998, vehicles till 2007, medicaments in 2007 and telephone sets and mobile phones and parts in 2017 from Chinese manufacturers.

It is known that Uruguay and Paraguay are dependent on their external export and import markets due to the limitation imposed by their geographical size and internal market size. Together, they are the one of the biggest exporters of bovine meat and soybean derivatives to the world and this is reflected in their global export baskets. Paraguay also remained a large producer and exporter of electrical energy owing to the production of hydroelectricity from the Itaipú dam it shares with Brazil. Brazil and Argentina are also the largest markets for 90 percent of the hydroelectricity produced by Paraguay. Rice, Wheat and Cotton were other exports to the bloc as well as the world from Paraguay. On the contrary, Uruguay exported a variety of goods in addition to bovine meat and soybean factions including milk to Brazil, malt and rice to bloc members and, bovine leather and wool to the rest of the world. The above analysis shows that all four Mercosur members are exporters of agro-based products, however, according to results from Chapter 4, the bigger members Brazil and Argentina have a diversified export structure, while Paraguay and Uruguay remain dependent on agro and food exports.

On the import side, both Paraguay and Uruguay imported a variety of processed petroleum oils and vehicles throughout the twenty-year period of our analysis; Paraguay also imported alcoholic beverages, cigarettes and fertilizers from the bloc and the world in various years, and an array of capital goods from the rest of the world including computers, mobile phones, data processing machinery and still photography cameras from outside the region. on the contrary, Uruguay imported various food preparations and swine meat from the bloc, set of medicaments and chemicals along with capital goods like transmission devices and telephones from the rest of the world. These import baskets have remained greatly unchanged over the years indicating the permanence of preferences in the bloc.

Table 7: Top export and Import Baskets

	Mercosur		World	
	Export	Import	Export	Import
<i>Argentina</i>				
1998	Motor Vehicles for passengers and goods Wheat Crude Petro oils	Motor Vehicles for passengers and goods Electrical Energy	Crude Petro oils Soybean oil Soybean oilcake Corn Wheat	Motor Vehicles for passengers and goods Vehicle parts Transmission apparatus
2007	Motor Vehicles for passengers and goods Wheat Refined Petro oils	Motor Vehicles for passengers Transmission apparatus Soybean, whole Electrical energy	Refined Petroleum oils Soybean oilcake Soybean oil Soybean, whole	Refined petro oils Motor Vehicles for passengers Transmission apparatus Airplanes and other aircraft
2017	Motor Vehicles for passengers and goods Wheat	Motor Vehicles for passengers and goods Soybeans, whole	Motor vehicles for goods Soybean oilcake Corn Soybean oil Soybeans, whole Vehicles	Motor Vehicles for passengers Medium Petroleum oils Parts of telephone sets, mobile telephones Natural gas in gaseous state
<i>Brazil</i>				
1998	Motor Vehicles for passengers and goods Vehicle parts Cigarettes containing tobacco	Motor Vehicles for passengers and goods Wheat Crude Petro oils Rice	Coffee Soybeans Iron ores and concentrates Soybean oilcake Orange juice	Crude Petro oils Motor Vehicles for passengers Vehicle parts Wheat Transmission apparatus

2007	Motor Vehicles for passengers and goods Transmission apparatus Refined Petroleum oils	Refined Petroleum oils Wheat Motor Vehicles for passengers and goods	Crude Petro oils Iron ores and concentrates Soybeans Refined Petro oils Airplanes and other aircraft	Crude petro oils Refined petro oils Motor Vehicles for passengers Medicaments
2017	Motor Vehicles for passengers and goods Crude Petro oils	Motor Vehicles for passengers and goods Wheat Malt, not roasted	Soybeans Iron Ores and concentrates Crude Petro oils Raw sugar not containing added flavor Bleached wood pulp	Medium/light Petroleum oils Crude Petro Oils Bituminous Coal Parts of telephone sets, mobile telephones
<i>Paraguay</i>	Export	Import	Export	Import
1998	Soybeans Cotton Soybean oil Soybean oilcake Meat from bovine animals	Cigarettes containing tobacco Petroleum spirit except aviation or motor fuel Herbicides Buses and lorries Motor Vehicles for goods	Soybeans Cotton Soybean oilcake Soybean oil Meat from bovine animals	Cigarettes containing tobacco Motor Vehicles for passengers and goods Petroleum spirit except aviation or motor fuel Whiskies
2007	Electrical Energy Soybeans Corn Crude oil Wheat other than durum wheat, meslin	Refined Petro Oils Minerals or chemical fertilizers Motor Vehicles for goods Buses and lorries	Electrical Energy Soybeans Soybean oilcake Corn Crude oil	Refined Petroleum oils Portable data processing machines Computer parts and accessories Minerals and Chemical fertilizers Still image video cameras
2017	Electrical Energy Soybeans Corn Milled Rice Ignition wiring sets	Petroleum oils, refined Mineral or chemical fertilizers Motor Vehicles for goods Beer from malt Tobacco	Electrical Energy Soybeans Soybean oilcake Meat from bovine animals	medium petro oils light petro oils Mobile telephones Motor Vehicles for passengers and goods
<i>Uruguay</i>	Export	Import	Export	Import
1998	Rice Motor Vehicles for goods Bovine Meat Cigarettes containing tobacco Malt, not roasted	Crude Petro oils Vehicle parts Motor Vehicles for goods Food preparations	Meat from bovine animals Rice Wool Bovine leather and equine leather	Crude Petro Oils Vehicle parts Motor Vehicles for passengers and goods Medicaments

2007	Rice Carboys, bottles, flasks Malt, not roasted Electrical Energy Vehicle parts	Crude petro oils Refined petro oils Electrical Energy Motor Vehicles for passengers Vehicle parts	Meat from bovine animals Bovine leather and equine leather Soybeans Rice	Crude petro oils Refined petro oils Transmission apparatus Polythene terephthalate Vehicle parts
2017	Electrical energy Concentrated milk and cream Malt, not roasted Margarine Carboys, bottles, flasks	Mate Motor Vehicles for passengers and goods Meat of swine	Soybeans Bovine meat frozen/fresh Eucalyptus wood Rice	medium petro oils light petro oils Mobile telephones crude petro oils Motor vehicles for passengers

Source: UN Comtrade and World Bank (WITS)

Revealed Comparative Advantage

Balassa (1965, 1983) popularized the concept of *Revealed Comparative Advantage*⁷⁴ as an index where the actual export flows ‘reveal’ the country’s strong sectors. It is also called the Balassa index and can be computed as:

$$BI_j^A = \frac{\text{Share of industry } j \text{ in country } A \text{ exports}}{\text{Share of industry } j \text{ in global exports}}$$

If $BI_j^A > 1$, country A is said to have a revealed comparative advantage in industry j, since this industry is more important for country A’s exports than for the exports of the world.

According to the above equation, the revealed comparative advantage index is based on the export values from a particular industry as a share of total exports in that year. However, this index uses past export values and fails to predict future trends. Gnidchenko & Salnikov (2015) noted that a competitiveness index should consider total trade. However, RCA is an incomplete index as it only considers the exports of a

⁷⁴ Revealed comparative advantage index has various drawbacks, however, it continues to be used extensively in trade literature.

country. Moreover, it judges the relative importance of an industry for a country vis-à-vis the world; but a country can have comparative advantage even though it occupies a small share of the export basket. RCA is also sensitive to number of exported goods, if a country exports only a few products, their share in the export basket will be high as compared to a country that diversifies its exports. Additionally, it does not consider non-price factors (Sanidas & Shin, 2010). Utkulu and Seymen (2004) noted that government interventions like export subsidies, import restrictions, other protectionist policies can distort export patterns, and the misreport the “revealed” comparative advantage.

However, the RCA remains a widely used tool to comment on the export competitiveness of an industry of a country vis-à-vis other reference countries, and the table below summarizes the top industries in Mercosur members that have a revealed comparative advantage in global exports along with their respective growth rates (CAGR). The period chosen for this analysis has tried to capture relative export competitiveness of Mercosur countries after the advent of the commodity supercycle driven by Chinese demand in 2002.

A comparative analysis across Mercosur members emphasizes on the similarity of industries with an $RCA \geq 1$ in the period 2002-2017 (Table 8). For example, vegetable products, animal products, food products and hides and skins industries dominated the analysis across members. Brazil had an $RCA \geq 1$ in seven industries, Argentina and Paraguay in five, and Uruguay in only four industries. The large number for Brazil signifies that it is specialized in the production of a diverse set of exports with positive growth rates exceeding 5 percent per annum in the fifteen-year period. Mineral, vegetable and animal products had the highest CAGR of 13.44, 13.22 and 10.90 percent per annum respectively. The RCA for each of these industries dipped between in 2014 and 2017 due to the advent of the political crisis in Brazil. Consistent with the prediction, they recorded the highest RCA between 2002 and 2014 during the commodity supercycle. Argentine industries also followed a similar pattern, however food products replaced mineral products, along with vegetable and animal products that recorded the highest CAGR among industries with $RCA \geq 1$.

Although the Fuel-based industry in Paraguay recorded a CAGR of 55.21 percent per annum between 2002 and 2017, it did not have a ‘revealed’ comparative advantage vis-à-vis the world. This is one of the caveats of the RCA index methodology; while the industry performed well in Paraguay in absolute terms, it did not perform as well as other countries in relative terms. As mentioned earlier, Paraguay is one of the largest exporters of hydroelectricity in the world but it fails to secure an $RCA \geq 1$ relative to other countries in the world that specialize in exports of fuels. Another peculiar example is the Hides and Skins industry in Uruguay. Although the RCA increased from 4.96 to 16.84 (the highest for the country) between 2002 and 2017, its CAGR for the same period stood at less than 0.1 percent per annum. This implies that Uruguay’s relative competitiveness in hides and skin exports rose despite stagnation in the domestic industry.

In general, the results from the analysis on revealed comparative advantage conform with the findings in Chapter 4; Mercosur members primarily export products belonging to the industries in which they also display a revealed comparative advantage vis-à-vis the rest of the world. for example, soybean and bovine meat are top exports from Mercosur members and simultaneously, the countries displayed a high RCA in animal and vegetable products.

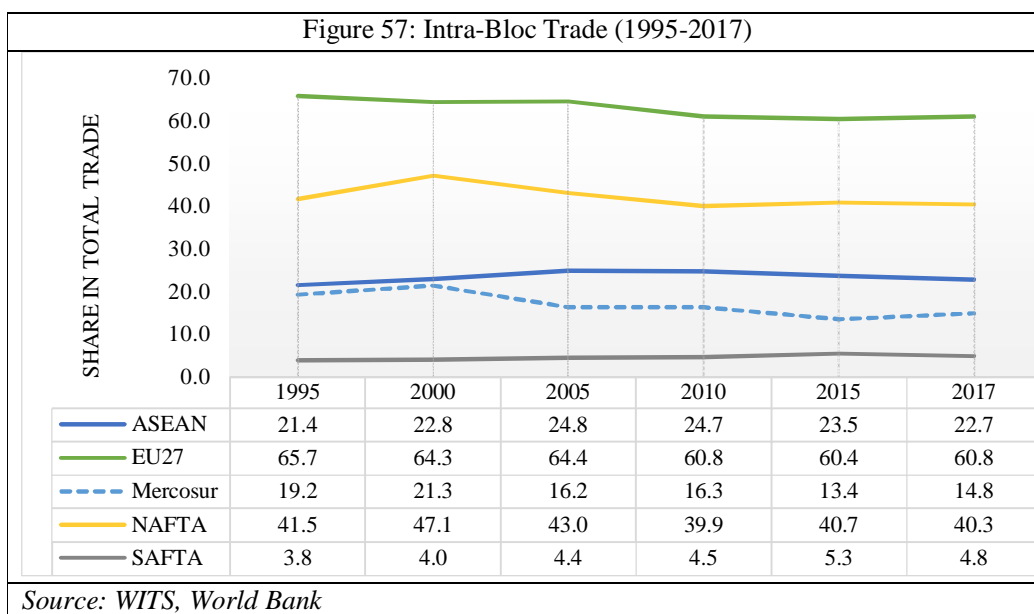
Country	Product	RCA 2002	RCA 2014	RCA 2017	CAGR 2002-2017
Argentina	Vegetable Products	9.32	7.51	8.71	7.04
	Food Products	5.06	7.63	6.69	8.38
	Animal Products	3.13	3.63	3.90	7.43
	Hides and Skins	3.69	2.32	2.04	0.09
	Mineral Products	3.54	1.45	1.01	2.13
Brazil	Mineral Products	7.63	9.42	8.76	13.44
	Vegetable Products	5.18	5.29	3.79	13.22
	Food Products	3.46	3.74	4.33	8.09
	Animal Products	3.45	3.90	2.72	10.90
	Wooden Products	2.22	1.88	1.86	7.33
	Hides and Skins	1.42	2.03	2.22	4.26
Paraguay	Metal Products	1.11	1.06	1.64	6.75
	Vegetable Products	10.97	12.10	19.01	13.73
	Animal Products	7.25	7.53	4.71	19.54
	Food Products	3.07	4.40	5.58	12.17

	Fuels	2.41	1.52	0.03	55.21
	Hides and Skins	2.40	3.24	7.90	5.52
Uruguay	Animal Products	16.71	15.63	14.74	11.28
	Vegetable Products	8.01	10.29	5.77	14.56
	Wooden Products	5.34	3.71	1.64	16.01
	Hides and Skins	4.96	5.58	16.84	0.05
<i>Source: World Bank WITS</i>					

Intra-bloc trade

Traditional trade theory predicts that the formation of a regional bloc will lead to a larger internal market that can facilitate the realization of specialization patterns in member countries. Proponents of trading bloc emphasize that regionalization is a building block towards greater multilateral trade as well. This idea has already been explored in Chapter 2 that also highlights other such trade theories in favor of and that opposing regionalization. Although the success of a regional bloc can be determined in several ways, this section emphasizes on the extend of intra-bloc trade in some of the largest regional bloc around the world; higher the share of intra-bloc in total trade of a bloc, higher the level of regional integration among members. This simplified quantitative measure can also briefly comment on the importance of the internal market for bloc members.

Figure 57 shows the recent trend in share of intra-bloc trade in total trade for five regional blocs including EU27, NAFTA (United States, Canada and Mexico), SAFTA (India, Pakistan, Sri Lanka, Bangladesh, Afghanistan, Nepal, Bhutan and Maldives), ASEAN (Indonesia, Singapore, Thailand, Cambodia, Brunei, Lao, Vietnam, Myanmar, Malaysia and Philippines) and Mercosur. With the exception of SAFTA, all regional blocs perform better than Mercosur. It is known that the low trade trend within SAFTA is explained by the geo-political uncertainty in the region. Although EU27 (1992), NAFTA (1995), ASEAN (1999) and Mercosur (1991) free trade areas were formed in the same decade, the difference in intra-bloc trade shares is stark. EU27 exhibited the highest share of intra-bloc trade with an average of 62.5 percent of total trade conducted by the bloc in the period 1995-2017, and was followed closely by NAFTA (average share of 42 percent).



Among the regional bloc that consisted primarily of developing countries like ASEAN, SAFTA and Mercosur, intra-bloc trade in ASEAN free trade area rose from 22.8 percent a year after the addition of all its ten present members to 24.7 percent in the next decade. This was due to the formation of regional value chains within the bloc, a possibility left unexplored by Mercosur members. Mercosur is the oldest free trade area in this study; given the time elapsed since its inception, it was expected that Mercosur members would have found a successful recipe to reap the benefits offered by a large internal market and formed regional value chains to exploit the advantages of close geographical and cultural proximity. However, as shown in Fig 1, the intra-bloc trade has remained fairly low since its inception with an average of under 17 percent in the last two decades; indeed, they have failed to fully integrate within the bloc and this finding is further explained in Chapter 7 that focuses on the non-economic factors that contributed to the formation of Mercosur in 1991.

Dependency among members

The degree of dependency between Mercosur members can be analyzed based on the share of intra-bloc trade in the total trade of each country; higher the share, higher trade-related dependency between members. Figure 58 presents the export and import shares for all four members in the period 1990-2017. Paraguay displayed the highest share of exports to Mercosur, together with the highest share of imports from Mercosur members. Notably, the share of exports destined for Mercosur members peaked in 2000

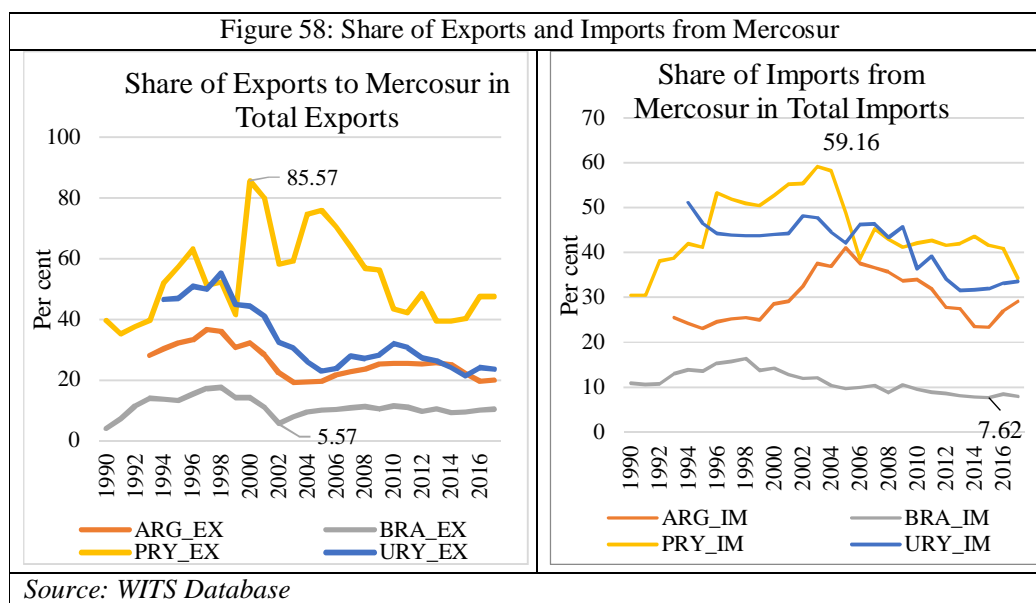
at 85.57 percent from just 41.49 percent in 1999. On the import side, Paraguay imported 59.16 percent of all imports from its bloc partners in 2004, the highest for the country as well as for all the members combined. Overall in the period 1990-2017, Paraguay maintained the highest shares for both intra-bloc exports and imports. This confirms our analysis in chapter 4 that Paraguay is highly dependent on the bloc; while it seeks Mercosur members as a market for its exports, it is also dependent on imported goods to fulfill the excess domestic demand that cannot be met by internal production.

Similarly, the other small country in the bloc, Uruguay also displayed high dependency on Mercosur members in the nineties with export shares reaching 55.24 percent in 1998 but the dependency fell to an average of 29.7 percent between 2005 and 2017 due to increased exports to the rest of the world. In terms of imports from Mercosur, 51.07 percent of total imports in 1994 originated in Mercosur countries; however, Uruguay imported only 33.5 percent of total imports from Mercosur members by 2017. This decline is synonymous with the increased importance of other trade partners, notably China; it also confirms the change in priority for Uruguayan trade policy due to political dynamics within the bloc. The political economy of the bloc has been explored in Chapter 7.

The low dependency of Uruguay on Mercosur member in recent times was also mirrored by the other two countries in the bloc: Brazil and Argentina. Brazil had the lowest dependency on other bloc members; it only exported an average of 15 percent of its total exports to Mercosur and imported an average of 10 percent of total imports from Mercosur members in the period 1990-2017. These low shares are consistent with the analysis in Chapter 4 that Brazil is not dependent on Mercosur as a market for its exports or as a supplier of imported products; its largest trade partners are located outside the region of South America. Moreover, Brazil's imports from the bloc are lower than its exports to the bloc; per the analysis in the previous section on top goods baskets for intra-Mercosur trade, Mercosur members are an important market for Brazilian high-value industrial exports and suppliers of low-value food-based imports.

On the contrary, both Uruguay and Argentina imported more than they exported to the bloc. This can also be explained by the composition of intra-bloc exports and imports; they imported high-valued vehicles and fuel-based goods, but exported food-based low-value goods. Furthermore, both Argentina and Uruguay are also competitive in exports

of soybean and bovine meat to the rest of the world- there is a clear preference of exporting these products to the global market to reap the benefits of perhaps a better international price. Hence, it is natural that their exports to Mercosur members will be lower than their imports from the bloc.



Trade Complementarity

Trade Complementarity index (TCI) can predict the extent of bilateral trade between two countries. According to trade theory, high trade complementarity index for a country pair can indicate greater scope for trade given that the trade structures of the two countries in the pair are complementary to each other. In other terms, high TCI means the export structure of one country matches the import structure of the other country in the pair.

For example, Brazil has the highest trade complementarity with its partners in the bloc. This means that Brazil exports goods similar to those imported by other Mercosur members. Notably, its export structure is very diversified such that it includes goods from the food industry, mineral products, manufactured goods and capital goods; its partner Uruguay mainly imports an array of capital and manufactured goods. In this example, they display high degree of trade complementarity due to the similarity in exports from Brazil and imports by Uruguay. In this analysis, Brazil-Uruguay have the highest TCI among the Mercosur members. This statistic is consistent with the analysis

in the previous subsections- the bilateral trade basket between Brazil and Uruguay consists mainly of Brazilian exports of capital and high-tech goods to Uruguay.

On the other hand, the value for Paraguay-Uruguay pair has been very low over the years. This predicts two things, one, that these countries will have very low bilateral trade, primarily because Paraguay's main exports are not consistent with Uruguay's import basket and two, in practice, it is possible that they export similar products that compete in the importer's market. They could hence benefit from intra-trade through joint-cooperation in agro-industries. Another important observation is that the TCI between Argentina and the small countries in the bloc- Uruguay and Paraguay has declined over the years, suggesting that Argentine export basket used to be similar to the import basket of Uruguay and Paraguay and was concentrated on manufactured goods; however, it has shifted over time towards greater exports of agriculture-based goods to Mercosur members as well as the rest of the world. In other words, its export structure has moved closer to those displayed by Uruguay and Paraguay in recent years.

The trade complementarity index for two big economies of Mercosur, Argentina and Brazil has been fairly moderate, but with a declining trend. Although the export basket from Argentina to Brazil has remained constant over the time period 1996-2017, a declining TCI highlights the changing nature of the Brazilian import basket; perhaps Brazil began to import a higher variety of goods from other partners that led to the increased mismatch in the Argentine export and Brazilian import baskets. Conversely, Argentina has been able to diversify its exports to the rest of the world and continues to export the same set of goods to Brazil over the years.

An important observation from the analysis is that there exists a difference between the trade complementarity statistics reported by the two countries in a pair; TCI for a country pair predicts only one side of relationship. For example, TCI for Brazil-Argentina analyses whether Brazil's exports are similar to Argentina's imports and not the other way around. For that purpose, the TCI for the reverse country pair needs to be analyzed. Although the value for Brazil-Uruguay was the highest in our analysis, the value for Uruguay-Brazil is very low, suggesting that the export basket of Uruguay does not match the import basket of Brazil or very few goods exported by Uruguay find their way to the Brazilian market. The same is true for all 'small country-large country' pairs- Uruguay-Argentina, Paraguay-Brazil and Paraguay-Argentina. As mentioned

earlier, the value for Paraguay-Uruguay has remained low; the same is also true for the opposite direction of trade from Uruguay to Paraguay. This follows from the previous explanation that Uruguayan exports of food-based and energy-based goods are dissimilar to Paraguayan imports of capital and consumer goods.

Table 9: Trade Complementarity Index (Bi-directional)				
	1996	2007	2016	2017
Argentina-Brazil	49.73	44.45	34.28	35.09
<i>Brazil-Argentina</i>	48.51	52.21	43.53	45.00
Argentina- Paraguay	38.77	42.11	34.57	35.58
<i>Paraguay- Argentina</i>	14.34	17.00	18.87	20.44
Argentina- Uruguay	47.84	46.89	38.78	41.89
<i>Uruguay- Argentina</i>	26.68	28.35	20.04	21.25
Brazil-Paraguay	45.76	49.23	42.55	44.44
<i>Paraguay-Brazil</i>	17.50	29.70	23.37	27.23
Brazil-Uruguay	52.86	55.29	46.98	50.05
<i>Uruguay-Brazil</i>	31.22	27.80	22.32	22.76
Paraguay-Uruguay	18.49	37.56	26.82	30.36
<i>Uruguay- Paraguay</i>	27.03	26.58	20.60	21.23

Source: WITS database

Preference Margins

According to *Treaty of Asuncion*, Mercosur members have maintained zero tariffs on all product lines except those listed as national exception and other special goods such as capital good and ICT goods under the BK and BIT tariff regime. These exceptions have been discussed at length in Chapter 3 that also highlights the recent changes in the individual members' trade policy. Members have also applied MFN tariffs to the rest of the world after accounting for the CET. For example, the simple average of MFN applied by Brazil is 13.4 percent on all goods and 13.7 percent by Argentina in 2017.

Hence, Mercosur members have clearly granted non-zero preference margins to other bloc members under the *Treaty of Asuncion*. Preference margins can be defined as the difference between the MFN applied rate and Preferential rate granted to preferential trade partners. The non-zero and positive preference margins within the bloc have promoted intra-bloc trade. Notably, Mercosur members benefitted from an average preference margin of 13.4 percent when they exported goods originating in Mercosur

area to Brazil; similarly, the preference margin when exporting to Argentina was 13.7 percent.

Despite these positive and high margins, as established in the previous sections, intra-bloc trade comprised a very low share in Mercosur's total trade. Therefore, it is safe to conclude that the preference margins alone cannot promote trade between two preferential partners. There are other non-tariff measures imposed by individual countries in terms of technical standards, sanitary and phytosanitary preferences, among others. These non-tariff measures can be interpreted as non-tariff barriers or NTBs if they hinder trade between partners; and these are highly prevalent in the case of Mercosur.

Section 3: WAY AHEAD

This chapter has attempted to quantitatively analyze the bilateral relationship between the Mercosur members by devising various known statistical tools. One of the first such tools applied was the Gravity Model of international trade that focused on three distinct layers of Mercosur's trade relations: intra-bloc, regional and extraregional. The gravity results were consistent with the conclusions of Chapters 3 and 4: Distance and common language play a significant role in determining extraregional trade patterns, for example, Mercosur members share two common languages with EU12 members, and this has contributed to greater bi-regional trade between the two blocs. In terms of regional trade, the signing of an FTA had a significant and positive impact on bilateral trade with seven of Mercosur's largest regional partners including Chile, Mexico, Colombia, Peru, Bolivia, Ecuador and Venezuela.

Notably, while the regional and extraregional trade patterns over the years 1991-2017 were explained by the independent variables chosen for the model, the same was not true for Mercosur's intra-bloc trade. The gravity equation specified in this analysis was insufficient in determining intra-bloc trade patterns although variables like area of exporting country and a shared border did increase trade between members. In general, Brazil tended to have greater trade with other Mercosur members in terms of exports and imports due to its large size; moreover, Paraguay and Uruguay do not share a common border that led to lower trade between the two small economies of the bloc.

Overall, it was also found that intra-bloc trade is very low in Mercosur as compared to other such regional initiatives around the world. For example, intra-bloc trade among the NAFTA members comprised a share of 40.3 percent in total trade in 2017, while the equivalent share for Mercosur members was just a mere 14.8 percent. This observation is unexpected because Mercosur members have offered clear preference margins to other members of the bloc since the inception. Notably, the Mercosur members are part of a free-trade area with zero percent tariffs on all product lines with the exception of the national sensitive lists along with sugar and automobile industries. For example, goods entering Brazil from other Mercosur members face a preference margin of 13.4 percent vis-à-vis MFN applied tariff rates applicable to all third partner countries. Despite these preference margins, trade between Mercosur members remains low; perhaps due to the existence of non-tariff barriers that affect trade before the border, at the border and beyond the border. There are other non-economic factors that have influenced the pattern of trade in the bloc and these have been explored in Chapter 7.

Over the years, the product baskets exported and imported within Mercosur have remained constant. It was expected that a free trade area in place for almost thirty years would be trading an array of goods, however, the baskets are quite limited to a few products from the food, energy and manufacturing sectors. There is scope for greater diversification of traded goods in Mercosur. Additionally, the level of dependency among members is low for the bigger countries and high for the smaller countries of the bloc. For example, in the period 1990-2017, Paraguay maintained the highest shares for both intra-bloc exports and imports. This confirmed our analysis in chapter 4 that Paraguay is highly dependent on the bloc; while it seeks Mercosur members as a market for its exports, it is also dependent on imported goods to fulfill the excess domestic demand that cannot be met by internal production. The same is true for Uruguay. On the contrary, the share of Brazil's exports and imports from Mercosur members was under 20 percent in the same period confirming our hypothesis that Brazil's largest trade partners lie outside the region and can be found in China, EU12 and the United States.

One of the possible ways to increase intra-bloc trade would be the development of regional value chains. Value chains have originated in the regional context in the world

and have expanded over time to include other productive hubs. The industrialized members of the bloc, Argentina and Brazil face a geographical barrier to engagement in such global value chains. To compensate for this loss, countries can focus on creation of regional value chains (RVCs) through identification of productive complementarity among neighbors, signing of preferential trade agreements that facilitate the trade in intermediaries and through investment agreements that secure the interests of foreign investors and the host country. Thus, improving regional integration can help reduce the costs that are exacerbated by geography. This has been further explored in the next Chapter 6.

CHAPTER 6: GLOBAL VALUE CHAINS AND INTRA-INDUSTRY TRADE IN MERCOSUR: AN ANALYSIS OF INTRA-BLOC TRADE

Global Value Chains have been the drivers of growth in developed and emerging economies for many years. They have generated higher value added, employment and income through more efficient production methods. In the past two decades, their rise has altered global production and the world economy. This study begins by exploring the current literature on global value chains in Section 1. It comments on the nature of global value chains that exist in the world today and highlights their increasing role in international trade. Section 2 presents a case study of the Southern Common Market or Mercosur and analyses trade patterns in intermediate goods the bloc. Traditionally, countries in close proximity to each other and with sufficient complementarity (in industrial production as well as trade) engage in value chains by either integrating themselves in existing *GVCs* or by forging new production/value chains in a regional context. It is important to identify whether Mercosur members have been successful in establishing such regional chains. It draws on the methodology employed by Athukorala (2005) that identified tariff lines from the UNCTAD database to form a category “Parts and Accessories” separated from trade in final goods.

The OECD-WTO TiVA database will also be used to shed lights on the nature of *GVCs* or Regional Value Chains that may exist in Mercosur, with focus on indicators such as foreign value added in exports of intermediate and final goods, domestic value added in partner countries’ exports and final consumption, and measures of backward and forward linkages. There is evidence that points towards the existence of production networks in Mercosur. As a special case study, the Automobile sector is analysed in the two biggest economies of the bloc, Argentina and Brazil in Section 3. There are various ways of determining the existence of value chains between countries; one way is to calculate the extent of trade in intermediate products, the other way is to determine the extent of intra industry trade between countries. Since value chains are just a specific kind of intra-industry trade, Section 4 comments on the extent of intra-industry trade between Mercosur countries by employing the *Grubel-Lloyd index*. In the end, Section

5 gives recommendations for improvement of regional integration through greater trade facilitation in promoting value chains in the region.

Section 1: An introduction to Global Value Chains

Value chains are been referred to as the geographical fragmentation of productive processes and slicing of tasks for optimization. This fragmentation has led to greater interdependency between countries and increase in trade of intermediate goods in manufacturing sector. “*Trade in parts, components and accessories encourages the specialization of different economics, leading to a “trade in tasks” that adds value along the value chain*” (WTO-JETRO, 2015). Countries and sectors can achieve very different value addition and job gains along global value chains depending on their position degree of participation based on comparative advantage in “tasks”.

According to the Global Value Chain Development Report 2017 by the World Trade Organization, global production can be divided into four types of value-addition activities: *pure domestic production*, where goods and services are produced and consumed domestically; *traditional trade* that involved domestic value addition in exports of final goods and services; *simple GVCs* covering domestic value addition in exports of intermediate goods that are used by partner country to produce goods for final consumption in its economy; and last, *complex GVCs*, comprising of domestic value addition in exports of intermediate goods that are used by partner country to produce exports for a third country. In complex GVCs, domestic factor content crosses international borders at least twice.

WTO (2017) notes that complex GVCs were the most important driving factor of the global economy during the period 1995 to 2008. However, post the financial crisis of 2008 /09, GVC production has remained fairly low and has been unable to recover from its pre-crisis levels. This was reflected in the breakdown of both backward and forward linkages in the manufacturing and mining industries around the world. The wave of protectionism that followed the global financial crisis, along with the growth of Chinese demand for imported intermediate products to foster domestic production and the recent technological and innovation boom has altered global production patterns in recent years.

Since GVCs mainly involve the trade in intermediate goods across national borders, governments can implement trade facilitation measures to reduce the tariffs and non-tariff barriers on intermediate goods to deepen value chains. To supplement these efforts, they can also improve global and regional connectivity through greater investment in transport and logistic networks, and develop a single window for customs clearances to facilitate faster imports and exports. However, given the nature of global production and trade, government are faced with a dual policy choice, whether to increase the imported content in production and exports, or, to facilitate higher domestic value added in exports. Notably, firms in emerging economies can enter GVCs by an increase in the share of imported intermediaries that can help raise their competitiveness through technology transfer embodied in imported inputs.

Today, GVCs are playing an increasing role in determining growth patterns around the world (WBG-OECD-WTO, 2014). The rise of global value chains has led to the development of trade-investment-service-know-how nexus with the intertwining of trade in intermediaries, the movement of capital and technology, and the supply of services to store transport and distribute goods and services. GVCs can empower local economies by enabling linkages to sophisticated imported technical know-how and a rich skillset (OECD-WBG, 2015). A recent report by OECD and UNIDO (2019) has also offered evidence that GVCs can also allow small and medium enterprises (SMEs) to participate in global markets and production networks by greater access to capital, technologies and services; this can empower small producers and create more inclusive growth. The ASEAN countries have identified the importance of inserting SMEs in global production networks in their 'ASEAN Strategic Action Plan on SME Development 2016-2025' (ASEAN, 2015) and recommended the creation of information platforms and capacity-building programs to enhance their market access.

Countries must focus on holistic approaches to tackle the supply chain bottlenecks including infrastructure and logistics, access to credit, flexible labour markets and enabling greater innovation and technology absorption. These policies must also be supplemented by widespread trade liberalization to increase the foreign content in domestic production in the form of parts and technology, as well as, greater domestic value added in other countries exports to third countries, relaxation on restriction of obtaining foreign exchange, and consolidation of customs procedures through

establishment of a single window. Border measures slow down access to imported inputs for exporters, hence, there is much to gain from producing important items on simplifying export procedures. Creation of SEZs can also help in attracting GVC production due to exemption of duty on imported inputs, direct export-import assistance, access to trade credit, and technical and knowledge spillovers. Overall, governments must create a conducive environment for production, investment, transportation, communication and trade, such that firms can realize their true potential in a business-friendly environment.

Another determining factor of successful insertion in GVCs is geography. The distance of a country from the economic global hubs like the United States, EU, Japan and other East Asian nations impacts the nature of value chains that may exist and can sometimes inhibit the insertion of far-away countries in value chains. For example, countries in the African continent and in South America largely remain disconnected from global production networks due to their distance from major hubs. But international production sharing can take on different geographical scales-global and regional (ESCAP, 2015). To compensate for the lack of participation in GVCs, countries in South America can focus on creation of regional value chains (RVCs). High intra-regional tariffs, poor infrastructure and border inefficiencies continue to hinder intraregional trade in developing countries; in particular, the delay in trade of intermediate goods could interrupt production processes in partner country (Slany, 2017).

Countries can facilitate RVCs through identification of productive complementarity among neighbours, signing of preferential trade agreements that facilitate the trade in intermediaries and through investment agreements that secure the interests of foreign investors in the host country and incentivize them to invest in regional production chains. Investing in transportation services and enabling infrastructure can reduce the cost and time spent on transporting goods between countries. Last, custom issues that interrupt transportation across borders can be simplified through introduction of a single customs window, online licensing systems, reduced paperwork and tariffs on intermediate goods (WEF, 2013). Thus, creation of regional value chains and improving regional integration can help reduce the costs that are exacerbated by geography that hinder participation in global value chains.

However, these value chains can potentially expose national producers to macroeconomic disturbances in partner countries. The increased interdependence and connectivity have also increased the risk of contagion of economic uncertainty and supply shocks in one country to other connected countries, especially in a regional setting. Hence, GVCs act as transmission channels that increase the risk of sudden spillovers. It is clear that this volatility will remain and countries must make efforts to reduce these risks and manage their impact (Dornbusch, Park and Claessens, 2000). On the other hand, in case of a supply shock, governments have a limited role to play; firms must employ “*just-in-time*” strategies to mitigate the risk through geographical diversification of supplier networks, and with the overall objective of supply chain management by building robust, flexible, agile and resilient global value chains (OECD, 2013).

Section 2: Mercosur: Participation in GVCs

With the fragmentation and dispersion of international production, exported and locally consumed goods and services contain greater foreign content in value added. This reflects the level of integration in today’s global economy. Argentina and Brazil continue to be closed to foreign trade, as well as to global and regional value chains, making them poorly integrated with the world. This lack of focus on development of RVCs has translated into an introspective model of integration that does not encourage joint global competitiveness (Viola and Lima, 2017). Ferraz, Gutierrez and Cabral (2015) compared Mercosur with EU and NAFTA on existence of RVCs and found poor integration between Mercosur partners vis-à-vis other regional blocs. Brazil being the largest economy in Mercosur can play the role of the central economy for productive and commercial integration in Mercosur bloc. Since Uruguay and Paraguay are small economies, the trade dynamics of Mercosur, have mainly been a result of the performance of two of the largest economies in the region, Argentina and Brazil.

Brazil has especially felt the absence of value chains in the region. Manufacturing occupied a share of 23 percent in GDP the eighties, today, it is lower than 10 percent. It has been shrinking in the last forty years. The main problem in Brazil is not a short-term problem, for the last 40 years, Brazil has had structural problems as it is very protected. The GVCs around the world exploded in the nineties but Brazil was

completely isolated from these value-chains. The products Brazil competes with in the global market are made in the world through global value chains but Brazil is still stuck in the old idea of only “Made in Brazil”.

Figure 1 is based on the methodology developed by Athukorala (2005) that uses UNCTAD database to separate trade in parts and components from total trade in final goods. It can be interpreted as follows: the existence of trade in parts and components reveals patterns and opportunities for development of *regional value chains*. Fig 59A shows the exports from Argentina to Brazil in parts and components, Fig 59B shows the same exports from Brazil to Argentina in the period 1993 to 2017; Fig 59C summarizes the previous statistics and draws a comparison between the bi-direction exports. According to Fig 59A, Argentina exports to Brazil in parts and components rose dramatically for a decade following 2003, as did the exports from Brazil to Argentina (Fig 59B).

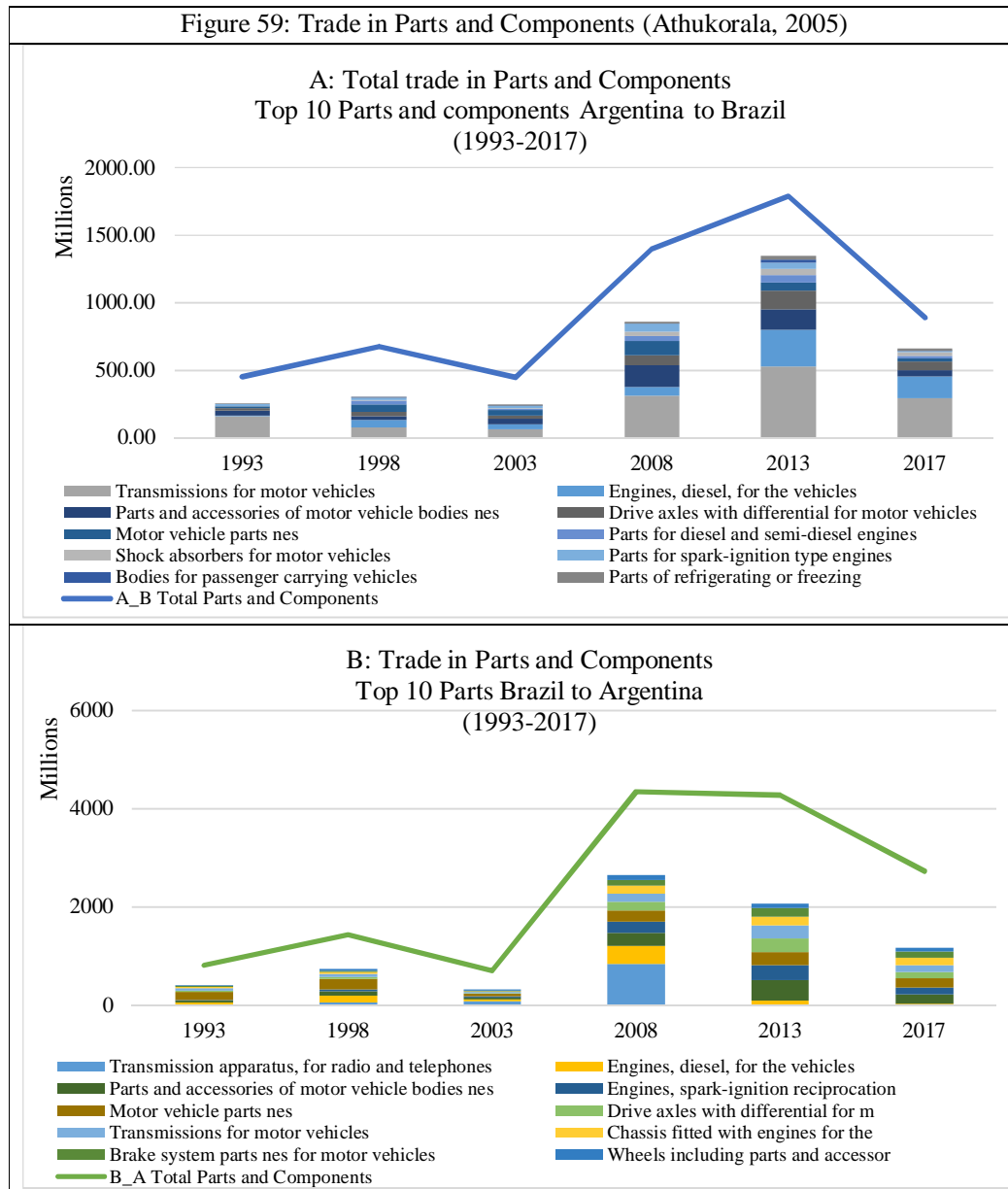
In case of Argentina, nine out of the ten top industries at six-digit HS classification included parts and components for the automobile industry including engines, engine parts, body and body parts. Similarly, exports from Brazil also comprised mainly of wheels, chassis, axles, body and engines for the automobile industry. Thus, the majority of product lines traded bilaterally is concentrated in development of the regional value chains in the automotive sector. As mentioned in Chapter 4, the *Common Automotive Policy (CAP)* co-signed by Brazil and Argentina in 1990 and further renewed till 2020, has contributed to the accommodating trade trend. This agreement aims to diversify and expand the bilateral trade in the automotive sector, especially in regionally produced parts.

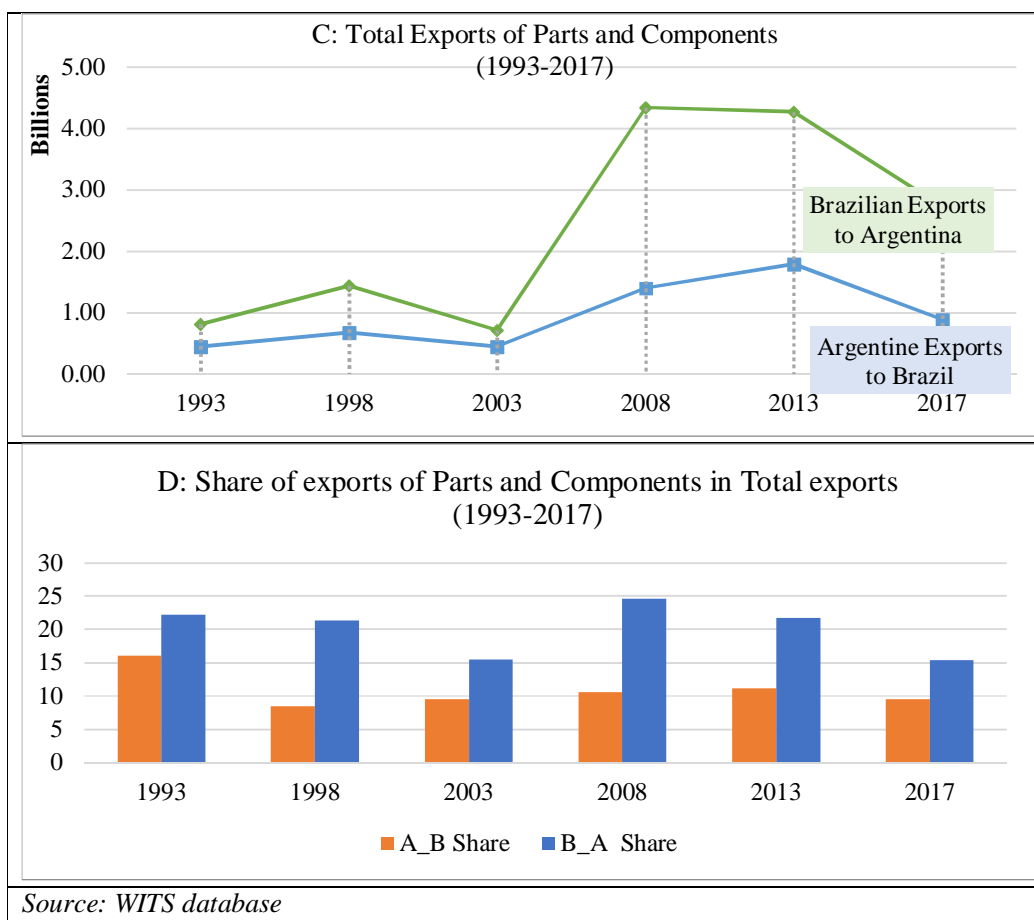
TRADE IN PARTS AND COMPONENTS

Overall, the bilateral exports in parts and components from Brazil far exceeded those from Argentina. For example, during the peak decade, Brazilian exports were valued at US\$ 4.3 billion as opposed to Argentine exports of only US\$ 1.3 billion in 2008 (Fig 59C). Another interesting observation is that bilateral exports regardless of origin followed similar trends. After the signing of the *Treaty of Asuncion* in 1991, bilateral exports rose marginally between 1993 to 1998. However, the regional crisis in 1999 clearly had a negative impact on exports. Moreover, it can also be seen that the

international commodity supercycle that lasted from 2002 to 2011 had a lasting effect on internal trade in parts and components as well. This confirms our hypothesis that the commodity supercycle did not only increase extraregional exports of agriculture-based goods but also of intra-Mercosur manufactured goods. Thus, the period from 2002 to 2011 was marked by an overall growth trend. However, political and economic crises in Mercosur in the period 2014 to 2017 led to an immediate decline in bilateral trade.

Figure 59: Trade in Parts and Components (Athukorala, 2005)





On comparison with total exports between Argentina and Brazil, exports of parts and components from Brazil comprised an average share of twenty percent, with a peak in 2008 of 24.7 percent. However, the share declined in the crisis periods of 1998 to 2003 and 2013 to 2017 in Brazil. On the contrary, exports share of parts and components in total bilateral exports to Brazil averaged to 9.8 percent in the ten-year period of 1998 to 2017, with an exception of 1993 when the share peaked at 16.0 percent of total exports, of which, one-third was just in transmissions for motor vehicles. It is possible that this peak value was a direct consequence of the CAP signed in 1990.

The possibility of RVC in Mercosur is very low as the trade in regional inputs and parts is very low in the region. There are very few inputs that countries can buy from one another to enhance domestic production. With the initiative to adopt trade facilitation and harmonize rules of origin within Mercosur, it would be easier for them to export “Made in Mercosur” goods to other countries in the region. For example, under ACE#62 between Mercosur and Cuba, Brazil exports products with value added content from Argentina and Uruguay. Moreover, the stop-and-go pattern of bilateral

trade shows that Argentina and Brazil turn protectionist during crises periods. Such a direct impact of a crisis on trade reveals the underlying rigid nationalistic policies at play. Certainly, both the countries can benefit from relaxing national sovereignty, by identifying opportunities to foster *regional value chains* in areas of manufacturing complementarity. They could also develop a *regional plan* rather than a nationalistic production plan, focused on infrastructural and logistical investment in combined regional projects.

VALUE ADDED IN PRODUCTION AND EXPORTS

Figure 60 shows the foreign value added in exports of Argentina and Brazil along with its top regional (Mexico, Chile, Colombia, Peru and Costa Rica) and extraregional partners (United States, China and EU15). The value of foreign value added reveals the '*backward participation in GVCs*'. Argentina and Brazil have one of the lowest foreign value added in exports in the period 2005 to 2016. Notably, it has declined in the period. For example, in the case of Argentina, foreign value-added content in total exports almost halved from 11 percent in 2005 to 6.9 percent in 2016. However, the fall for Brazil was not as drastic; foreign value-added in exports rose to 12.5 percent in 2015 from 11.2 percent in 2006 and then fell to 10.2 percent in 2016. National local content requirement policies in both Argentina and Brazil have resulted in these low figures as they have distorted foreign participation in production of exports. This is also evident from Table 10. It shows the disaggregated domestic value-added content in gross exports as a share of gross exports.

The share of indirect domestic value-added in gross exports, i.e.; the embedded exports in other countries' exports to third countries, is considerably higher for Brazil than Argentina; for example, in 2016, it was 40.8 percent of gross exports in Brazil and only 34.3 percent in Argentina. This reveals the extent of '*forward participation in GVCs*'- 40.8 percent of Brazilian gross exports to other countries are used as inputs for exports of final goods by them. Hence, Brazil and Argentina are more integrated in GVCs with forward linkages than backward linkages. The total GVC participation (as a share of gross exports) was 51 percent for Brazil in 2016 as compared to just 41 percent for Argentina in 2016; these shares have declined since their peak in 2005- total GVC

participation was 56.3 percent of gross exports for Brazil in 2005 and 46.0 percent For Argentina.

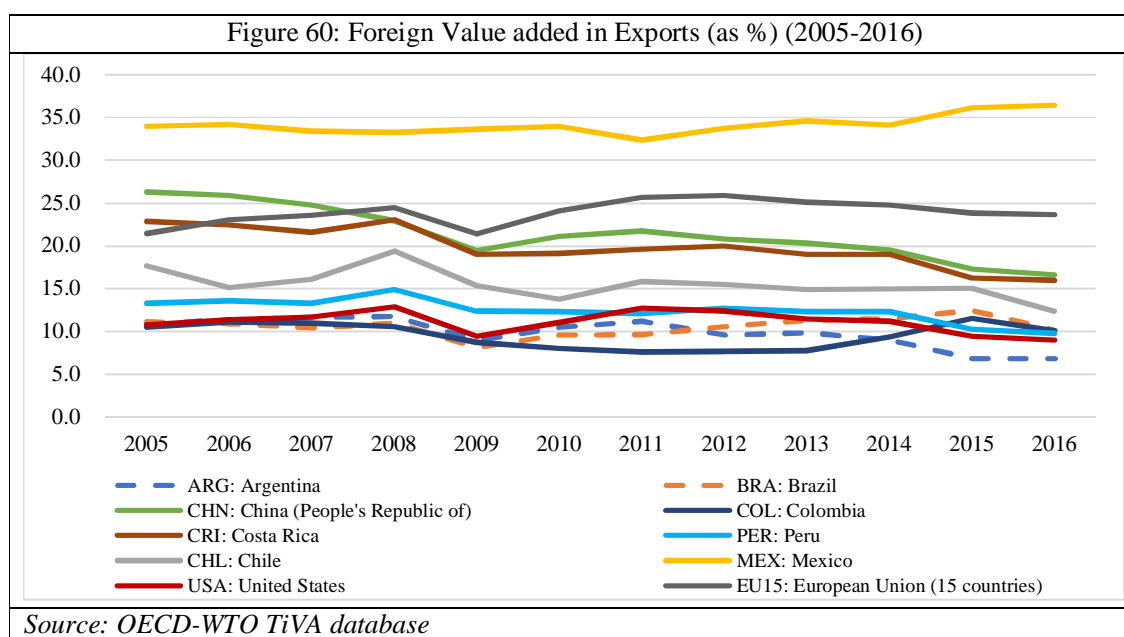


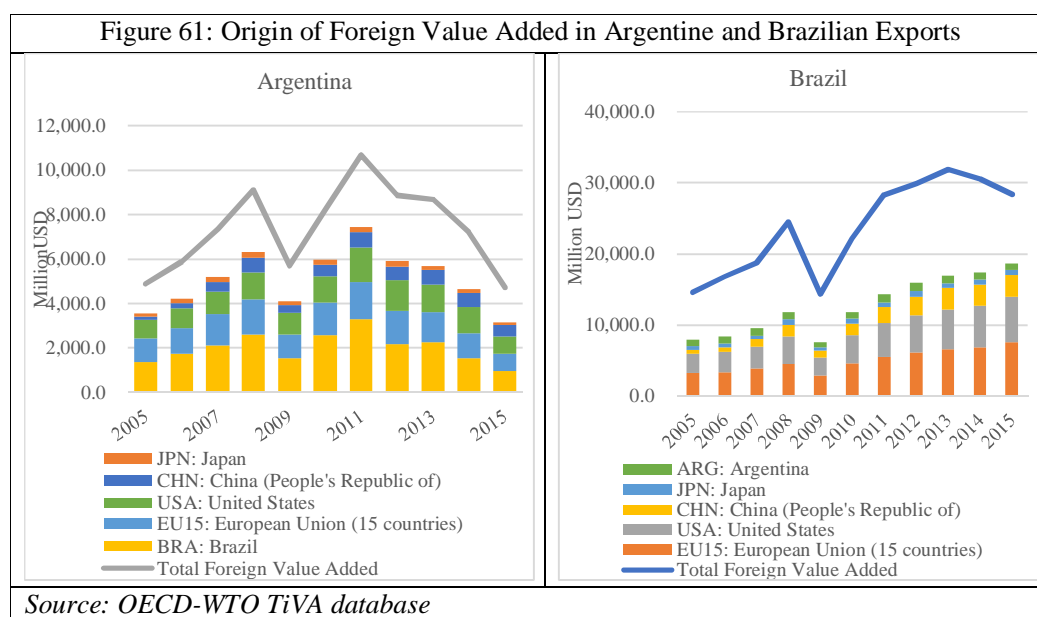
Table 10: Domestic Value-Added Content of Exports as % of Gross Exports (2005-2016)

	Domestic			Foreign (Backward Participation in GVCs)	Total	Total GVC Participation
	Direct	Indirect (Forward Participation in GVCs)	Re- imported			
2016						
Brazil	48.9	40.8	0.04	10.2	100	51.0
Argentina	58.8	34.3	0.01	6.9	100	41.2
2010						
Brazil	50.2	40.1	0.06	9.6	100	49.7
Argentina	55.3	34.1	0.03	10.6	100	44.6
2005						
Brazil	43.7	45.1	0.06	11.2	100	56.3
Argentina	53.7	35.0	0.04	10.9	100	46.0

Source: OECD-WTO TiVA database

Iapadre and Tajoli (2014) analysed the structure of RVCs and found that a successful RVC will resemble a hub-spoke system such that the hub, Brazil in case of Mercosur, would import intermediates from its spokes, in this case, Argentina, Uruguay and Paraguay, and export finished products to the rest of the world. Contrary to our

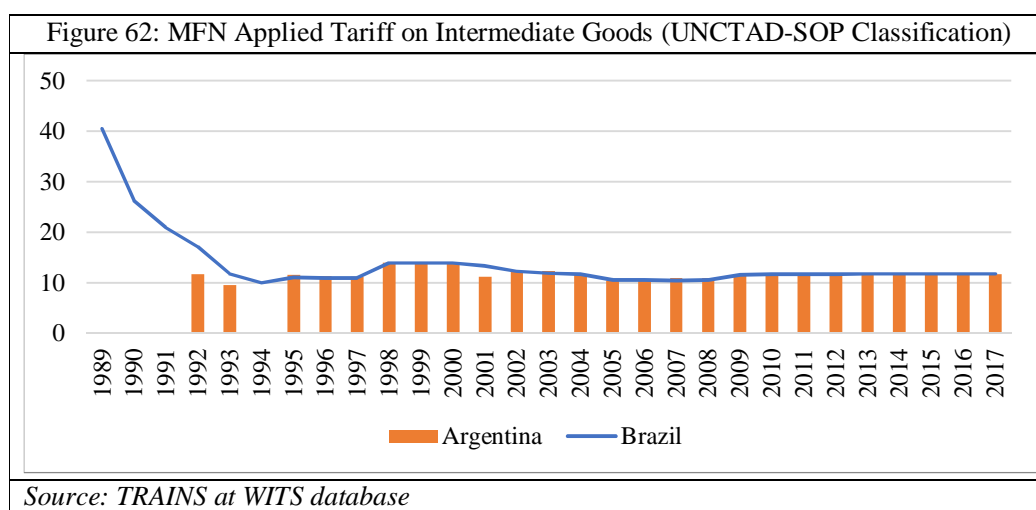
hypothesis, the foreign value added in Brazil's exports originates in extraregional partners such as EU, Japan and the United States rather than its regional partners. Figure 61 shows the origin of foreign value-added in Argentine and Brazilian exports. While Brazil contributed to a third of total foreign value added in Argentine exports in 2011, Argentina added only 4 percent to Brazilian exports in 2011. Baumann (2013) also discussed this hypothesis in terms of the hub-spoke model for RVCs in Mercosur countries. According to the hypothesis, countries should ideally experience a regional multiplier effect based on which, an increase in demand for finished goods exported by the hub should spur a demand for parts and intermediaries from spokes. However, the opposite is true in Mercosur; Brazil is a supplier of manufactured goods to the Mercosur members, while it imports primary products from them.



TARIFFS ON INTERMEDIATE GOODS

Another indicator of participation in GVCs is tariffs on intermediate goods. It should be expected that the lower the tariffs, the higher is the inclination to participate in production network by permitting imports of foreign-produced intermediates to supplement domestic manufacturing industry. Fig. 62 shows the MFN applied tariff on intermediate goods as reported by Argentina and Brazil. The early 1990s liberalization by the Brazilian authorities greatly reduced the tariff rates from 40.6 percent in 1989 to

10 percent in 1994 and stabilized at about 11 percent thereafter. Argentina also applied MFN rates of about 11 percent on all intermediate imports in the period 1992-2017.



In particular, Argentina imported an average of 4,245 tariff lines at HS 6-digit within intermediate goods, while Brazil imported an average of 4,773 product lines in the period 1990-2017. It was also found that both the countries have raised the maximum effectively applied tariff rate (abbreviated by the World Bank Group as AHS tariff rate)⁷⁵ on intermediate products in different periods. For example, Argentina raised its maximum rate (AHS) on imports of intermediate goods from 20 percent in 2006 to 70.81 percent in 2007 and 183.43 percent in 2010; this rate was gradually reduced thereafter to 35 percent during the period 2013-2017. It also remained fairly stable and low before 2007 with peak of 27 percent. For Brazil, the narrative is quite different. After the maximum rate (AHS) of 105 percent in 1990, Brazil has gradually reduced the binding to 35 percent since 2005.

The above analysis shows that Argentina has applied high tariff rates on imports of intermediate goods to protect its industry during 2007-2012. The rationale behind this policy move is however unclear. Perhaps Argentina was trying to protect its manufacturing industry in the period of overall economic growth. However, as pointed

⁷⁵ More information available at <https://wits.worldbank.org/CountryProfile/en/Country/ARG/StartYear/2013/EndYear/2017/TradeFlow/Import/Indicator/AHS-MXMM-RT/Partner/ALL/Product/UNCTAD-SoP2> and https://wits.worldbank.org/wits/wits/witshelp/Content/Data_Retrieval/P/Intro/C2.Types_of_Tariffs.htm

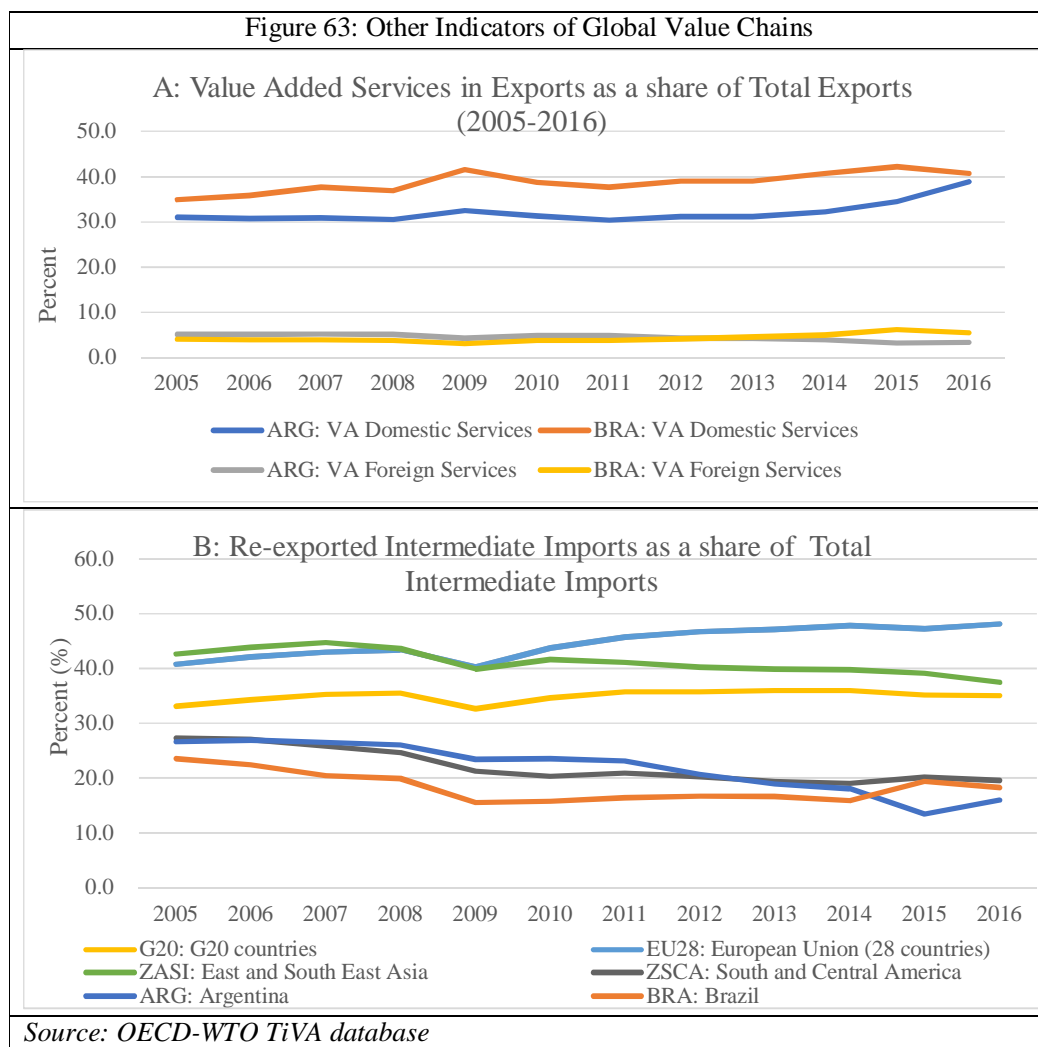
out in Fig 59A and Fig 59C, this period witnessed the largest bilateral growth in exports of parts and components (that are a subset of exports of intermediate products). The direct inference of that peculiarity is while Argentina applied high rates on imports of intermediate products from the rest of the world, it continued to grant preferential access to Brazil.

OTHER INDICATORS

According to OECD (2013), GVCs also involve a series of significant value additions by services in the pre-production (R&D) and post-production process (marketing and logistics). Services have become an indispensable part of the manufacturing process; business and infrastructural services are necessary for the smooth operation of value chains. In particular, development of infrastructure services is a precondition for the success of global value chains. Infrastructure services include transportation, logistics, telecommunication, finance and insurance (WTO-JETRO, 2015). Low and Pasadilla (2015) note that, *“The share of services in the firm’s value chain is expected to remain significant because the firm believes that in addition to price competitiveness, the principal determinants of success in the industry are factors such as product quality and reliability, design and engineering capabilities, product development, conformity to customer specifications, timeliness of delivery, effectiveness of the distribution organization, and the quality of after-sales support. Many of these are essentially services in character, or at least heavily reliant on services.”* Hence, the very existence of GVCs can be attributed to improvements in such services that has made the fragmentation and coordination of production tasks feasible (WTO, 2017).

Fig. 63A displays the recent trends of value addition by services in exports as a share of total exports for Argentine and Brazilian exports. Globally, services form a considerable share of total exports, but the pattern in Argentina and Brazil diverges from this trend. Domestic value-added by services as a share of total exports averaged to 30 percent in Argentina and 35 percent in Brazil in the period 2006-2015; while foreign value-added by services was almost negligible at less than 5 percent of total value of exports in the same period. Contrary to the assumption that Argentina is more closed than Brazil, Argentina actually added more foreign services in its exports as compared to Brazil up till 2011. However, the trend reversed in the period 2011-2016.

The low values for foreign services added to exports reveals the underlying concern: both Argentina and Brazil are closed economies and remain disconnected from international service providers, thus relying greatly on domestic providers. Foreign services can facilitate technology diffusion and knowledge sharing, both countries could potentially benefit from this opportunity through increased engagement with foreign service providers. In general, they must work together to promote their services sector and recognize the synergy that exists between the manufacturing and services sectors. Regional coordination in service provision could also help Argentina and Brazil to facilitate RVCs.



Another indicator from the TiVA database that reveals the extent of participation in value chains is the share of re-exported intermediate imports in total intermediate imports. According to theory, a high share indicates greater participation in global

production networks. Fig. 63B compares the trend for Brazil and Argentina vis-à-vis three regions: South and Central America, East and South East Asia, and the European Union (28 members), along with the average for the G20 group of countries. G20 countries represent 85 percent of the world's nominal GDP and comprises of strategically important developed and developing countries. Consistent with the earlier findings, both Argentina and Brazil perform the most poorly along with the overall average of the South and Central America region, in fact, Brazil performed worse than Argentina up till 2014. The share of re-exported intermediate imports remained under 30 percent for both the economies indicating that over 70 percent of all intermediate imports entered the manufacturing industry for the production of final goods meant solely for the domestic markets. Hence, it is clear that both Brazil and Argentina are not integrated in global value chains. The average for the G20 countries is slightly higher at 35 percent, while the share was the highest for the EU28 countries after 2009. The average share for East and South Eastern Asia was close to the average for EU28 countries before the financial crisis in 2008, but has converged to the G20 average thereafter.

Section 3: Automotive Regional Value Chain in Brazil and Argentina

Despite the lack of participation in global value chains, Mercosur members have integrated in a few sectors, however, they need to take steps to increase this participation and to identify other potential complementary sectors within the region to develop regional value chains. Some of the value chains that exist in the region belong primarily to the automotive sector and are notably in Argentina and Brazil. It can be said that these values chains have been an important engine for modernization of the automotive sector in the region and a supplier of the large demand for motor vehicles and cars in the region. Since the inception of Mercosur, Argentina and Brazil have lent active support for the automotive industry through cooperative automobile agreements aimed at reviving their domestic transport industries and initializing regional trade integration. However, the automotive industry remains disjoint from the international market due to protectionist policies, efforts could be made to make it more outward oriented. Notably, the automobile industry is characterized by external tariffs and domestic content requirements (Ciravegna, 2003) This ensured that automotive value

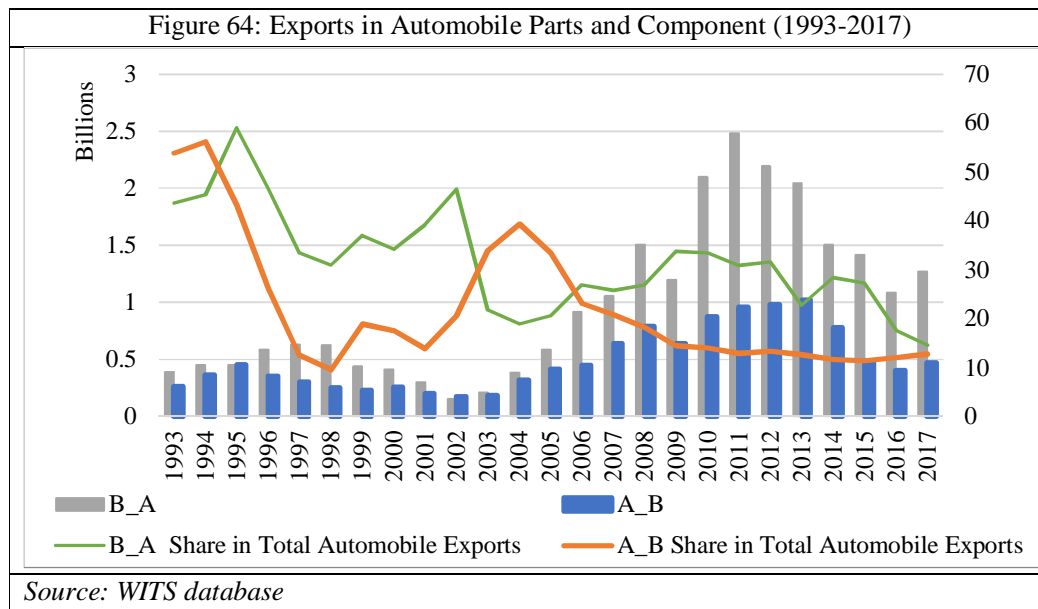
chains were located domestically. This move to minimize imported content forced firms to use global blueprints to adapt to local requirements, using locally available technology and materials. This led to an increase in production costs due to expensive local suppliers.

The reforms of 1990s lower tariffs on cars and parts that led to an increase in competition, and greater access to cheaper parts. At the same time, Argentina Brazil Uruguay and Paraguay formed the Mercosur bloc that coincided with the first automotive agreement between Argentina and Brazil: *Protocolo 21 (Programa de Integración y Cooperación Económica entre la República Argentina y la República Federativa de Brasil)*, April 1988. This was followed by a bilateral automotive agreement between Brazil and Argentina in 1990, details of which have been discussed in the previous section.

Ciravegna (2003) highlights that targeted public policies in the form of investment incentives, taxes, backward linkages with other domestic sectors of the economy, among others, have aided in the development of the industry in Argentina and Brazil. In recent times, trade liberalization effort, economic stabilization in Brazil and Argentina, increased demand for automobiles and regional efforts to consolidate the industries have led to the growth of the joint automotive sector in Mercosur. Assemblers began to look at Brazil and Argentina in a joint perspective and responded positively to the initiatives given by the respective governments to promote the automotive sector. This rationalized local operations and made them more efficient due to regional planning in establishing complementarity between production in Brazil and Argentina. For example, Fiat and Volkswagen regionalized the global value chain in automobiles through local exchange of information, standardization of suppliers, developing economies of scale and by avoiding duplication in production across the plants in Argentina and Brazil. They aimed to diversify and expand the bilateral trade in the automotive sector, with increasing participation of regionally produced parts (Agreement of Economic Complementation No. 14, Annex VIII: Economic Complementation in the Automotive Sector, Article No. 1, 1990).

Fig. 64 shows the recent trends in the trade of automobiles and parts between Argentina and Brazil from year 1993 to 2017. Bilateral exports of parts and components in the automobile industry have grown dramatically, notably from Brazil to Argentina. For

example, they grew from US\$ 393 million in 1993 to their peak of US\$ 2.48 billion in 201; and halved between 2011-2017 to just over US\$ 1.2 billion in 2017. In turn, exports from Argentina to Brazil grew remarkably as well and reached their peak of US\$ 1.018 billion in 2013. The largest growth can be seen since the turn of the century in 2002 till the recessionary phase in Brazil in 2013-2014. The figure also shows the share of parts and components in bilateral total trade in the automobile sector (right-hand side). The shares of both Argentine and Brazilian exports were at their peak closely after the signing of the Automobile Agreement in 1990. However, the shares plummeted with time to less than 20 percent in recent years. As mentioned earlier, both countries turned protectionist after the financial crisis of 2008; as a result, there was a sharp rise in the tariffs on imports of intermediate goods. The subsequent crises in Brazil starting in 2013-14 also depressed overall trade in automobiles and parts, notably due to decreased demand.



Section 4: Intra-Industry Trade

The previous sections have attempted to determine the nature and extent of value chains in the Mercosur trade bloc. Trade in intermediate goods is a clear indication of the existence of value chains. To supplement the earlier findings, this section explores the concept of intra-industry trade in the bloc. Intra-industry trade is defined as simultaneous exports and imports in the same industry. It can take two distinct forms,

it can be horizontal (trade in similar products) or vertical (transforming inputs into higher value output). Horizontal *IIT* is trade in goods of similar quality and offers a large variety of goods for the domestic consumers, while vertical *IIT* is trade in goods of different qualities; it lays the basis for value chains and as mentioned earlier, value chains are a subset of intra-industry trade.

Jensen and Lüthje (2009) have cited the origin of intra-industry trade in Linder's (1961) theory that assumes that “*the individual demand for quality of a given variety is increasing with income. Considering two countries, an overlap in income distribution determines whether the demand for a given good will exist in both countries.*” This demand will give rise to intra-industry trade in the given good with opportunities for both countries to produce slightly differentiated goods. It was Balassa (1966) that first introduced the concept of intra-industry and it was later upgraded to the present form by Grubel and Lloyd (1971)⁷⁶. It can be calculated as:

$$GLI = \sum_j w_j \frac{2 * \text{Min} (X_{ij}, M_{ij})}{(X_{ij} + M_{ij})}$$

$$\text{with } w_j = \frac{X_{ij} + M_{ij}}{\sum_{j=1}^n (X_{ij} + M_{ij})}$$

where, X_{ij} is the value of exports from a country to its partner country i in industry j

M_{ij} is value of imports by a country from its partner country i in industry j

and, w_j is the share of each industry j in total trade between a country and its partner i

The GLI measures the extent of intra-industry trade within an industry. GLI lies between 0 and 1; if a country only exports or imports products from an industry, GLI will be 0, conversely, GLI will take the value 1 if exports equal to imports in an industry. It is said that GLI also measures the openness of a country through trade liberalization, level of access to enabling infrastructure and trade facilitating efforts. It is known that countries that are geographically located away from economic hubs of

⁷⁶ Conceptualized from Causa and Cohen (2006), Egger, Egger, and Greenaway (2004) and Andresen (2003).

the world are less integrated in global value chains and will display a low GLI vis-à-vis partner countries. The lack of geographical proximity can be compensated by trade facilitation measures that reduce non-tariff barriers and reduce time spent at the customs through investment in enabling infrastructure; in such a way, “*GLI should be considered a variable that is representative of both geographical and institutional handicaps*” (Causa and Cohen, 2006). Krugman (1979) emphasized that IIT emerged out of a process called product differentiation in which, firms located in different geographical locations produced similar but slightly differentiated goods that were close substitutes (Gullstrand, 2002). Such trade was thus mobilized to provide a wider choice of goods to cater to consumer preferences based on their income levels and is mainly driven by productivity gains or increasing returns to scale (De Ferranti, 2002). This nature of trade can lead to development of greater specialization patterns in countries.

It has been hypothesized that countries geographically close to each other will display similar patterns of production and consumer preferences given the similarities in cultural and history. This will give rise to higher intra-industry trade due to lower information and logistics costs. Firms or industries located in these regions can form industrial clusters or agglomerates that benefit from knowledge spillovers and help develop regional specializations vis-à-vis the rest of the world (De Ferranti, 2002). The following section on the South American region, with particular focus on Argentina and Brazil tests these hypotheses. It is expected that the GLI between Argentina and Brazil will be high because of close proximity to each other and similarities in production and consumption patterns. Hence, the low trade complementarity between Argentina and Brazil would also contribute to the existence of intra industry trade between the two countries in the region.

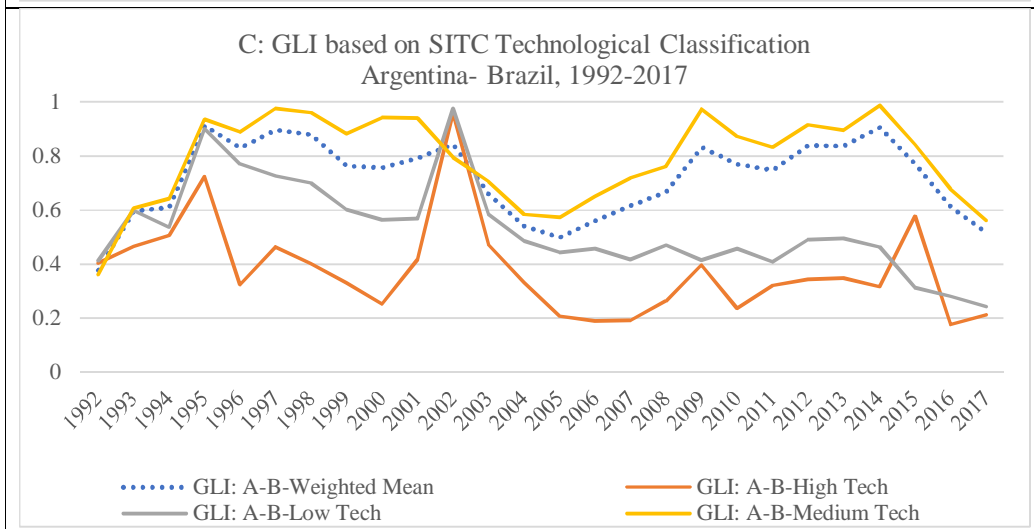
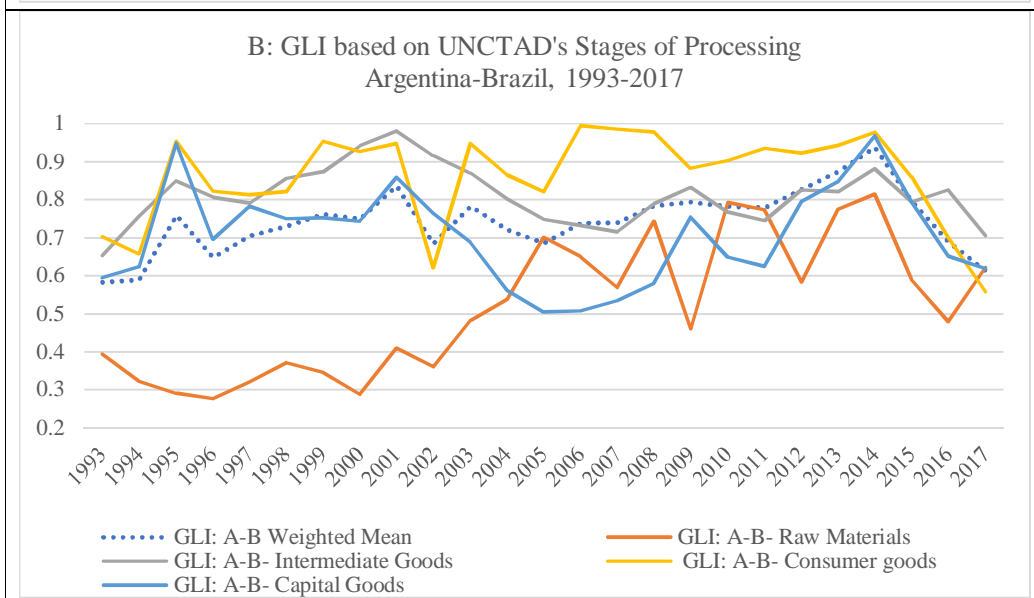
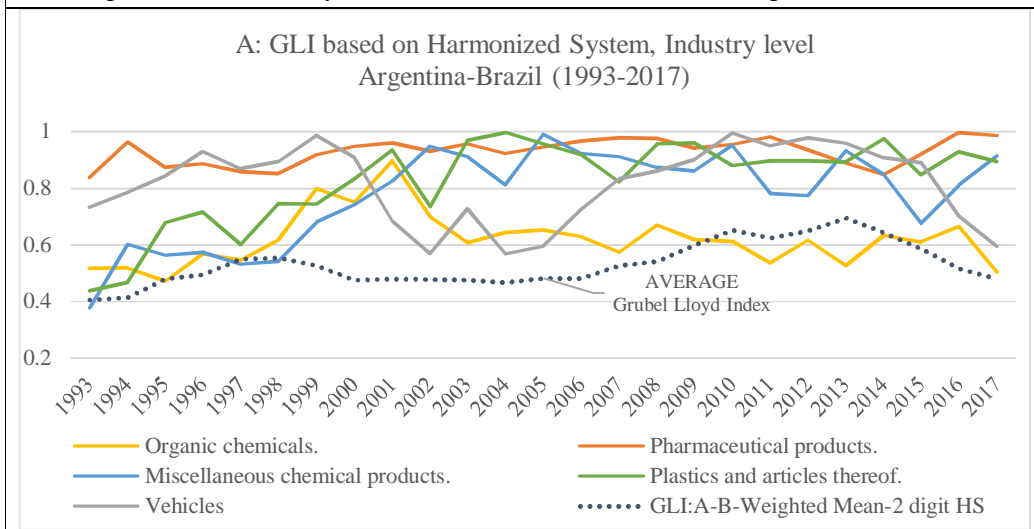
The GLI for trade between Argentina and Brazil has been presented in the figure below. It has been calculated on three products levels, on HS 2-digit industry level, on UNCTAD’s stages of processing level, and on SITC’s technology standard classification of goods. The industries in Fig 65A were chosen based on existing literature and our analysis confirms that these industries displayed above average GLI, indicating high occurrence of intra-industry trade. Notably, the weighted GLI for all the industries averaged to 0.5, with a peak in the period 2010 to 2013. This is low, perhaps

due to inefficient transport systems between the neighbours that leads to delays in transportation and adds to logistic cost, thus deterring growth of intra-industry trade.

Pharmaceuticals, Vehicles and Plastics displayed highest intra-industry trade; the trend has although been very erratic. For example, in the case of the automobile industry, intra-industry trade declined between Brazil and Argentina after the regional crisis in 1999 and lasted through the first half of the commodity supercycle to 2007. This trend highlights the trade policy decisions made by Argentina and Brazil that did not focus on engagement with its neighbour; it also reflects the fall in demand for motor vehicles and cars in the same period after the crisis. On the contrary, the GLI for the Pharmaceutical industry has remained stable over the fifteen-year period, suggesting that trade in 'necessary goods' is not influenced by changes in trade policy, nor by economic crises. Other industries with significant value of GLI were organic chemicals and miscellaneous chemical products.

Fig 65B calculates the GLI based on UNCTAD's stages of processing classification. Bilateral trade between Argentina and Brazil displayed a significant value of the GLI in Consumer goods, followed by Intermediate goods. High intra-industry trade in intermediate goods confirms the existence of value chains mentioned in the previous section. Trade in products originating in the automobile industry are included under both the categories and contributes to their high values. Subsequently, Fig 65C shows the GLI based on SITC's technology standards and categorizes goods into three tech-types: High tech products, medium tech products and low-tech products. As expected, the intra-industry trade in medium tech products is the highest and includes all the industries from Fig 65A- vehicles, chemicals, plastics and pharmaceuticals. An important observation from this analysis is that the GLI index for the same set of countries depends on the level of aggregation of the products. In most cases, over-aggregation leads to an upward bias in the GLI calculation. This is drawback of the GLI and the results should be interpreted with caution.

Figure 65: Grubel Lloyd Index for Bilateral Trade between Argentina and Brazil



Source: Computed by the author based on WITS database

Section 5: Way Ahead

It is clear that Mercosur members stand to gain from forming their own regional chains; given the level of integration among Mercosur members, it would be natural for members to expand vertical intra-industry trade. As predicted by Iapadre and Tajoli (2014), Mercosur value chain should ideally resemble a hub-spoke system such that Brazil can import raw materials and intermediate products from the smaller partners and export finished high-value products to the rest of the world. Such a system will lead to higher forward and backward linkages within the bloc and will be prosperous for all the members as well. Uruguay and Paraguay face low barriers when exporting to Brazil and Argentina; this lowers overall trade costs and benefits the exporters located in these countries. Such increased engagement will also raise the dependency of members on the Mercosur free trade area and lead to greater economic and social integration.

Twenty years ago, it was easier to develop GVCs, today, with the addition of intellectual property rules, it has become more difficult. Within the region as a whole, there exist regional value chains in the Automobile sector, for example under the automobile agreements between Brazil and Argentina. Apart from automobiles, there are three more value chains that have worked including Pharmaceuticals, Machinery and Textiles. But due to lack of leadership and available infrastructure, other value chains that had potential could also not be developed. To supplement regional productive links, countries need to harmonize standards in technology, salaries, infrastructure and research, such that countries can develop combined productive capacity to be more competitive in the external market.

It is common for members of a regional bloc to expand investment relations, align political ideologies and invest in enhancing social engagements; although Mercosur members have furthered political and social alignment, they stand to gain by investing in economic regional development aimed at improving connectivity, trade facilitation and raising the productivity of the region as a whole. Countries can explore the productive complementarity within the bloc and identify scope for regional value chains. Increased trade in parts and components can help develop national specializations that would reduce overlap in exportable products and competitiveness between members that compete for similar markets abroad. The resultant alignment in production would also attract greater foreign investment in the region as whole that

could benefit from a large unified ‘factory’ and market as well. However, this unification would require attempts to increase trade facilitation and connectivity between Mercosur members.

For further such integration, the governments need to build government-to-government and public-private bridges to foster production chains and cooperation based on complementarities in manufacturing industries. Being the leader of the pack, Brazil must initiate creation of *infrastructural corridors* to reduce production costs and increase exports. For example, the Brazilian railroads are not connected to the Argentine railroads. Goods must be de-boarded and transported in trucks across the border. One, it is time consuming and two, it is costly. The border controls and the customs procedures are very complex such that goods are stranded at the border for days because multiple agencies need to verify the quality and content of shipments. Thus, the partners could benefit from trade facilitation efforts.

Brazil and Argentina have already ratified the Trade Facilitation Agreement proposed by the World Trade Organization to simplify and reduce regulatory barriers, revise import and export licensing procedures, facilitate the insertion of MSMEs in foreign trade and reduce elaborate customs procedures by establishing single customs window. These measures can also be implemented by Argentina and Brazil within the Mercosur free trade area to increase intra-bloc trade. Today, Mercosur bloc is an imperfect customs union; the bloc leaders can initiate a trade-facilitation agreement in Mercosur along with greater investment in regional development aimed at all the objectives mentioned above to evolve into a truly-integrated common market.

Chapter 7: POLITICAL ECONOMY OF MERCOSUR

“Latin America is a remarkable example of how the concept of a region is not geographically determined, but shaped and reshaped by interactions among various regional actors, subject to international influences. The diverse regionalisms present in Latin America illustrate this vividly.”

- (Santos Lima, 2018)

Mercosur has evolved over the last thirty years, and its formation as well as its integration process has been influenced by historical events and several political factors. Notably, the tremulous past of the Argentine-Brazilian relationship, the external pressures from the European Union and the United States, as well as the internal asymmetries in size between the members continue to shape the bloc today. Paraguay and Uruguay are small countries and as demonstrated earlier, are economically dependent on its larger neighbors; moreover, Brazil is the largest country in the bloc and is believed to assert political pressures on the rest of the members. This chapter discusses these issues faced by Mercosur members since the late eighties. In particular, it discusses the political economy of Mercosur members- Argentina, Brazil, Paraguay and Uruguay. Unless otherwise mentioned, this analysis is based entirely on interviews with diplomats, policymakers, and economists in Brazil, Argentina and Uruguay conducted during the course of the thesis⁷⁷. The motivation for carrying out this exercise is to supplement the empirical analysis conducted in the previous chapters and enhance our understanding of the regional integration efforts in the bloc.

The integration efforts that led to the formation of Mercosur date back to the Argentine-Brazilian relationship in the eighties. It was marked by the strengthening of the relationship between Argentina and Brazil. The major incident that triggered this was Brazil’s explicit support for Argentina during the Falkland Islands War or *La Guerra de Las Malvinas* in 1982 (Caichiolo, 2017). Given that Brazil was Argentina’s traditional rival, Brazil’s endorsement of the Argentine claim on the islands was a positive political step towards greater peace and integration in the region. Later,

⁷⁷ A sample questionnaire and the list of interviewees are mentioned in Annexure 2 and 3 respectively.

between 1984 and 1989, both the countries signed a series of bilateral protocols to encourage trade. Alongside, the two countries signed a cooperation agreement agreed to cooperate on the development of nuclear energy for peaceful purposes, and to dissolve and permanently displace military units from the shared common border. This agreement laid the basis for the Treaty of Asuncion adopted in 1991 (Caichiolo, 2017). Hence, we must consider the historical events before 1991 that softened the one rivalrous relationship between the two large countries.

In 1989, the American government sent a strong signal of its intention to sign PTAs with the Latin American countries under the Free Trade Area of the Americas (FTAA). Both Brazil and Argentina perceived that individually they would be weak in their unilateral negotiation and understood they will be stronger together. Mercosur was thus established through the Treaty of Asuncion in 1991, following which, the CET was applied in 1994 to ensure that they could negotiate together with the European Union and USA. It was not a mere coincidence that the FTAA negotiations and those with the European Union began around the same time. It has been confirmed that the Mercosur negotiators used them to cross-negotiate for a better deal for Mercosur countries. However, the negotiations stalled after the crises in the bloc and later due to the emergence of a leftist-protectionist administration in three of the four members.

The inception of Mercosur was also marked by unilateral liberalization efforts in Brazil and Argentina. The CET covered all goods trade except the automobile and sugar sectors. The inconsistencies in the CET have contributed to several debated about the future of Mercosur as a regional trade bloc. Article 1 of Chapter 1 of the Treaty of Asuncion required countries to coordinate their macroeconomic policies and to harmonize legislature and rules in areas including commercial matters, customs matters, land transportation, maritime transportation, agricultural policy, industrial policy and labor relations among others (Annexure V of the Treaty of Asuncion). However, the present level of coordination and harmonization is questionable.

The findings from Chapter 3 indicated that each member state has had different experiences and these have shaped their commitment to the Mercosur bloc; hence, it is quite clear that each member state has had different expectations and commitments to the integration process in Mercosur. These differences could have been reconciled with the presence of a coordinating or *supranational agency*. However, as highlighted in the

following sections of this chapter, supranationality was never the end goal for Mercosur. In its absence, Brazil has assumed the role of the national leader, however countries continue to have reservations about its role in truly leading the bloc to further development and regional integration. Thus, intergovernmental coordination continues to govern the working of the bloc.

Mercosur has a long history of twenty-eight years and it should be analyzed according to the characteristics of the countries involved and not in a theoretical framework. This chapter is organized as follows: Section 1 explains the unique structure of Mercosur and focuses on the model of interpresidentialism that has allowed for *margin of maneuver* in the bloc; Section 2 addresses the pending issues in application of a perfect customs union and provides the view held by academicians and policymakers in the region regarding the economic future of the bloc; later, Section 3 highlights the ideological developments in the 2000s and the rationale for the Venezuela's accession; Section 4 presents the expectations held by the four member countries in the bloc in the nineties, as compared to their hopes today; Section 5 and 6 focus on the *non-economic determinants* of Mercosur's trade policy, both regionally and extra-regionally. Last, section 7 emphasizes on the need to view the integration process in a positive light despite its departure from traditional economic integration theory.

1. INTERPRESIDENTIALISM IN MERCOSUR

Mercosur bloc is often criticized for lack of harmonization between the members in terms of policy coordination and this has been attributed to the apparent lack of a centralized or supranational agency to coordinate the efforts of the members. Moreover, although the formation of the bloc had a strong economic rationale, political factors have contributed to the functioning of the bloc. One of the economists interviewed commented that “*the economic rationality in Mercosur was deeply nested in the political rationality*”.

Today, “Mercosur can be viewed through an intergovernmental lens: the main actors have been Argentina and Brazil, and their economic interests are the main drivers” of the bloc (Caichiolo, 2017). The intergovernmentalism model adopted by Mercosur does not lead to any kind of supranational institution and neither was it envisioned by any of its member states at the time of inception in 1991. Members have continued to maintain

national political loyalties and have not parted with the sovereignty over national matters. Individual preferences are a result of interactions among domestic interest groups that influence the national agenda. Hence, government decisions result from multiple interactions among a range of domestic actors, all pursuing their own interests. Later, direct negotiations are conducted between the Presidents of the member states. This model of interpresidentialism is well suited to the aspirations and interests of the larger members of the bloc as they get to control the pace and direction of the integration process in favor of their national industrial and political interests.

Notably for Brazil, Mercosur was a launchpad to increase its regional and international stature as the leader of South American nations. This stature and the bloc itself were instrumental in improving its bargaining power in the negotiations with the United States during the FTAA and with the European Union in the nineties. This was true for Argentina as well as it sought to preserve its autonomy in national issues pertaining to industrial policy and institutional structure, while engaging globally with an increased political clout via Mercosur. Thus, Brazil and Argentina managed to retain their “*margin of maneuver*”, resisted regional institutionalization within Mercosur, furthered their globalization agendas and maintained their regional position through “*de facto integration efforts*”. It was emphasized during an interview that the accession of Paraguay and Uruguay must also be viewed in similar terms. They responded to the potential losses from not joining the bloc as Brazil and Argentina were not only their natural trade partners, but were also two of the largest economies in the region. Particularly for the landlocked country Paraguay, who was largely dependent on its big neighbors for maritime access to engage in international trade.

The model of intergovernmentalism meant that all decision in the bloc were taken through government interactions and through consensus. Mercosur followed a special type of intergovernmentalism that was the “functional equivalent to regional institutions” (Malamud, 2003) and called *Presidentialism*. It was deliberately created and maintained as an intergovernmental organization, the founders insisted that decisions be taken through a process that exclusively involves unanimous consensus between national officials and presidents. All significant decisions were then adopted by the national legislature through a process of internalization and implemented by each

member. Thus, the adoption of any decision within the institutional structure of Mercosur passes through the process of *Double veto*⁷⁸.

Thus, the process depends on the absolute trust between the members who have unanimously agreed to implement a decision, but in some cases, the system could fall due to the unilateral decision of one member to disobey a consensual decision in the second stage of internalization. Such protocols are thus not implemented in the bloc and such a threat continues to exist in Mercosur. The critics among those interviewed believe that the absence of a supranational law has led to the differences in hierarchy and internalization of rules in each member state, such that they are free to select the nature of adoption of the protocols. There have been cases where the Brazilian supreme court has overturned some of the protocols adopted by Mercosur because they fail to “*harmonize with the Brazilian legislature*”. Contrary to the popular belief, Mercosur does not idealize the supranationality in the European Union and follows a pragmatic approach. Mercosur holds a functional view and has implemented what works for the members given their political situation. The politicization of the bloc caused by intergovernmentalism is more beneficial to the functioning of Mercosur than a supranational agency at the center. It has been established that supranationality will not make sense in Mercosur’s reality and it is not a step towards evolution of the bloc, “*it is an alternative but not a better solution to integration*”.

Countries have prioritized short-term national issues in their respective economies, with the idea that “*although we agree to negotiate together, we are still responsible for our people and their problems. At the beginning, they thought about maintaining sovereignty, and not transforming themselves into a single country- it was never a part of the plan of economic integration*”. Thus, the trade policy of each country highlights the immediate national interest, with the intention to work together and cooperate on regional issues. The right to navigate through national interests while supporting the Mercosur bloc was an active decision by the Mercosur countries. “*Expecting them to*

⁷⁸ Double Veto worked in two ways: the first veto was given to the presidents of each members to “block” the adoption of a decision during consensus- building; while the second veto was given during the process of internalization of the decisions taken. If a member failed to adopt and internalize a decision in its legislature, it was considered to be ‘not applied and not in practice’.

give up national sovereignty over pursuance of a common market system was never the idea nor the intention". Hence it is vital we see Mercosur through this lens.

Interviews conducted in Uruguay highlighted the importance of this institutional structure for the smaller members of the bloc. "The lack of supranationality allows the smaller countries like Uruguay to implement an independent trade policy without giving up national sovereignty on several policy fronts. Mercosur is not a deep integration model, neither does it require deep commitments. Although the provisions do not allow countries to negotiate unilateral trade agreements with third countries on issues of reduction or elimination of tariffs, countries are permitted to unilaterally negotiate other chapters with third countries. However, the smaller countries in the bloc are unable to attract third countries to sign agreements with them alone as they have a small market and are not attractive without the backing of the Mercosur bloc".

The unanimous opinion held by majority of the economists and academicians interviewed was that although Mercosur works well without supranationality, the bloc still needs a coordinating agency that can facilitate the building of equilibrium of different interests in a continuous way. "Countries, governments and the private sector must find new ways to work together in a rational manner, reconcile differences, while maintaining a degree of flexibility in the current economic and political realities, and predictability that can help foreign investors reap the benefits of a large-integrated market".

2. POLITICS OF A PERFECT CUSTOMS UNION

Mercosur is often criticized about the imperfect application of the CET and is compared to the European Union's (EU) experience in establishing a perfect customs union. However, it is well known that even European Union has exceptions to the customs tariff and its administration (European Commission, 2018). The comparison between the two regional initiatives was highlighted in Chapter 2 and is revisited in the following sections as well. It was found that it is not viable to compare EU, a customs area comprising entirely of developed countries with Mercosur, given the structural and geographical differences. Mercosur itself was a monumental decision as it was the first such agreement that involved all developing countries. After its inception in 1991, the members agreed to the establishment of a free trade zone and a customs union through

the implementation of the CET by 1995. Many interviewees believed that *“it was very ambitious of Mercosur to try to apply CET in four years; it was an unprecedented move and naturally, it was very tough”*. However, despite the hurdles, Mercosur members were successful in applying an imperfect CET that “gave a lifeline to Mercosur”.

On the contrary, some interviewees highlighted the array of existing issues and pointed towards the main debate today- “whether Mercosur should go back to a free trade agreement or go forward to form a customs union that they were unable to implement perfectly before”. A successful CET requires coordination of trade policy and reduction of the imperfections that exists. Conversion to a full Customs Union would create an intense debate about distribution of customs revenues collected, and the issue of double taxation. The scope for a customs union within Mercosur is dependent on the fulfilment of technical requirements; although it will cement the political commitment already made, it will require persistence of commitment by every member. Essentially, Mercosur needs to liberalize the sugar and automotive industries, remove or reduce non-tariff barriers, harmonize the CET, make greater and unwavering commitment to the integration process and ensure political stability in Brazil.

The rules in case of a perfect customs union will be applicable equally to the smaller members and critics believe that it is a difficult task for them even today. This concern questions the basis of the customs union that Mercosur members have attempted to achieve; the pertinent question to ask is, whether a perfect customs union is possible in Mercosur? The short answer is no. The asymmetries in the members countries in terms of their economic size and application of the CET confirm that Mercosur is unlikely to move to a full customs union, at least not in the medium term. Critics believe that it would require great political impulse to restart the process of homogenizing the tariff regime. The political momentum in 2017 within Argentina and Brazil had created political convergence between the Presidents of the member countries and it was possible to deepen the economic cooperation in Mercosur.

The aspirations set in nineties were very ambitious and unattemptable, but they were not unrealistic. In a better and more stable macroeconomic environment, Mercosur would have made better progress to attaining these goals; differences would have remained but they could have been solved in a more constructive way. The external issues, including rise of China hampered the growth and integration of Mercosur due

to instability in trade preferences. “Mercosur cannot be a perfect customs union due to the holes in the tariff regime but they can take steps towards deeper integration including trade facilitation, avoidance of double taxation, investment protection and inclusion of services”.

Today, Mercosur is characterized by a free trade area in addition to coordination in external negotiations and a common external tariff. It may not be a perfect customs union in theory, but advocates believe that “it works for Mercosur nonetheless”. Although Mercosur has been unsuccessful in creating the full customs union, it has built a network of economic interests and relations that were not present in the region before, and also changed the structural relationship of strategic competition between Brazil and Argentina, that is a positive effect and it is of utmost importance, despite “the failure in achievement of a theoretically sound customs union”.

Mercosur has achieved economically more than it could have achieved as separate countries, and that is “the real deal in understanding the benefit of being in the bloc versus the cost of leaving the bloc”. But the question is, is the CET really imperfect? Article 24 of GATT states that “in case of a regional agreement, the discrimination between members and non-members should be defined by the CET”. One of the interviewees aptly expressed that “Article XXIV of the GATT has different interpretations according to reality”, and in some ways, Mercosur’s *special* CET has made it possible for members to experience greater economic growth than otherwise predicted by an imperfect model of integration in theory. Advocates of Mercosur believe that members need to just “re-assign the rules of Mercosur” to adapt it to the current reality. Some even redefine Mercosur as an “*imperfect common market*”, given they have signed protocols on circulation of people, investment, productive factors and services.

3. IDEOLOGICAL MISMATCH IN THE 2000s

The negotiation of the Treaty of Asuncion included interactions between political, economic and social actors from the four members in addition to a representation from the labor unions and business associations from the members. It is believed that although the initial concept of Mercosur was rooted in “political alignment between the members”, the main rationale was economic in nature. Members aimed to increase

intra-bloc trade through economic integration and hoped to negotiate better market access for its exports with extraregional developed countries. However, there was a change in opinion in the new millennium (2000s) due to the growing political clout of the labor parties in Brazil, Argentina and Uruguay that contributed to the increased emphasis on strengthening the social aspects of Mercosur. As a result, this period was characterized by a *stalemate* in terms of both economic development and regional integration as economic progress was not a priority for the labor-party led administrations in the members. On the contrary, the members increasingly organized intergovernmental meetings to enlarge the concept of civil society within the bloc through engagement with the civil society organizations.

The same period was simultaneously marked by a shift in preference for negotiating extraregional trade agreements. Through the nineties, Mercosur countries were focused on negotiating terms with its biggest partners located in the United States, through the Free Trade of the Americas (FTAA), and an FTA with the European Union. However, in the 2000s, the governments were not focused on enhancing North-South relations anymore and the new focus was on the South-South approach to trade. Mercosur members chose to counterbalance trade deficit with developed countries with trade surplus with developing countries in extraregional trade. They began to look for potentialities to be explored with other developing countries. This new agenda can be categorized into three sub-agendas: signing PTAs with Jordan, Israel, Palestine; Accession of Venezuela; and the rising importance of BRICS and G20 for Brazil, China for Argentina, as well as new PTAs with India and SACU. These two sub-agendas have been explored in the following section.

Emphasis on South-South Relations

The Kirchner government in Argentina (2003-2007, 2007-2015), along with Lula's administration in Brazil (2003-2010) changed the philosophy of the bloc. Their priority lay in formalizing "shallow trade agreements with developing countries that posed little threat to their industrial sectors". The rationale was to increase "Brazilian integration with other developing regions" because they were not competitive enough to trade with the developed countries. The other members of the bloc did not agree with this ideology and were not in favor of signing trade deals with other developing countries. According

to the economic ideology under President Lula, trade was not a tool to raise productivity, instead, and “exports were good and imports were bad for their economy”; hence if Brazil signed a preferential agreement with a “poor” country, it will be able to export more than it could import and maintain a *desirable* trade surplus. One interviewee vehemently expressed that “*It seems this was a big excuse because Brazil was unable to cope with competitiveness of the developed countries, thus it preferred to divert all its attention to negotiating shallow trade agreements with developing countries and engaging in multilateral negotiations at the Doha Round*”. The Brazilian negotiators continued to use the “age-old excuse that developed countries refuse to give Brazil market access for their agricultural goods”.

During this period, Mercosur, backed by Brazil signed preferential agreements with Jordan, Palestine and Israel. Although Israel was a strategic trade partner in terms of foreign investment, generic pharmaceuticals, chemicals, fertilizers and plastics, the total imports from Israel amounted to US\$ 1.057 billion and less than 0.5 percent of total imports of the bloc in 2017. Hence, this agreement had little economic value. It is widely believed that these agreements were signed to improve Brazil’s south-south relations and foster deeper cooperation with other developing countries. Given these countries were not natural partners, these agreements meant little economically. “It was a failed attempt to increase the political clout of Brazil in global politics”; it was just “*political theatre by Lula’s government*”. This agenda also coincided with Brazil’s accession to BRICS and G20 group of countries that comprised mainly of other developing countries. Brazil’s multilateral engagements have been explored at length in Chapter 3. During the interviews, some experts in Uruguay and Argentina voiced their concerns that “Brazil should have taken all of Mercosur along in its multilateral negotiations, including the BRICS association. It is a shame that we were left behind by Brazil.”

Brazil had initiated the formation of the BRICS and the IBSA in the first decade of 2000s. It was also the time when Brazil led the negotiations with India and South African Customs Union (SACU) for a preferential trade agreement. Brazil spearheaded these negotiations after the formation of BRICS as it was important for them to “unify the developing world and create a political clout comprising of south-south countries”. It was Brazil’s trade policy alone that dictated this phase of negotiations for Mercosur.

However, through the interviews it was found that other Mercosur members “did not feel threatened by Brazil’s increasing involvement with the BRICS as geopolitically, they were very different groups to than Mercosur”. It was emphasized by economists in Brazil and Uruguay that the agreement with India had very scattered preferences and was signed due to purely political reasons. Brazil would not have liberalized its industrial sector and India refused to open-up its agricultural and textile sector. Hence, there was little economic rationale, thus, the agreements with India and later with SACU had very little coverage and did not impact Mercosur’s integration process and their internal relations.

Uncertainty Around Venezuela’s Position

The federal politics within Brazil play an important role in the overall regional position of perspective of Brazil. The underdeveloped states of the north-east were “left-out” of Mercosur and remain disjoint from the bloc. Hence, during the 2000s, Brazil was occupied in trying to balance its internal politics with the regional plan; it could not ignore its population for the sake of a bigger regional strategy. One of reasons cited for the inclusion of Venezuela was its geographical positioning vis-à-vis Brazil. Venezuela is situated in the north-east of Brazil and the inclusion of Venezuela was a way for Brazil to include its less prosperous area into Mercosur. Moreover, Venezuela was added to Mercosur to increase the geographic coverage of the bloc and to enhance energy security in the bloc, given Venezuela is the largest oil-producer in the region.

The other pertinent rationale for the addition of Venezuela was the coordination in the political ideology in Brazil-Argentina-Uruguay and Venezuela. The “*Lula-Chavez-Kirchner trilogy*” believed in the common vision for a bloc that was unified in political ideology. As mentioned earlier, the labor parties in these three members aimed to extend their national politics to the entire region. However, critics knew that the addition of Venezuela would not produce economic benefits and “it would bring more problems than solutions”. They believed that Venezuela’s entry into Mercosur would be problematic, and indeed it was.

Soon Paraguay was suspended as it did not approve of Venezuela’s accession in 2012. Moreover, Venezuela failed to internalize the existing protocols, notably on human rights in their national legislature and blocked Mercosur’s subsequent extraregional

relations as well. Moreover, it could not ratify the commitments made by Mercosur under ALADI in a four-year period. According to Treaty of *Ouro Preto Article 6*, a *Consejo del Mercado Común (CMC)* meeting must be held once a semester but the tensions due to the addition of Venezuela and suspension of Paraguay resulted in an unprecedented cancellation of the meetings. In 2013, then President of Venezuela, President Maduro was also blamed by Mercosur members for widespread human rights violation. Finally, within two years, in 2015, the change in political parties in Brazil, with the election of President Dilma, in Argentina with President Macri, and in Uruguay with President Vázquez, started the process that led to Venezuela's suspension in 2016 "due to failure to comply with Mercosur's democratic principles". Naturally, the new governments did not align with the "*Bolivarian ideology*" anymore and it was difficult to sustain Venezuela in the bloc.

4. MEMBERS' EXPECTATIONS FROM MERCOSUR

Power Role of Brazil

Without doubt, Brazil is the largest economy in Mercosur due to its sheer size in terms of land mass, population, GDP, and trade volumes. At the time of inception in 1991, Brazil's GDP was almost nine times that of Paraguay. Brazil is also the only country in the bloc with a positive trade balance with the other members. Thus, Brazil is the "natural leader of Mercosur" to the extent that Mercosur's overall external trade policy remains greatly influenced by Brazil's trade policy. Historically, Brazil's trade policy has been more stable than Argentina's trade policy. Until the late eighties, Argentina was a strong and stable economy but during the nineties, it was burdened with persistent crises after the inception of Mercosur. Naturally, Brazil assumed the role of the leader in the absence of an alternative; Uruguay and Paraguay were "too small" in terms of population, GDP, trade values or foreign investment. It is well accepted within the academic community that that they continue to be "dependent on Brazil for leadership".

It is believed that the formation of Mercosur was compatible with the Brazilian industrial and foreign trade policy at the time, while the smaller countries attempted to fit their economic agendas in the larger regional narrative. Mercosur also came at a strategic time when the productivity had begun to rise in Brazil around the late eighties. "Mercosur was not designed to increase the competitiveness of the countries or to

increase trade with the world; Argentina and Brazil formed Mercosur to protect their regional market from the rest of the world, in order to safeguard their industries from foreign competition, while securing a market for their manufactured exports with the region, especially in the smaller members”.

In the beginning of 1990s, Brazil was inclined towards trade liberalization and as previously mentioned, it undertook unilateral liberalization efforts to increase volume of trade and reduce barriers to trade. This was a “good moment for trade” and together with Argentina, they lay the foundation for Mercosur in 1991. Argentina was also in a favorable moment as their liberal government was also implementing unilateral trade liberalization measures to “*re-launch Argentina in the international market after a long hiatus*”. Some of the academicians in Argentina and Uruguay stated that “initially, Argentina was more inclined to open their market to the rest of the world, but Brazil convinced them to abide to the Brazil’s protective framework of Mercosur”. This protection was imposed by the private sector of Brazil and it extended to include Argentina as well.

Consequently, Mercosur also imposed these barriers to trade on imports from the rest of the world. The plan at the time was that “Argentina will buy industrial and automotive products made in Brazil and Brazil will buy Argentine wheat”. Brazil wanted to export manufacture products to the region as it was unable to compete with the rest of world due to years of protectionism that shielded it from global competitiveness and forced it to maintain low levels of productivity. The main intention for Brazil was to secure market access in the three members’ markets and to restrict them from signing agreements that threatened Brazilian competitiveness in the three countries. Hence, Brazilian entrepreneurs were also supportive of an agreement with Argentina as they needed its market for their exports. During the nineties, ninety percent of Brazilian exports to Argentina comprised of manufactured goods; thus, it is safe to conclude that Brazil had great dependence on the Argentina at the time of formation of Mercosur.

As mentioned earlier, Brazilian foreign policy has been focused on cementing its place “among the big countries of the world” by engaging in multilateral negotiations. Whether in its attempt to secure a permanent seat in the Security Council or in the OECD, BRICS or the prestigious G20. The underlying policy in its overall foreign

policy highlighted the need to promote its position in the world and equally emphasize regional integration at home (Jorge Ramalho, 2013). This decade witnessed the decline in economic importance of Mercosur in Brazil's foreign policy; during an interview, it was emphasized that "*Mercosur was not a label they carried between 2004-2010, it was a conscious decision and Brazil did not engage with the rest of the world as a part of South America. It assumed the identity of a BRICS country rather than a South American country at the time and the foreign policy choice was very obvious*".

Based on the evidence, during the first decade of 2000s, Brazil did not engage in North-South trade deals- "*it did not want to trade with them but be one of them*". Simultaneously, Brazil also experienced a momentous growth in its foreign trade due to the commodity supercycle and concentrated its exports in the Chinese market. During the commodity boom, Mercosur was not a priority for them and as the leader, it was expected that Brazil will take steps to increase competitiveness and productivity in the region. However, Brazil lacked incentives to develop a coherent strategy to develop the region. At the time, Brazil showed interest in being the leader of developing countries through BRICS. "*BRICSmanship*" was an agenda followed by Brazil that led to the preferential trade agreements with two of the partners, SACU and India. Regionally, "it continued to act as the leader of Latin America by projecting its external agenda onto other Mercosur countries, while avoiding pressing issues at home". Hence, it is widely believed that growth in exports due to the supercycle was the "perfect excuse" to not negotiate any new trade deal of economic value during the time. However, after 2011, with the decline in international commodity prices, Brazil began to improve the market access for its exports and redirected its focus on enhancing integration between Mercosur's members. Thus, "Brazil, once again, began to show leadership skills in Mercosur's external negotiations after 2011".

Critics believe that Mercosur needed a leader "who could sacrifice itself to concentrate on the bigger picture of the bloc; Brazil should have taken the responsibility but it never really did". They compared Mercosur with the European Union and commented that Germany and France assumed the leadership role in the European Union and would financially assist other members to stabilize the regional economy, but it was not the same in Mercosur. Brazil lacked the objectivity or the leadership in the foreign trade policy to integrate Mercosur in the global market through value chains because that

required greater liberalization within the bloc and with the global partners., but “Brazil was not ready to do that”.

The previous analysis of Brazil’s trade policy has revealed that Brazil does not have a consistent foreign trade policy; it wavers according to political and external economic impetuses. Historically, Brazil has liberalized by reducing its import tariffs, however, the temporal analysis of the agreements negotiated by it clearly shows that Brazil initiated negotiations with third countries during its crisis period. For example, Mercosur was formed as Brazil was recovering from a bout of hyperinflation of the eighties; later, the devaluation crisis of 1999 put a lot of pressure on Brazil and they pushed for the FTAA negotiations, negotiated preferential agreements with other developing countries and also joined the BRICS group between 2002-2008; the global financial crisis of 2008-09 lay the foundation for the relaunching of the Mercosur-European Union free trade agreement in 2010 that were stalled in 2012, but later revived and concluded soon after the political crisis of 2015-16. Thus, it is evident that “Brazil’s focus on the external agenda is a way to cement growth internally”.

Argentina’s Priority Set

Mercosur was a part of the liberalization agenda in the nineties undertaken by President Menem in 1991. At the time, the trade agenda of Mercosur was greatly influenced by the trade policy of Brazil. It is believed that had Brazil not been a part of Mercosur, Argentina would have lowered external tariffs much more than the agreed common external tariff by Mercosur. From the beginning, Argentina’s foreign policy office has been pro-trade liberalization, but the national agricultural clout has opposed liberalization. Agriculture is the main export-interest of Argentina and the little progress has been made in liberalization of agriculture in the world. Thus, the world, especially the developed countries continues to be hostile to agricultural exports and this has not helped Argentine interests.

The importance of Mercosur in Argentina’s foreign policy has not been stable and this feature is similar to the unpredictability of Brazil’s foreign policy. For example, President Menem in the nineties was convinced that Mercosur was necessary to further trade liberalization and unify the region; on the contrary for the Kirchner family from 2003-2015, Mercosur was not an immediate priority. This period was marked by the

increasing interest in China as a strategic partner and a greater protectionist tendency towards the rest of the world. There is clear evidence to say that the shift in trade policy was a result of the changing presidencies in Argentina. During the long reign of the Kirchner family, the importance of intra-Mercosur trade had been low and this led to underdevelopment of trade links between the members. This inward-looking trade policy towards the region was driven by domestic interest groups in the country.

However, after the election of President Macri, Mercosur was re-launched as a priority, perhaps to secure the trade agreement with the European Union, or to promote regional integration in general. This administration is inclined towards both internal and external agreements and as a result, there is a noticeable increase in cross-border trade, especially in automobile sector and an increase in investment flows between the partners. This political cycle in Argentina coincided with that in Brazil. Hence, Argentina and Brazil are more connected today than ever.

Expectations Held by The Smaller Countries: Uruguay and Paraguay

In the nineties, Uruguay believed that they would be stronger with Mercosur and could benefit from the alliance between two of its biggest neighbors. Uruguay had a lot of hopes from Mercosur. One of the objectives of Mercosur was developing value chains with the small countries but Uruguay and Paraguay were reduced to suppliers of only commodities. Uruguay is a very small country and relatively rich among others. At the time of the inception, Uruguay wanted to be a “part” of the negotiations, and participation in Mercosur was considered to be “an important win at the time”. Given Uruguay is a *very small country and with low capacity for negotiations*, “the Mercosur platform was a trampoline”, thus, Mercosur was a way to be economically connected to the rest of the region and the world. Today, Uruguay faces several restrictions to growth, and Uruguayan representatives believe that it must make efforts to grow the demand for its exports in order to achieve economies of scale. During the time of the inception of Mercosur, it was hoped that Mercosur would provide a large internal market for Uruguayan exports, however, it has proved to be insufficient as per its needs. Some of the academicians in Uruguay expressed that their country “needs to expand its frontiers beyond Mercosur” to reap benefits from an export-led growth.

The Uruguayan trade policy is different from the Brazilian and Argentine trade policy. It is less protectionist than Mercosur's CET, and its licensing and customs procedures are quite simple as compared to other members. Given Uruguay is a small country dependent on trade, it needs to sign external trade agreements to increase market access and achieve economies of scale by expanding the demand for its products in international markets. Until twenty years ago in the nineties, Uruguay was highly dependent on Brazil and Argentina for their domestic markets. However, after the 2001-02 crisis in Argentina, efforts were made by the government in the form of incentive packages to diversify export destinations and avoid such a demand failure in the future. As a result, the Uruguay's dependency on intra-Mercosur trade has reduced. Uruguay has been inclined to signing agreements with "North" countries and not "South" countries to find a suitable market for its agricultural exports. However, the economics of Mercosur have been driven by political negotiations with Latin American countries and with other developing countries to find ways to support the national industries in Brazil and Argentina.

Uruguay has recently developed competitiveness in certain key industries and is prepared to negotiate agreements with China, Canada, European Union and the United States. China is one of the largest trade partners for Uruguay outside Mercosur. Naturally, closer ties with them would be a great opportunity to reduce the trade barriers faced by Uruguayan exporters at the Chinese border for processed agricultural products. Such an agreement would be an ideal way to counter the preferences given by China to its global competitors such as New Zealand, Australia and the United States, especially in exports of Bovine Meat. However, "given the apprehension of Brazil and Argentina, Uruguay is unable to strike a suitable deal with China; the large members remain protectionists and fearful of dumping from China".

Some of the questions during the interview were aimed at understanding Uruguay's role in Mercosur. It was found that Uruguay has respect for law and internalizes the protocols adopted by Mercosur easily. Given both Argentina and Brazil are big countries and are concerned with protecting their industries, Uruguay provides the balance and plays the role of the mediator. "It is *institutionally solid, economically stable and, politically sound*". This has attracted investors to the country and the recent increase in investment has compensated for the loss from extreme protectionism in

Mercosur. Moreover, unlike the larger countries, Uruguay does not have any power of retaliation. Countries frequently use non-tariff measures against each other, for example, Brazil imposed protective trade measures against Uruguay with the suspicion that the Milk exported by Uruguay to Brazil had originated outside Uruguay. The only solution was diplomatic talks due to the lack of a bidding dispute settlement mechanism in Mercosur. Critics believe that “Brazil should have made direct consultations and not just stopped the channel of trade”. Perhaps, the problem originated in the private sector lobbies in Brazil. Uruguay is very prone to these concerns because they don’t have the capacity to respond; but, when this kind of measure is imposed on Argentina, there is a fear that they would retaliate.

Uruguay joined Mercosur with great expectation from the integration process, but the reality set in. Despite the myriad of problems in Mercosur, Uruguay continues to trade extensively with the bloc. There has been extensive talk in the academia of Montevideo that “Uruguay would be better-off exiting from Mercosur altogether because it does not provide solutions to structural problems in Uruguay, including its small market size”. Although statistics shows that Uruguay can sustain as an individual country outside of Mercosur, there is a legitimate fear that Brazil and Argentina, being the natural partners and big neighbors, could impose barriers on Uruguay. Being left out from Mercosur was worse than being a part of the *stalemate* agreement. There are no better alternatives because “if they leave, they will have to re-negotiate rules of origin with the two giants Argentina and Brazil and that will not a favorable negotiation for a small country like Uruguay”. Apart from trade in goods, Uruguay is also heavily dependent on Argentine and Brazilian tourists every year. If Uruguay decided to exit Mercosur, they would have to face the repercussions, including the backlash from the industrial sector. Critics believe that those who advocate that Uruguay should exit Mercosur fail to understand the cultural and social ties between the countries and have based their decision on simple macroeconomic factors.

Paraguay joined Mercosur with political and strategic considerations and to ensure continuous access to its most important trading partners. Given that Paraguay is landlocked between Argentina and Brazil, it is heavily reliant on the port and maritime services of the two neighbors. It is also a small country and trades extensively with these two countries such that they are the largest market for Paraguayan exports. Hence,

it is clear that it will lose more by not joining Mercosur than gain by joining it. However, under-invoicing and smuggling of goods in and out of Paraguay is a common and known problem. The *Regimen de Turismo* has been effective in curtailing some of the black economy transaction. Moreover, a large share of trade reported and destined for Brazil or Argentina is in reality, destined for the international market.

Paraguay has worked to address the structural asymmetries between the members and looks for *Special and Differential Treatment from Mercosur* to apply the new rules and protocols, as well as for financial assistance in the form of investments from the bloc. On the contrary, the other small members, Uruguay has looked for solid institutional and regulatory structures in the bloc and calls for harmonizing of fiscal and monetary policies to reduce the distortions that exist. Although both of them are small economies, their situations are very different. While, Uruguay is a producer and exporter of Wind Energy and Biofuels and Paraguay is the largest producer of Electrical energy in the bloc. Its relationship with Brazil is unique due to the power-sharing agreement at the Itaipú Dam. According to the treaty signed in 1973, Brazil and Paraguay each receive half of the electricity produced and given Paraguay's smaller size, the left-over electricity from their share is sold to Brazil in exchange of a suitable compensation. Hence, unlike Uruguay, Paraguay is greatly dependent on Brazil and Argentina for their market and is an important energy producer for the bloc as well. Clearly, Paraguay's rationale for joining Mercosur in 1991 was mostly due to its geographical restrictions and prospective economic prosperity.

Both the smaller countries in the bloc, Uruguay and Paraguay had joined Mercosur as a gateway to the rest of the world, with obvious expectations that Brazil being the largest economy in the region would use its global geopolitical position to promote all the members in the bloc, but they were disappointed. Although Brazil has projected its image as the "*big brother*" in Mercosur, it has been unable to consolidate efforts for further regional integration in the bloc. There is greater scope for Brazil to mediate talks on internal issues as well. Most interviewees believed that given Brazil's position, it must exercise greater responsibility towards the bloc.

5. INTERACTION WITH PACIFIC ALLIANCE

South America is a priority area for Mercosur and it has trade surpluses with all its regional partners. It was difficult to negotiate with all of South America under the same agreement, hence Mercosur has signed bilateral agreements with all the South American countries under the ALADI Framework. *These regional efforts are usually overlooked and Mercosur is heavily criticized about being a protectionist bloc.*

Mercosur has made progress within the region in terms of tariff liberalization, for example, signed tariff agreements with Andean Community members Bolivia and Ecuador, and all the Pacific Alliance members except with Mexico. Additionally, all the members of Pacific Alliance except Mexico are associate members of Mercosur and all Mercosur members except Brazil hold the observer status in the Pacific Alliance. Moreover, Mercosur and the Pacific Alliance approved a roadmap in six areas in April, 2017 including trade facilitation, non-tariff barriers, rules of origin, regional value chains, small and medium enterprises and services⁷⁹. These agreements have also initiated dialogue between the Mercosur members to cooperate on these issues within the bloc as well. Hence, *“the regional integration efforts have cemented the need to integrate with other Mercosur members as well”*.

There are some similarities between the two blocs: Uruguay in Mercosur is very similar to the Pacific Alliance members, Chile and Peru. They are all small countries and do not have a large national industrial base to protect, they rely on a few natural resources and are keen to open their markets to the rest of the world. While Chile and Peru have been successful in doing so, Uruguay has remained constrained in the Mercosur bloc. A recent debate surrounding the relationship between the two regional initiatives in South America has led some to believe that the *“Pacific Alliance is indeed a role model*

⁷⁹ They can implement trade facilitation measures from Bali Ministerial Conference and use experience sharing from the Pacific Alliance. The next step is Accumulation of Origin and formation of regional value chains by harmonizing the rules of origin, stimulating use of regional inputs in the final products exported to the regional markets and creating better connectivity in terms of transport and logistic services. Today, the cost of importing from the other Pacific countries is lower than the cost of importing from the region. South American countries could learn from the experiences of the European Union members in expanding intra-regional trade and value chains. Together, they need to invest in regional projects and explore the complementarities between the countries in the region. Moreover, Pacific Alliance members have free trade agreements with both Australia and New Zealand, and given Mercosur members are natural competitors, they need to strengthen their trade with the Pacific Alliance to continue to reap the benefits of market access.

for Mercosur countries”. Although both the initiatives were formed with very different rationale in mind, Mercosur does perceive Pacific Alliance as being “aggressive” and courageous in signing agreements with developed countries. They have sold themselves as a combined hub in the Pacific to attract investments and trade in goods as well as services. Moreover, as mentioned earlier, the Pacific Alliance has signed “modern” trade agreements with deep commitments with other countries and this has forced Mercosur countries, amid growing concerns that Mercosur is not a modern-updated bloc, to begin an internal dialogue to negotiate similar commitments. During the inception period of the Pacific Alliance, “*Mercosur members hoped that they could work together towards a unified free trade area of the South America*”. This is turning into a real possibility given the “mothership” role played by ALADI⁸⁰. Under the chapeau of ALADI, the only agreements pending are those with Mexico, including those between Mexico-Brazil, Mexico-Argentina and Mexico-Venezuela. Mexico renewed its interest in deepening integration with Mercosur countries. Interestingly, this renewed interest in its “Latin Brothers” coincided with the call for renegotiation of the NAFTA by President Trump.

6. MERCOSUR’S EXTRAREGIONAL RELATIONS

The main incentive to negotiate preferential and cooperative agreements is to use these international negotiations to lock-in policy reforms that have been difficult to implement otherwise at home. Mercosur is a prime example of this tendency. The new age trans-regional agreements such as the Trans-pacific Partnership, Transatlantic Trade and Investment Partnership and the Regional Cooperation Economic Partnership have become the basis for negotiations around the world for many countries in different chapters and levels of commitment. These agreements will potentially lead to losses for those not party to them and this especially includes Mercosur. As mentioned earlier, the external trade agenda of Mercosur is greatly influenced by Brazil’s internal and

⁸⁰ One of the principles of ALADI is providing flexibility in signing agreements between countries. The goal of ALADI according to *Tratado de Montevideo* of 1980 (Article 1) is to create a free trade area under ALADI. In 1998, only 35 percent items were liberalized, in 2017 it was 82 percent. The remaining 18 percent are made up of protected industries including agriculture and automobile. Most of the agreements signed under ALADI are outdated- they need to be upgraded to include ROO, IPR, Public Procurement and services including e-commerce, and digital trade. This will spur growth and development of regional value chains.

external policies. Brazil needs to catch up to the new age agreements⁸¹. As mentioned earlier, during 2000-2010, Brazil was “obsessed with the multilateral Doha Round and was cut off from signing bilateral-regional agreements”. This period has been aptly termed as a “*lost decade*” for Brazil. The Doha stalemate of 2012 led to a shift in focus on bilateral agreements and the end of the commodity price cycle was also a wake-up call for the Mercosur members. It was imperative that Mercosur engaged in negotiations, implemented liberalization policies and undertook other economic reforms to continue the growth momentum.

Recently, Mercosur members have come to appreciate the importance of and the impact of the international negotiations on internal and regional integration process. For example, Mercosur presented the Government Procurement protocol to the European Union and that started a dialogue in the bloc as well. This way, Mercosur *internalized the external process*. Brazil and Argentina have also realized that the countries can learn new things from the new partners in areas such as trade facilitation, productive means for cheaper goods, and ways to absorb higher technology. “*Given the current political dynamics, the focus for Brazil is on the region*” and it aims to create regional value chains as the first step to international integration, while using Brand Mercosur to negotiate its new deals. This optimism led to the conclusion of the FTA with the European Union in July 2019. Two important trade initiatives have been discussed in the following sections: the proposed FTAA in the nineties and the simultaneous negotiations for an FTA with the European Union. These two external negotiating processes exerted tremendous pressure on Mercosur and its internal dynamics. They addressed the weaknesses in the bloc and coerced Mercosur members to introspect and solve these real issues.

Free Trade of the Americas

The Free Trade Area of the Americas was proposed as the “trade liberalizing cornerstone” (Bruner 2002) by President Bush’s administration that had earlier also

⁸¹ Although the Brazilian industries are protected from international competition, they are threatened by the Chinese and Korean goods. Brazil feels the need to increase its competitiveness by producing cheaper goods, high-tech goods and services as well. The Brazilian domestic market is not sufficient for the industrial sector anymore and it needs external markets. The support that was earlier missing from the private sector is now available to the government as they see external competition as an opportunity to grow, be more productive and be more competitive. This new support from the private sector was well-balanced with the economic and the political stability in the region after 2017.

promoted the “Enterprise for the America Initiative⁸²”. President Bush envisioned a free trade area from “*Alaska to Tierra del Fuego*” (Saguier, 2007; Phillips, 2002). This process began at the Miami Summit in 1994 where 34 countries vowed to the creation of the FTAA by 2005, but the formal talks began four years later at the Santiago Summit in 1998 (Carranza, 2004). FTAA has been defined as an effort to promote “*minilateral geographically concentrated regionalism*” (Feinberg, 2003).

The FTAA Plan of action⁸³ targeted a broad range of economic and non-economic issues including trade, democracy, corruption, poverty, science and technology, drug trafficking and gender equality. This plan created a bridge between “*hemispheric free trade*” and the democratic values of North America. The FTAA was the “most ambitious free trade initiative of the postwar trading system”, never before had “so many countries of such diverse sizes and levels of development joined to negotiate a reciprocal free trade agreement” (Schott, 2005). The proposal of the FTAA coincided with the general trend in Latin America to move away from the import-substituting industrialization policies of the seventies (Schott, 2005; Bruner, 2002) and towards trade liberalization by the adoption of the Washington Consensus (Carranza, 2003).

For the United States, it was a tool to bolster the unified Western Hemisphere position as a market for American exports and at future WTO negotiations. The FTAA was a result of the impatience towards the WTO’s slow multilateral negotiations, especially during the Uruguay round and was structured to compensate for the deficiencies of the multilateral negotiations and speedup the liberalization process (Bruner, 2002; Phillips, 2002). It consolidated the United States’ supremacy in the region and “*reasserted the US hegemony in the Western Hemisphere through its imperial project*” (Carranza, 2003, 2004; Feinberg, 2003). Bruner (2002), Katz (2002) and Phillip (2002) note that it was a way for the United States to underpin stability, security, liberal democracy and avoid narcotics trafficking in the American region, thus “*embedding a neoliberal project in region*” that had already adopted the “*neoliberal reforms*” during the nineties as a way for trade liberalization and deregulation. These negotiations coincided with the efforts made by the European Union to gain market access in the Latin American

⁸² The Enterprise for the America Initiative was designed to support democracy and pro-market reforms in Latin American Countries (Schott, 2005).

⁸³ More information at https://www.ftaa-alac.org/ministerials/plan_e.asp

region and the APEC negotiations to create a free-trade area in Asia-Pacific (Schott, 2005); hence the United States used the FTAA to slowdown competing European moves in the region (Carranza, 2003; Katz, 2002). The FTAA has been aptly defined as the “*entrenchment of the hegemony of the US*” (Phillips, 2002). Although it did have economic benefits for the United States in the form of lower tariffs, reduction of “*bothersome regulations*” and increased trade related predictability and transparency (Feinberg, 2003), it was to be used as a “staging ground for the impending battle for the world market among the leading centers of capitalist powers” (Carranza, 2004). The plan also included a “democracy clause” that excluded Cuba from the negotiations, much to the United States wishes (Bruner, 2002).

For the smaller countries in the region, it was a way to cement the existing dependency on the regional market. After the formation of NAFTA, LAC countries eagerly pursued NAFTA membership or at least bilateral trade agreement with United States to “avoid cost of exclusion”. This defensive incentive for those excluded was based on the availability of a large market for export and FDI in the United States (Carranza, 2003; Bouzas, 1995).

For Brazil, it facilitated greater market access to the United States’ market and worked to reduce the fear of trade diversion from NAFTA agreement with Mexico (Bouzas, 1995). However, Brazil believed that the non-tariff barriers in terms of quality and hygiene and antidumping laws were to “*keep Brazilian goods out*” of the United States (Bruner, 2002). Brazil emphasized on two negotiating principles for the FTAA: one, the agreement will be a single undertaking with no interim agreements, thus restricting the United States from signing “incremental agreements” to liberalize sensitive sectors and two, the smaller countries can organize themselves as blocs to reduce the disparities and increase their negotiating leverage (Bruner 2002; Carranza, 2003, 2004). The adoption of these two principles was a “diplomatic victory for Brazil” and legitimized Mercosur’s collective stance in the negotiations (Carranza, 2004).

However, Brazil continued to have political issues with the FTAA. It was “*fundamentally uncomfortable with the US hegemony in the Western Hemisphere*”. Bouzas (1995) quoted the Workers Party of Brazil as “the FTAA is *not a free-trade agreement* but a process of *economic annexation* of Latin America by the United States”. “Brazil [viewed] its role in the hemispheric politics as quite different from that

of other Latin American nations” (Bruner, 2002) and “[wanted] *to consolidate itself as the regional hegemon in South America*” to avoid the hub-and-spoke model that the United States was aiming to create as an extension of the NAFTA (Carranza, 2004). The FTAA came at a high cost of foregoing subregional autonomy in Mercosur and Brazil felt the need to forge a unified South America negotiating bloc that was “capable of standing up to the United States”; hence, it proposed the South American FTA (SAFTA) under the Brasilia Communique (1993), as a way to expand Mercosur and consolidate the negotiating leverage. Mercosur came to be a counterweight to the US’s hegemony in Latin America (Schott, 2005). This integration effort was seen as “*a building block towards larger hemispheric integration*” (Bruner, 2002). The same document also reaffirmed Brazil’s focus on parallel negotiations with the European Union that instilled fear in the United States of the ability of the Southern Cone to negotiate an FTA with the European Union at their cost (Feinberg, 2003). Through this, Brazil sought to on one hand, “*play one external trading partner against the other*” to reduce dependence on a single partner and to establish an “*auction dynamic*” between the two partners for the South American market; and on the other hand, wanted to push for greater liberalization in lowering barriers to Brazilian agricultural exports.

These efforts by Brazil to unify South America were met by an effort by the United States to “fragment South America through bilateral negotiations” with each country separately by using its asymmetric structural power (Bruner, 2002 and Carranza, 2004). These bilateral negotiations were seen as a way to expand NAFTA, one country at a time. It would have been much easier for the United States to persuade a single country to accept its demands rather than an organized bloc. This was aimed to “*isolate Brazil* by negotiating bilateral trade agreements with Brazil’s neighbors” under the policy of “*divide and rule*” (Feinberg, 2003). One such case was the proposed FTA with Chile in 2000 that coincided with its full membership of Mercosur. The USA positioned this agreement as a way to provide further impetus for the FTAA negotiations. This common position of US-Chile weakened Brazil’s negotiating power and the creation of SAFTA. It also signaled to the rest of the Latin American countries that they can obtain access to the US market in a simpler way. Hence, the United States did not hesitate to use it to leverage in terms of asymmetry in market power against the smaller Latin American countries.

The other issue faced by Brazil was the difference in opinion with Argentina, owing to the new numerous trade disputes between the two, the recurrent crises in Argentina and Brazil efforts to strengthen its subregional leadership. Argentina was looking for faster negotiations with the USA as opposed to Brazil's glacial pace, especially in capital goods that were protected by Brazil. This tension coincided with the idea to revert to an FTA (Mercosur) so it could push bilateral relations with the United States. This led to a fragmented negotiating agenda in Mercosur (Bouzas, 1995). However, the initial inclination of Argentina towards the FTAA soon dissipated during its implosion in 2001 as it failed to gather the support of the United States; "the callous indifference of the US towards Argentina's plight in 2001 – 2000" lead it to strengthen a strategic alliance with Brazil instead (Carranza, 2003).

The examination of the FTAA process revealed the dominance of "realism" in the negotiations such that "power determines the outcome of state interventions". As a supplement liberal international relations theory says that "state behavior is not only affected by international balance of power but also by the relationship between the state actors and the government". Hence, domestic interest groups exerted pressure on policymakers, amounting to complex priorities and international dealing – in the case of FTAA, the major domestic political lobbies in Brazil and the United States were resisting a compromise (Saguier, 2007). This can be understood as a two-level bargaining game in which level one was conducted at the American Summits and trade minister conferences and level two beginning involved "parallel discussions among domestic constituents over the pros and cons" of the agreement (Carranza, 2003).

Given the problems between Brazil and the United States, the process came to be characterized as the ability of Brazil and USA to reconcile their competing demands and achieve convergence of views (De Paiva Abreu, 2006). The added pressure of the United States to include labor and environment rules as advocated by civil rights domestic movement, the Hemispheric Social Alliance⁸⁴, the lack of a compensation mechanism for sectors that will lose out due to the trade liberalization (Saguier, 2007), and the withdrawal of the "fast-track negotiating authority" had serious ramifications for the negotiation process (Katz, 2002). On the other hand, Brazil was forced to "forge

⁸⁴ HSA was formed in 1997 to uphold democracy equality and sustainable development during the negotiations because they believed it was tainted with the lack of transparency (Saguier, 2007).

a coalition that was substantial and stable enough to stand up to United States” (Bruner, 2002). “Success in the FTAA negotiations depended on the balance in Brazil and the United States between the interests of exporting sectors likely to be favored by increase market access and resistance of protected sectors that feared import competition” (De Paiva Abreu, 2006).

The issue with FTA was the lack of reciprocity and equivalent concessions by the two sides. Mercosur, and more importantly Brazil, refused to include market access in industrial products and services and adopt rules-related issues including investment, intellectual property public procurement and competition; on the contrary, the United States refused to grant concessions for market access in agriculture goods and in the application of the anti-dumping law. This opened the door to plurilateral agreements between countries and an “FTAA-lite” version of the agreement, also called the “Miami Compromise” or the “FTAA à la carte” (Bouzas, 2002; Carranza, 2004, 2003; Schott, 2005). “The bottom line was that protectionism in Brazil and the USA was the main obstacle to the successful completion of the FTAA negotiations” (De Paiva Abreu, 2005). The economic and political problems in Latin America reduced the political momentum of the FTAA and this situation was further exacerbated by civil society’s opposition on grounds of lack of transparency in the negotiating process and by the election of nationalist presidents in Brazil Argentina who were “skeptical about the FTAA process” (Carranza, 2004).

The greatest obstacle was the “asymmetric distribution of power in the Western Hemisphere”; this asymmetry made it “impossible to achieve a mature relationship between United States and Latin American countries” (Carranza, 2003). It was clear that the trade agreement was less about trade expansion and more about instilling trade rules in the region. The plan was not based on economic rational because the United States were not a major trading partner of Mercosur; it had greater trade with the EU; similarly, USA had greater trade relations with Mexico than with Mercosur countries. “Progressively, the FTA process had gradually crystallized as a negotiation between blocs” and was characterized by the existence of “subregionalism within hemispheric integration” (Phillips, 2002). The divergent ideas and rationale for the FTAA, along with the myriad issues due to the power-struggle between Brazil and the United States led to the eventual collapse of the negotiations in the region. Subsequently, the Latin

American region moved from neoliberal-open regionalism towards post-hegemonic liberalization after the failure of the FTAA. Brazil believed that the failure of the FTAA worked in its favor as it was still inclined towards subregional unity under its leadership rather than an extension of the United States' hegemony in South America (Santos Lima, 2018).

Mercosur- European Union Relations

Mercosur's relationship with European Union has gone through three distinct phases: During the nineties, European Union was concentrated on promoting heavy inter-regionalism. It also influenced integration between South American countries and actively promoted the idea of regionalism through FDI aimed at experience-sharing, promotional events and technical assistance for this shift to regional initiatives. The European Union thus "*exerted soft-power in South America given the success of the EU, in favor of integration that could possibly reduce inequality, increase intra-regional trade, and consolidate democracy in the bloc*". Next, in 2000s Mercosur failed to advance bi-regional integration with the European Union and this was also a period of protectionism in Mercosur. It was revealed that the European Union started unilateral engagements with Brazil as Argentina was recovering from a crisis in 2001-02. The last phase of the bi-regional relationship began after the election of President Temer in Brazil and President Macri in Argentina. Their joint proposal renewed negotiations with European Union due to a more liberal economic stance adopted by their administrations. Given the recent failure of the TTIP, these negotiations were very important for success of the European Union as well.

Mercosur is often compared to the European union and many have cited the European Union model as the basis for the formation of Mercosur. This comparison has already been covered in Chapter 2, however, some of the feature have been revisited here to complete the analysis in this chapter. The European process was a long and tedious one, and the members were aware of the costs of non-Europe⁸⁵ (Hafner, Enora and Stijn, 2014). It was expected Mercosur would learn a great deal from the European experience and their plans as laid out in the Cecchini Report of 1988. However, critics strongly believe that twenty-eight years later, apart from having the European Union as an ideal,

⁸⁵ defined as the untapped potential of the single market due to its incomplete implementation

nothing about Mercosur resembles it. Despite this pessimism, it has been suggested that *Regionalism* cannot be copied, thus, Mercosur cannot be compared to the European Union given the clear asymmetries: the difference in the number of countries in each bloc- Mercosur has four and European Union has twenty-eight, the difference in political views and type of leadership, and difference in GDP and size of the members. Mercosur may have borrowed the initial idea from the European Union, but Mercosur used this model to adapt to the realities of the region. Regional integration is about the sequence of steps followed by the member countries and this has been emphasized by the difference in experiences in European Union and Mercosur.

There are two distinguishing factors between the two regional blocs: One, the European Union is highly invested in facilitating factors such connectivity, logistics, exploring complementarity between the economies, focus on democracy, establishment of institutional structures and other enabling infrastructure. Although the legislatures of Mercosur do emphasize on the importance of connectivity and interdependence, *the reality is far from it*. Infrastructural delays and low intra-bloc trade prove that Mercosur countries are a long way from the European model of integration. Two, the German-Franco leadership has developed over time that involved a series of diplomatic steps. In Mercosur, *the persistent trade wars between Brazil and Argentina continue to hinder the integration process*; moreover, subsequent periods of protectionism have delayed the harmonization of trade policy among member; it has been said that “if they take two steps forward, they take one step backwards”.

The nineties were a better time for enhancing relations with the European Union as they not only wanted to mimic the European Union, but also because the European Union was investing in the institutional set-up for future bi-regional integration. These negotiations also helped create the *Secretaria del Mercosur* as a permanent agency for technical and customs cooperation during the time. European Union has been important for Mercosur for both *economic and political reasons*; Mercosur countries received immigrants in the 20th century from the European Union and this added to the power of the cultural and colonial ties that have influenced the negotiations. European Union also comprises of about one-fifth share in Mercosur’s external trade, hence it was a natural partner as well. The average tariff (CET) on automobiles, capital goods, chemicals in

Mercosur is 12 percent on MFN basis and this will reduce to zero if the negotiations went through.

Moreover, the negotiations with the European Union entail two very big regions. Given the 700 million population of European Union and 280 million population of Mercosur, the Mercosur- European Union free trade area would involve a lot of people and would bring several opportunities for both sides. There exist volatile trade patterns between the four members of Mercosur, and there is evidence to prove that the deal with the European Union cemented the internal Mercosur integration as well. *“The negotiation process helped the four countries to arrive at a coherent position vis-à-vis the rest of the world. It led to higher transparency between the partners and initiated a dialogue about the existing issues and deeper commitment such that they can have a common position in external negotiations”*.

The simple coincidence in the timelines of the negotiations with European Union and those under the FTAA was really *not a coincidence* at all. As mentioned earlier, Mercosur used cross-negotiation to bargain for better deals in both the cases. European Union’s renewed interest in Mercosur were fueled by the FTAA talks due to perceived threat in occupying market share and securing preference margins. The negotiations with the European Union began in 1999 although the framework agreement was already signed in 1994. Between 2001-2004, countries exchanged offers, following which, the negotiations stalled until the relaunch in 2010 with the initiative of the Spanish and the Argentine presidencies. This renewed interest included chapter requests on public procurement and services. The mandate also required the strict inclusion of all sectors of the economy in both the blocs. By 2013, Brazil made its first offer and by 2014, President Kirchner and President Dilma’s administrations were supportive of the offer. In 2016, European Union presented their offer that excluded bovine meat and ethanol, two products essential to the export baskets of the Mercosur members. As it was a clear rejection of the 2010 mandate itself, it stalled the negotiations till 2017 once again. It has been expressed that *“the seesaw of the negotiation process has been because of the mismatch of political moments in all the countries involved. Countries need to find the window of opportunity”* and they did find one very recently.

While some European Union countries were weary of presenting a paper on agriculture to Mercosur in 2017, others including the United Kingdom, believed that the

negotiating momentum should be maintained. Naturally, the Brexit created trouble in Mercosur as Britain was a big supporter of the deal and an important partner; however as highlighted by an interviewee, *“on the European side, the Brexit did not really slow down the momentum, rather the political will was more renewed than ever to complete the trade deal. Brexit was an indication towards bilateralism and against regional integration; and the European Union wanted to project unity”*.

Finally, in June 2019, Mercosur and the European Union signed the first bi-regional free trade agreement of the world⁸⁶. Many believe that although Mercosur- European Union trade agreement may have been signed, the ratification process is going to be a tough process for both the sides. It was a *big win* for both the regions as they have been involved in these negotiations for the last 20 years. It was the first time that Mercosur coordinated their external positions with an important ally to sign an economic agreement rather than a political one. It called for a common position of all the Mercosur members on issues such as public procurement, services, investment, e-commerce, sustainable development. It is believed that these deeper commitments could help Mercosur evolve into a more mature bloc and support their internalization process. With this one stroke, all the critics of the bloc have been proved wrong and the advocates are now confident that the ratification of this trade deal with *“relaunch Mercosur once again, for the members and for the world to see. Whether it is a win-win situation remains to be seen but the conclusion of the negotiations alone is a monumental task that has been achieved by the bloc”*.

7. De Jure versus De Facto Integration: Expectations from the bloc and Conclusions

The Mercosur members have come a long way in the integration process and as they complete almost thirty years together, it is important to point out that it has been a commendable effort by the countries, given it was the first such initiative involving only developing countries. Critics have questioned the viability of Mercosur, and emphasized on the shortcomings of the integration process. However, one interviewee emphasized that *“Integration in developing countries is not a linear process, they need*

⁸⁶ Press release can be found at <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2039>

to be mindful of what is *politically possible, economically necessary and socially responsible*".

The most common observation is that Mercosur, both internally and externally, has witnessed alternating periods of upswings and crises. This cyclical process can be attributed to the short-sightedness of the member countries. As mentioned in previous sections, members have taken decisions towards Mercosur's external agenda based on their domestic experiences shaped by the interest groups in their economies. For example, during the commodity supercycle, the governments as well the private sector were confident that international commodity prices alone will lead them to a better future and they did not take steps to further integrations among the members nor did they sign many agreements in that period. This is followed by a period of economic crisis that compel each member to adopt a protectionist stance that hurts the integration process even further. Moreover, it is natural for a bloc to sign trade agreements with its largest trade partners to reap the benefits and secure preference margins. However, in the case of Mercosur, they have failed to sign agreements with its biggest partners due to internal private sector resistance in both Argentina and Brazil.

Mercosur is indeed characterized by an array of crossing agendas that are heavily influenced by external forces. Mercosur members produce and export similar goods and are natural competitors. However, they still formed Mercosur to exploit the existing complementarities in production and trade. It has been proven that in Mercosur, political decisions drive the macroeconomic trends and the overall trading agenda as well. The integration process continues to be influenced by economic and non-economic factors. Political and social factors shaped the decisions of the past and even today, they are used as a tool to maneuver decisions by the member states. Mercosur is sometimes called an *imperfect customs union* and the most pertinent question today is about its existence and institutional structure: whether it should go backwards to just be a free-trade-area or perhaps, it should move forward to being a common market. The answer to that question lies in the interplay of economic and political realities of the member countries.

It was also found that Mercosur is a safety net inside the region as well as outside the region for all the four countries. Mercosur has always been a priority for Brazil, whether during the nineties, through the Lula administration and accession of Venezuela, or as

the mainstay in its regional integration policy in recent years. Similarly, the smaller two countries Uruguay and Paraguay have always remained dedicated to the bloc as they realize the benefits of staying in Mercosur despite the unfulfillment of their expectations from the bloc. On the contrary, Argentina's interest in Mercosur has wavered and followed an unstable trajectory influenced heavily by the political events and economic crises at home, as well as international events such as the rise of China after 2002. Countries agreed that they will not play by the orthodox idea of economic integration and Mercosur was a way to harmonize the differences in their respective national agendas. The question was whether it was possible for countries to develop and achieve common objectives in medium to long term.

Another common critique of Mercosur involves the nature of their integration process. Academicians in members countries have described the integration process as *de jure* rather than *de facto*. In 1991, the member countries signed a comprehensive *Treaty of Asuncion* that laid out specific steps that countries must take to achieve *full* economic integration. Later, in order to deepen the integration, they signed multiple protocols regarding services, investment, government procurement. However, as it has been pointed out earlier, Mercosur members have neither been able to transform into a perfect customs union, nor have they truly internalized the deeper commitments in their national legislatures. This is described as *de jure* integration rather than *de facto*, i.e.; although they may be a perfect customs union on paper, they have failed to accept the responsibility that comes with being an economic union in reality.

Indeed, it is true that Mercosur is defined an imperfect customs union. Recently it has also been called an *imperfect common market*. But the reality is that Mercosur is exactly where it wanted to be. It sought to develop three main elements through its integration process: a free trade area among the countries, a common external tariff and coordination in external relations; and today these are the characteristics that define it. It is known that the process of integration requires strong political decisions to work together, continuous steps towards further integration, but is also requires an understanding that *it will never be exactly as in economic theory* and *it will take a lot of time* reach an acceptable level of cooperation. For example, the European Union took over 50 years and they are still finding ways to continue the process; it was not a linear

process and members have sometimes followed erratic behaviors. Similarly, it is not possible to imagine Mercosur as a linear process either.

Another fact that is not outlined in traditional economic theory of integration is that members of an economic union may alter their individual stance during an integration process. It is natural for a sovereign nation to give priority to its internal subjects, especially in matters concerning security and jobs. This reality can be seen in two distinct examples: the integration in European Union began 50 years ago, and one of the main reasons cited by the United Kingdom in 1991 for joining the European Union was the tremendous cost of staying out of it. However, today, Brexit is a reality because their sensibilities have changed. Similarly, NAFTA called for re-negotiation of terms after 25 years of existence. Hence, it is accepted that economic unions and free trade zones to go through periods of re-orienting themselves by finding new ways to integrate, subject to the present macroeconomic realities, international events and national crises.

The main question is how to understand and explain the integration process given these present realities, and to analyze how far it is from the normative judgement about what the goals of integration ought to be according to economic theory. This is the *Fact-Value Gap* and we must analyze Mercosur in this light. Priorities and visions change over time and these changes must be given importance within the integration process that allows for flexibility in the medium term. Another acceptable analysis would be to answer the question that what would Mercosur members achieve if they left the bloc, or, what is the *second- best alternative*. Each country in the bloc has cited reasonable concerns if they exited the bloc and believe that being a part of Mercosur, although it is often described as a *stalemate*, is a far better option than deciding to leave it after nearly thirty years. Mercosur has been a safety net for all its members and its internal and external policy has been a *sum* of the individual national policies. Hence, its present reality is a unanimous decision, whether to stay together or negotiate external deals.

Despite this positive analysis, one of the main problems in Mercosur today is the *huge credibility gap*: the perception that Mercosur is engaged in an economic integration process; although countries are not behaving based on what they started out with, they are continuously trying to engage and that continuity is important. We need to make a distinction between the *existential dimension of economic integration* that answers the

question “why are we working together” that needs to be answered continuously, versus, and *the methodological dimension* that answers the question on “how to work together”. Members of an economic bloc need to find an equilibrium and continuously make changes in the working methods of a bloc. The problem in Mercosur is the methodological crisis as even after nearly thirty years, they continue to find ways to increase cooperation between the governments, private sectors and people- in a consensual way to arrive at a win-win situation. It has been rightly pointed out by an eminent economist: “*Economic integration cannot be a one-shot integration process, it requires 72 hours a day of negotiations to achieve a common goal*”.

It is however recognized by most academicians in the Mercosur members that the bloc needs to be more mature in its institutional structure. It is underconfident in its international negotiations and it must find ways to market itself as a strong-independent hub of economic opportunities. It must also be looked at as imperfect, yet real integration of governments and people. The aim was never to achieve total economic integration, it was always to project itself as a single unit in international negotiations, while maintaining it as a free trade area that allows free movement of peoples in search of better jobs and livelihood. Given that the political sensibilities of the members are finally aligned, members can build solidarity through further integration by tying up the members in production and innovation networks, and by investing in trade facilitation at internal borders. Like any other economic union, Mercosur is an interplay of macroeconomic factors- rules-political sensibilities-the power struggle-sovereignty and national interests-degree of flexibility-common interests- and predictability dynamics. Surely, we have seen that the *internal dynamics in Mercosur certainly determine its external agenda* and this answers the main hypothesis of the chapter.

CHAPTER 8: CONCLUSIONS

This study was undertaken to develop an understanding of the process of regional integration in developing countries. There exists vast literature on regional integration, analyzing the formation of such agreements and level of integration, while, assessing their successes or failures, and drawing a comparison with other such regional arrangements around the world. According to several theories, regional integration must follow certain steps in order to be successful, to enhance national trade and growth, as well as, to develop the region as a whole. For example, traditional trade theory predicts that a regional bloc will be effective if trade creation is greater than trade diversion (Viner, 1950), the preferential access granted to the bloc members is substantial and a large share of total trade is concentrated within the bloc in the form of intra-bloc trade. Moreover, regional integration is sometimes used by countries as a tool for development (Schiff and Winters, 2003). It increases the level of competition in the newly enlarged internal market that could lead to development of clusters and increase resource efficiency by achieving economies of scale; the consumers can also benefit from increased product differentiation. Overall, regional trade integration encourages specialization based on comparative advantage, promotes industrialization, and helps overcome barriers to factor mobility that constitutes real integration.

This study aimed to provide an insight into the working of one such bloc, Mercosur or *Mercado de Sur*, the regional integration initiative in the Latin America and Caribbean region. It was one of the earliest attempts at regional integration consisting of only developing countries from the region. Mercosur was conceived as a customs union, emulating the European Union, which was coming into existence just as the Latin American and the Caribbean countries were putting their model together. Today, this bloc is defined as an imperfect common market; many economists in the region have deemed it to be an unsuccessful endeavor, but policymakers in the region remain optimistic, especially now, given that Mercosur has signed one of the biggest bi-regional free trade agreements with the European Union, a feat that may just be the cementing block for Mercosur. Hence, it is imperative to understand the functioning of the bloc today.

In particular, this thesis explains the economic and political rationale for the formation of the bloc in 1991 and analyzes the historic trade trends of the bloc on three main trade platforms: intra-bloc trade, regional trade within LAC, and extra-regional trade with their biggest trade partners. It employed various econometric tools including quantitative and qualitative techniques to develop a suitable gravity model that explained these trade patterns. Subsequently, other classic trade indicators were used to supplement the gravity results and comment on the extent and nature of regional integration within the bloc. Modern patterns of trade, for example, regional value chains and intra-industry trade were also studied in the context of Mercosur to enhance our understanding of the nature of intra-bloc trade relations.

However, during the course of this thesis, it was found that trade integration within Mercosur and its external trade relations cannot be explained using statistical analytical tools alone. For this purpose, an additional commentary on the political economy of the bloc has been made that offers a plausible explanation for the discrepancies in the statistical analysis. This commentary drew on historical events that led to the inception of the bloc, while analyzing the interplay of economic and political realities of the member countries that have shaped the bloc over the last thirty years and offers a suitable explanation of Mercosur's trading agenda, including their choice of preferential trade partners.

KEY FINDINGS

Chapter 1 introduced the topic of this thesis by offering a brief background on preferential agreements and regional integration. It also highlighted the relevance of the study undertaken through this thesis and presented the research questions, main hypotheses, research methodology and the structure of this thesis. Last, it presented the shortcoming and scope of the study that are re-visited in this concluding chapter as well.

Chapter 2 dealt with the vast literature that exists on regional trade integration and explained the rationale and benefits of such agreements. Countries have different motivations when they sign a trade deal and include the need for increased political alignment between countries in a region, peace and security among members, to strengthen public policies and good governance practices through cross-border spillovers of information and knowledge, and help regulate opposition to domestic

policy reforms. On a global scale, if a country joins such a regional trade agreement, it could benefit from increased local and foreign investment in regional projects, increase its bargaining power in dealings with third countries due to increased regional cooperation, and improve its terms of trade with the rest of the world.

Literature on regional integration revealed that to achieve this level of integration, it is vital that members focus on regional development plans rather than on national sovereignty and nationalistic productive plans. For example, to create a successful customs union, members must establish a common external tariff that actually grants preferences to other members, such that these preferences cover majority of traded goods and services with well-established rules of origin to avoid delays. Members can also benefit from measures that go beyond trade in traditional goods and establish productive links through trade in services, free movement of factors including persons and capital, greater investments, and agreement on government procurement and intellectual property rights. As a consequence, members can achieve harmonization of trade and industrial policy. The next step towards greater integration would be to increase intra-regional trade facilitation and collectively manage supply-side bottlenecks such as connectivity to ports, transport networks, storage and warehouse management, single custom windows to speed-up custom procedures, automatic licensing and provision of online-paperwork to reduce time spent at the border.

This chapter also explored the motivation for the formation of the Mercosur bloc, assessed their integration efforts so far and identified the pending issues within the bloc. Four countries from the Latin American region, Argentina, Brazil, Paraguay and Uruguay, initiated the formation of an economic integration agreement through the Treaty of Asunción on March 26, 1991. The inception of Mercosur accompanied the trend of “New Regionalism”, that characterized the international scene at the time. The new wave of regionalism and globalization came to be seen as an opportunity by the South American nations to come from the periphery into the new integrated- global economy and the formation of Mercosur was based on this very motivation, as well as the challenge to achieve greater economic integration. It involved the free movement of goods, services and factors of production between member countries through elimination of customs duties and non-tariff restrictions on the movement of goods, supplemented by the establishment of a common external tariff (CET) and adoption of

a common trade policy in relation to third countries. It was found that at first it was a political project, aimed at bringing Argentina and Brazil together after their re-democratization process, but it was deeply rooted in strong economic objectives that required a series of unilateral and cooperative economic liberalization efforts.

Although the aim of the Mercosur members was to establish a customs union and a common market, the degree of integration has remained limited. The failure to fulfill the objectives of Mercosur has been attributed to the adoption of unilateral policy measures that undermined the economic integration efforts. Some member states adopted protectionist measures, often in the face of economic uncertainties that they encountered. Yet another impeding factor is the process of decision-making within the bloc, which is largely driven by intergovernmental diplomatic summits that suffer from the problem of double-veto. It was found that over time, the external agenda has become the 'glue' holding Mercosur together. External negotiations with preferential trade partners require members to internally coordinate on several trade-related issues.

It is common in the literature to draw a comparison between Mercosur and the European Union, given that the inception of Mercosur is seen as an extension of the success of regionalism in the EU. The literature revealed that there are many structural differences between the two initiatives, given the diverse historical setting, and motivations for their respective formations. If the blocs are compared with the same yardstick, it is obvious that Mercosur has not been as successful as their European counterparts in terms of level of macroeconomic integration and maturity as a bloc. Needless to say, while the process for the formation of the EU began almost seventy years ago, Mercosur is still young. Hence, it is not viable to compare the two initiatives that have been successful in the way they envisioned. The rapid integration achieved in Mercosur has been attributed to the high cultural affinity, the need to coordinate in matters of international negotiations and simultaneous trade liberalization policies. Notably, the recent ongoing negotiations with the European Union have underpinned greater coordination on trade disciplines and facilitated further cooperation between Mercosur members (González, 2019); for example, Mercosur members have already adopted a Protocol on Public Procurement (CMC Decision No. 37/17) to foster regional integration and create a common market (Manzini, 2019).

The analysis in Chapter 3 revealed that the collective trade policy of Mercosur is a sum total of the trade policies implemented by the members of the bloc and in that sense, the personality of the bloc is made up of individual personalities of each member. It focused on the two largest members of the bloc- Argentina and Brazil, and on the two small members- Paraguay and Uruguay that displayed high dependence on their large neighbors. Historically, each member has had similar yet very different growth experiences shaped by internal and external factors: domestic policies and political decisions, changing contours of the regional relationship, including shift of power asymmetries, as well as changes in the global economy. These trajectories were discussed in this chapters that also highlighted the policy stance in the subsequent periods of trade protectionism and liberalization. The interplay of policies and preferences has defined the external agenda as well the internal dynamics of the bloc since its inception, and this was confirmed through the analysis. Notably, the manipulation of the import tariffs has been a profound tool that drives national trade policy and has led to reduced policy alignment in the four members of the bloc. These policy measures are justified due to the occurrence of persistent economic and political crises in the members, however, the lack of harmonization is a concern and a deviation from the agenda adopted through the Treaty of Asuncion.

Chapter 4 analyzed the evolution of trade relations of the four members. The trade policies highlighted in the previous chapter have impacted the overall composition of export-import baskets and trade partners for each of the members. For example, the smaller countries remain dependent on the larger Mercosur members for market share as well as for tariff-free imports of consumer and capital goods. On the contrary, Brazil and Argentina showed low reliance on the internal market of the bloc. Natural resources, food and other agro-industrial products of animal and plant origin comprised the largest share of exports for each of the members alike. These exports included iron ore, soybean, bovine meat, rice, wheat, poultry, oilcakes, wool and leather. Another observation was the diversification of export baskets of Brazil and Argentina as opposed to those of Uruguay and Paraguay. Both, Brazil and Argentina are large exporters of motor vehicles and parts that contribute to intra-bloc trade. This analysis confirmed that the composition of trade baskets and partners is influenced by the trade policy decisions taken by the members before and after the inception of Mercosur.

Chapter 5 analyzed the nature of bilateral trade and regional integration within Mercosur using standard statistical tools. First, this chapter developed a gravity model to quantitatively establish the determinants of trade between the Mercosur members, their trade with regional and extraregional partners. This gravity model complemented the study presented in the previous chapter. The previous chapter on country-policy studies drew on the historical perspective and analyzed the economic factors, including policies that have shaped the recent trade trends. The gravity model analyzed and confirmed these conclusions from the previous chapter. It was found that the top trade partners of the Mercosur members, especially for Brazil and Argentina, were located outside the region: China, EU12 and United States were some of the major extraregional partners. It became clear that “distance between partners” and “common language” were significant determinants of extraregional trade. For example, Mercosur members share a common language with EU12 members Spain and Portugal, and this has led to greater trade between the two regions vis-à-vis other extraregional partners. Moreover, the existence of FTAs with regional partners enhanced trading relations over time, and this was reflected in the gravity results as well.

Notably, while the regional and extraregional trade patterns during the years 1991-2017 were explained by the independent variables chosen for the model, the same was not true for Mercosur’s intra-bloc trade. The gravity equation specified in this analysis did not adequately explain intra-bloc trade patterns. However, the variable ‘the existence of a shared border’ significantly explained trade between members: Brazil had greater trade with other Mercosur members in terms of both, exports and imports as it shared a common border with all three members; however, as Paraguay and Uruguay do not share a common border, trade remained low between the two small economies of the bloc.

The Gravity Model was followed by other indices to supplement these results. The top goods (6-digit level) traded between the countries (bilaterally), and those traded between Mercosur bloc and regional/extraregional partners were established through this analysis. It was noted that the goods’ basket remained unchanged over the years and mainly consisted of food-based products, energy and fuels, especially hydro-electricity and high-value manufactured goods including vehicles, parts and components, and transmission apparatus. It was recommended that members need to

diversify their trade baskets and must find ways to enhance intra-industry trade in order to facilitate formation of regional value chains given geographic proximity and level of dependence of the countries in the region. This identification of top products was complemented by the revealed comparative advantage index developed by Balassa. It was found that members primarily exported goods that belonged to industries that also displayed a significant revealed comparative advantage in global exports.

The rest of the chapter quantitatively determined the extent and nature of regional integration within the bloc. A comparison was made with other regional schemes on the level of intra-bloc trade and the level of interdependence among members. Through this exercise, it was evident that Mercosur members have low intra-bloc trade as compared to most other regional blocs, and they have scope for greater integration by exploring bilateral trade complementarities. Moreover, despite the existence of substantial preference margins due to the CET vis-à-vis the MFN tariff rates, trade remains low.

The analysis on member relations was broadened in [Chapter 6](#) to study the relationship between the two biggest members in the bloc- Brazil and Argentina. Traditionally, countries in close proximity to each other and with sufficient complementarity (in industrial production as well as trade), engage in value chains by either integrating themselves in existing GVCs or by forging new production/value chains in a regional context. One of the most important results of this analysis was that Argentina and Brazil are not part of global value chains; as a result, it was expected that they had make efforts to secure regional productive chains as a compensation for the lack of geographical proximity to global economic hubs; however, Mercosur members, especially Brazil and Argentina have been unsuccessful in forging such links within the bloc. This analysis was done by examining the extent of trade in parts and components, as well as several other indices from the OECD's TiVA database.

As value chains are a subset of intra-industry trade, this section also commented on the level of intra-industry trade using the Grubel-Lloyd index at two-digit level product level. As expected, Argentina and Brazil have had significant intra-industry trade in automobile, pharmaceutical and chemical industries, given that motor vehicles are the most freely traded goods within the region after wheat and electrical energy. In terms of the pharmaceutical industry, Brazil imports a variety of generic drugs from India and

has become a local hub for affordable medicines within the bloc. Furthermore, an array of intermediate products belonging to chemicals, plastics and mineral extraction industries have also been historically traded between Argentina and Brazil.

Although this empirical analysis was able to explain the nature of regional integration amongst the bloc members, it was unable to effectively comment on the determinants of the trade policy of the bloc highlighted in Chapter 3. As mentioned earlier, Mercosur members have adopted various measures over the last thirty years that have proven to be protectionist in nature. These policy directives have influenced the selection of trade partners for the bloc, as well as the decision to grant preferential access to a few partners. These decisions have not always been based on pure economic rationale; they were subject to the changing contours of the political setup within each of the countries over time.

Chapter 7 dealt with these political and historical issues surrounding the integration process of Mercosur that continue to shape the bloc even today. This chapter was based on several interviews with diplomats, policymakers, and economists that I conducted in Brazil, Argentina and Uruguay. The interviews revealed the internal dynamics and external political pressures that have shaped the bloc over the last thirty years, including the annexation of Venezuela, the diverse preferences of the members during the labor party administrations in 2000s, and the simultaneous trade negotiations with the European Union and the Free Trade of the Americas (FTAA). Overall, it was found that Mercosur has been a *safety net* in terms of trade, both inside the region as well as outside the region for all the four countries. The various political experiences in Mercosur have determined the integration process in the bloc. Through the analysis, it became clear that integration in developing countries is not a linear process, and they need to be mindful of what is politically possible, economically necessary and socially responsible.

The interviews revealed that Mercosur members lack policy alignment on areas such as production of commodities and services, energy, or international funding. They produce and export similar goods and are natural competitors; yet they cooperated to form Mercosur. Hence, it is apparent that political decisions have driven the macroeconomic trends and the overall trading agenda in the bloc when there was little economic motive to sign the regional agreement. Even today, the integration process

continues to be influenced by economic and non-economic factors. Political and social factors that shaped the decisions of the past continue to be used as a tool to maneuver decisions by the member states today.

Mercosur is sometimes called an *imperfect customs union* due to the inadequate implementation of the Treaty of Asunción. Advocates of the bloc strongly believe that Mercosur members have come a long way in the integration process and as they complete almost thirty years together, it is important to point out that it has been a commendable effort by the countries, given it was the first such initiative involving only developing countries. However, critics have questioned the viability of the bloc, and have emphasized on the shortcomings of the integration process, suggesting that Mercosur should go back to just be a free trade area. But the most common observation is that Mercosur, both internally and externally, has witnessed alternating periods of upswings and crises. This cyclical process can be attributed to the short-sightedness of the member countries.

Recently, Mercosur has also been called an *imperfect common market*. Many questions were raised during the interview process on whether Mercosur has achieved what it set out to accomplish in 1991. There was a mixed opinion to this pertinent question, but advocates of the bloc convincingly stated that “*the reality is that Mercosur is exactly where it wanted to be. It sought to develop three main elements through its integration process: a free trade area among the countries, a common external tariff and coordination in external relations; and today these are the characteristics that define it. It is known that the process of integration requires strong political decisions to work together, continuous steps towards further integration, but is also requires an understanding that it will never be exactly as in economic theory and it will take a lot of time reach to an acceptable level of cooperation*”. Hence, Mercosur must be analyzed given the present realities on the basis of how far it is from an *archetype* of a successful regional integration model.

Another acceptable analysis would be to answer the question that what would Mercosur members achieve if they left the bloc, or, what is the *second- best alternative*. Each country in the bloc has cited reasonable concerns if they exited the bloc and believe that being a part of Mercosur, although it is often described as a *stalemate*, is a far better option than deciding to leave it after nearly thirty years. Unraveling of the bloc will

have geopolitical implications for the region as a whole, for example, it could disrupt regional security, especially between the historical rivals Brazil and Argentina, or members could impose trade-restricting barriers against each other. Therefore, to avoid such unfavorable economic losses, Mercosur members continue to maintain relations with their neighbors, despite differences in political opinions.

Moreover, there was unanimous opinion that the bloc needs to develop a more mature institutional structure. Many researchers indicated that Mercosur remains underconfident in its international negotiations and it must find ways to market itself as a strong-independent-hub of economic opportunities. It must also be looked at as imperfect, *yet real integration of governments and peoples*. The aim was never to achieve complete economic integration for that would have brought in issues of larger questions of alignment of currencies and macroeconomic policies. Mercosur always sought to project itself as a single unit in international negotiations, while maintaining it as a free trade area that allows free movement of peoples in search of better jobs and livelihood. Advocates of regional integration emphasize that given the present alignment of political sensibilities of the members, Mercosur members can build solidarity through further integration in production, through development of innovation networks, and by investing in trade facilitation at internal borders. Like any other economic union, Mercosur is a result of an interplay of macroeconomic factors- rules-political sensibilities- power struggle- idea of sovereignty and national interests, with an adequate degree of flexibility and some shared common interests. Surely, we have seen that the *internal dynamics in Mercosur certainly determine its external agenda* and this answers the main hypothesis of the chapter.

RECOMMENDATIONS

These chapters have highlighted and proven that there exist several shortcomings in the integration process of the Mercosur countries. Hence, Mercosur members need to take a firm stand about the future of the bloc. If they are concerned about only *de jure* type of integration, then they have largely been successful, but if they are serious about the bloc and collectively want *real integration*, they need to step up efforts and they need to do them now. They can benefit from efforts aimed at trade facilitation behind the border, at the border and beyond the border that will help broaden the prospects for

further regional integration in the real sense (de facto integration) amongst the members.

Mercosur recently signed a free trade agreement with the European Union that covers increased market access for agricultural and industrialized goods, services and government procurement, through reduction of tariff and non-tariff barriers. It also includes some new topics that have emerged (termed as WTO-plus and WTO-extra) such as rules for protection of the environment (based on UNFCCC, Montreal Protocol and Paris Agreement), labor laws (per ILO Conventions), investment protection, anticompetitive practices, regulation of e-commerce, and intellectual property rights. Although it is believed that this agreement will lead to increased trade between the two regions, one of the considerable challenges for Mercosur will be to internalize this rule-based system. Moreover, intra-bloc protocols on competition, digital trade and sustainable development will be important prerequisites to implement the rule-based EU-Mercosur FTA.

Another pertinent issue is that of connectivity. Given that members share common borders with each other, there is the possibility of developing “economic corridors” that facilitate the free movement of goods within the bloc. To ensure smooth trade, members also need to address supply-side bottlenecks that were highlighted in Chapter 2. Members must address behind the border issues that hinder trade such as non-tariff barriers and protectionist policies within the bloc, issues at the border and issues beyond the border such as transportation and logistics: better roads, inexpensive warehouse facilities, etc.

Finally, intra-Mercosur trade is relatively low and is less diverse. Real integration will occur when members invest in regional projects, including in the creation of regional value chains. Given the level of integration among Mercosur members, it would be natural for members to expand vertical intra-industry trade and form value chains. They should ideally resemble a hub-spoke system such that Brazil can import raw materials and intermediate products from the smaller partners and export finished high-value products to the rest of the world. Such a system will lead to greater forward and backward linkages within the bloc and will prove to be prosperous for all the members as well. Uruguay and Paraguay face low barriers when exporting to Brazil and Argentina that lower overall trade costs and benefit the exporters located in these

countries. Such increased engagement will also raise the dependency of members on the Mercosur free trade area and lead to greater economic and social integration.

It is common for members of a regional bloc to expand investment relations, align political ideologies and invest in enhancing social engagements; although Mercosur members have furthered political and social alignment, they stand to gain by investing in economic regional projects aimed at improving connectivity and trade facilitation and raising the productivity of the region as a whole. Perhaps, they could further explore productive complementarities and identify scope for regional value chains through increased trade in intermediate products. Traditional trade theory predicts that supply-chain coordination can help members develop product specializations that would reduce the competition between members that seek similar markets abroad. The resultant alignment in production would also attract greater foreign investment in the region.

Brazil and Argentina have already ratified the Trade Facilitation Agreement proposed by the World Trade Organization to simplify and reduce regulatory barriers, revise import and export licensing procedures, facilitate the insertion of MSMEs in foreign trade and reduce elaborate customs procedures by establishing single customs window. These measures can also be implemented by Argentina and Brazil within the Mercosur free trade area by initiating a trade-facilitation agreement in Mercosur along with greater investment in regional development aimed at all the objectives mentioned above to increase intra-bloc trade and evolve into a truly-integrated common market.

SCOPE AND FURTHER RESEARCH

Several statistical tools have been used by researchers around the world to comment on Mercosur's internal and external trade relations, however, as we have seen from the existing literature, these tools have failed to explain the true nature of intra-bloc trade. As already mentioned, the trade policy of the bloc has been influenced by the political realities of the member countries over the last thirty years, leading to cyclical periods characterized by protectionist national policies and trade liberalization. While these ideas have been explored before in areas of international relations and political economy, this thesis analyzed the interplay between economic and non-economic determinants of Mercosur's trade policy and presented it in a comprehensive study.

Additionally, it includes findings of primary research based on the interviews with diplomats, policymakers, academicians, and researchers in Mercosur countries. Such views have not been published in an academic work before and this thesis has presented them as an unbiased narrative.

There is further scope to study the impact of the regional agreement on industrial production and development in Mercosur members that analyzes the nature of shift in industrial policy over the years, with focus on macroeconomic trends such as wages, employment, profits, and investment- both domestic and foreign (FDI). Further research can also be conducted to examine the legal and institutional structure of the bloc, and highlight the inadequacy of the integration process. Mercosur members are entering into new-age agreements on intellectual property rights, government procurement and competition law; an analysis of these agreements can comment on their level of preparedness in adopting international standards.

Moreover, Mercosur has recently signed the first bi-regional free trade agreement with the European Union in 2019. It is obvious that this agreement will create some winners and loser inside the bloc; there will also be impediments to the ratification process, for example, in terms of importance given to bilateral safeguard measures and the role of the civil society in the implementation of the terms of the treaty. An impact assessment of the Mercosur-EU free trade agreement can draw relevant policy implications from the economic analysis, and recommend ways to minimize the losses from it; it could also comment on the scope for bi-regional value chains especially in the area of automobiles and agro-industries between Mercosur and the European Union members.

ANNEXURE 1

Extraregional Trade Gravity Model: Variable Summary

Variable Summary					
Variable	Obs	Mean	Std. Dev.	Min	Max
year	648	-	-	1991	2017
Time- Invariant Variables					
comlang_off	648	0.3333333	0.4717687	0	1
dist	648	12479.14	4396.469	8069.483	19110.13
Time Variant Variables					
pop_o	648	3.52E+08	4.40E+08	3131936	1.39E+09
pop_d	648	3.52E+08	4.40E+08	3131936	1.39E+09
gdp_o	648	4.72E+12	5.71E+12	6.33E+09	1.95E+13
gdp_d	648	4.83E+12	5.80E+12	6.33E+09	1.94E+13
gdpcap_o	648	15946.86	16068.36	329.7491	59927.93
gdpcap_d	648	15942.47	16056.61	329.7491	59531.66
gdp_const_o	648	5.44E+12	6.03E+12	1.55E+10	1.73E+13
gdp_const_d	648	5.44E+12	6.03E+12	1.55E+10	1.73E+13
ExportsUSD	629	6.27E+09	1.04E+10	528188	4.9415E+10
Log of all continuous variables					
lpop_d	648	18.41	2.05	14.96	21.05
lpop_o	648	18.41	2.05	14.96	21.05
lgdp_o	648	27.43	2.56	22.57	30.60
lgdp_d	648	27.43	2.56	22.57	30.60
lgdp_pc_o	648	9.02	1.28	5.80	11.00
lgdp_pc_d	648	9.02	1.28	5.80	11.00
ldist	648	9.37	0.34	8.99	9.86
lexp	629	20.96	2.18	13.18	24.62
lgdp_const_o	648	27.72	2.46	23.46	30.48
lgdp_const_d	648	27.72	2.46	23.46	30.48
Averages Calculated for Hybrid Model					
lgdp_d_bet~n	648	27.44	2.49	23.25	30.09

lgdp_o_bet~n	648	27.44	2.49	23.25	30.09
lpop_d_bet~n	648	18.41	2.05	15.02	20.97
lpop_o_bet~n	648	18.41	2.05	15.02	20.97
lgdp_pc_d~n	648	9.02	1.15	7.48	10.60
lgdp_pc_o~n	648	9.02	1.15	7.48	10.60
lgdp_const_d_bet ween	648	27.72	2.43	23.83	30.22
lgdp_const_o_bet ween	648	27.72	2.43	23.83	30.22

Regional Trade Gravity Model: Variable Summary

Variable Summary					
Variable	Obs	Mean	Std. Dev.	Min	Max
year	1512	-	-	1991	2017
Continuous Variables					
POP_o	1512	4.61E+07	5.82E+07	3131936	2.08E+08
POP_d	1512	4.61E+07	5.82E+07	3131936	2.08E+08
GDP_cur_o	1508	3.09E+11	4.81E+11	5.34E+09	2.48E+12
GDP_cur_d	1508	3.10E+11	4.81E+11	5.34E+09	2.48E+12
GDP_pc_o	1508	5887.236	4064.422	768.0698	18087.26
GDP_pc_d	1508	5919.531	4154.291	768.0698	21893.81
GDP_constant_o	1500	4.12E+11	5.99E+11	9.80E+09	2.42E+12
GDP_constant_d	1500	4.12E+11	5.99E+11	9.80E+09	2.42E+12
Areainsqkms	1512	2013961	2581854	176215	8511920
Dist_cap_kms	1512	3776.184	1805.319	1039.744	7563.498
ExportinUS	1508	5.46E+08	1.07E+09	32522	7.61E+09
Dummy Variables					
FTA	1511	0.28	0.45	0	1
Contiguity	1511	0.25	0.43	0	1
Landlocked_o	1511	0.20	0.40	0	1
com_lang_off	1511	0.86	0.35	0	1
Log of all continuous variables for the Gravity Model					
lpop_o	1512	16.90	1.26	14.96	19.15
lpop_d	1512	16.90	1.26	14.96	19.15
lgdp_o	1508	25.32	1.63	22.40	28.54
lgdp_d	1508	25.32	1.63	22.40	28.54
lgdp_pc_o	1508	8.42	0.75	6.64	9.80
lgdp_pc_d	1508	8.42	0.76	6.64	9.99
larea	1512	13.84	1.16	12.08	15.96
ldist	1512	8.11	0.54	6.95	8.93
lexp	1508	18.16	2.40	10.39	22.75

lgdp_cons2~o	1500	25.68	1.55	23.01	28.52
lgdp_cons2~d	1500	25.68	1.55	23.01	28.52
Means calculated for Hybrid Model					
lgdp_d_bet~n	1512	25.32	1.52	23.23	27.63
lgdp_o_bet~n	1512	25.32	1.52	23.23	27.63
lpop_d_bet~n	1512	16.90	1.25	15.02	19.02
lpop_o_bet~n	1512	16.90	1.25	15.02	19.02
lgdp_cons_d~	1512	25.69	1.52	23.49	28.19
lgdp_cons_o~	1512	25.69	1.52	23.49	28.19

Intra-bloc Trade Gravity Model: Variable Summary

Variable Summary					
Variable	Obs	Mean	Std. Dev.	Min	Max
year	432			1991	2017
Continuous Variables					
POP_o	432	5.8E+07	7.4E+07	3.1E+06	2.1E+08
POP_d	432	5.8E+07	7.4E+07	3.1E+06	2.1E+08
GDP_cur_o	432	4.0E+11	6.0E+11	6.3E+09	2.5E+12
GDP_cur_d	432	4.0E+11	6.0E+11	6.3E+09	2.5E+12
GDP_pc_o	432	6.7E+03	4.2E+03	1.1E+03	1.7E+04
GDP_pc_d	432	6.7E+03	4.2E+03	1.1E+03	1.7E+04
Areainsqkms	432	3.0E+06	3.4E+06	1.8E+05	8.5E+06
Dist_cap_kms	432	1.2E+03	7.7E+02	1.6E+02	2.4E+03
ExportinUS	432	1.7E+09	3.6E+09	1.0E+00	2.4E+10
gdp_const_o	432	5.5E+11	7.6E+11	1.6E+10	2.4E+12
gdp_const_d	432	5.5E+11	7.6E+11	1.6E+10	2.4E+12
Dummy Variable					
RTA	432	0.72	0.45	0	1
Contiguity	432	0.62	0.49	0	1
Landlocked_o	432	0.25	0.43	0	1
comlang_off	432	0.75	0.43	0	1
Log of all continuous variables for the Gravity Model					
ldist	432	6.76	0.91	5.06	7.76
lexport	432	15.31	8.96	0.00	23.88
lpop_o	432	16.76	1.59	14.96	19.15
lpop_d	432	16.76	1.59	14.96	19.15
lgdp_o	432	25.34	1.88	22.57	28.54
lgdp_d	432	25.34	1.88	22.57	28.54
lgdp_pc_o	432	8.58	0.72	7.03	9.73
lgdp_pc_d	432	8.58	0.72	7.03	9.73
larea	432	13.95	1.53	12.08	15.96

lgdp_const_o	432	25.70	1.79	23.46	28.52
lgdp_const_d	432	25.70	1.79	23.46	28.52
Means calculated for Hybrid Model					
lgdp_d_bet~n	432	25.34	1.81	23.24	27.63
lgdp_o_bet~n	432	25.34	1.81	23.24	27.63
lpop_d_bet~n	432	16.76	1.59	15.02	19.02
lpop_o_bet~n	432	16.76	1.59	15.02	19.02
lgdp_cons_d_bet~n	432	25.70	1.78	23.83	28.19
lgdp_cons_o_bet~n	432	25.70	1.78	23.83	28.19

ANNEXURE 2

Questionnaire on drivers of Mercosur's negotiation agenda in the past 30 years

Over the past quarter of a century, Mercosur has implemented an unusual trading agenda by signing agreements with countries that are not among the bloc's top ten trading partners. The only exception has been the European Union, with whom it started negotiations in 2000. Within the region, it signed free trade agreements with Bolivia (1996, which is now in process of becoming a full member) and Peru (2005), as well as Complementary Economic Agreements with Chile (1996) and Mexico (2005). It has also signed FTAs with Israel (2007), the South African Customs Union (SACU, 2008), and Egypt (2010). Mercosur also signed a Preferential Trade agreement (PTA) with India in 2005, and has ongoing negotiations to convert it into a full free trade agreement. Other negotiations for framework agreements are under way with Turkey (since 2008), Jordan (since 2008) and with the Gulf Cooperation Council (since 2005).

Based on the theoretical and empirical literature on trade agreements and regional integration, this questionnaire aims to investigate the factors that have shaped the negotiating agenda of the Mercosur over the past 30 years. These can be summarized into four groups:

1) Domestic and subregional dynamics: there has been a backlash to the subregional integration process for almost a decade due to the adoption of unilateral trade protectionist measures and divergent macroeconomic policies by some Mercosur members. In this context, it has been difficult to make progress toward the full implementation of Mercosur's customs union, and other aspects of Mercosur such as its external negotiations. In this context, the following questions arise:

- To what extent have domestic macroeconomic trends within Mercosur countries including the subsequent trade wars between Brazil and Argentina, diverted the attention from continuing integration and external trade negotiations?
- Comment on the lack of coordination of macroeconomic policies in the bloc.
- What has been the impact of the political and economic difficulties of Venezuela on Mercosur's integration process?

- Based on recent economic and political dynamics since 2016, can Mercosur now re-think of forming a full customs union within the next 5 or 10 years?
- The treaty of Mercosur needs to be upgraded by including deeper commitments in areas such as services, investment, IPR, competition policy, trade facilitation and public procurement, SPS, TBT, etc.). Are countries willing to do this? What will the agenda and the time frame?
- Who is the leader of the bloc, given the lack of supranationality? Is establishing supranationality on the agenda?
- Despite the various internal problems, what factors continue to drive the bloc forward?

2) Economic factors: Commodity exports from Mercosur to China have boomed since 2003, turning this country into its first export destination. In this context, possible questions arise:

- As these primary goods face few import barriers in China, is it true that there is little need and interest to negotiate an FTA with this country?
- What other economic factors have driven the external trade negotiating agendas: exploit comparative advantages; promote intra-industry trade through GVCs to reap benefits from international specializations?
- What has been the influence of the end of the commodity price cycle on Mercosur's integration process?

3) Political and strategic priorities: Mercosur has sought to deepen political and economic relations with some other BRICS countries through preferential trade agreements with SACU and India. In this context:

- What has been the role of BRICS in terms of negotiating PTAs with these countries? How important was the influence of Brazil in this context?
- Does Mercosur want to upgrade these deals to full free trade and economic partnership agreements?
- What is the political rationale for signing agreements with Turkey, Israel, Pakistan, Egypt, Morocco, GCC and Jordan?

- Does Mercosur consider trade agreements as an instrument to cement internal integration efforts and underpin domestic policy reforms?
- How important are historical bilateral relations and cultural ties in explaining the continuing interest in negotiation an FTA with the EU?

4) Global and regional developments: The recently created Pacific Alliance is implementing an ambitious subregional integration agenda. Additionally, countries in other parts of the world are negotiating agreements that include topics that are not covered by traditional trade agreements. Both trends may give new impulses to Mercosur's internal and external integration efforts, as illustrated by several meetings with the Pacific Alliance that aimed to look for areas of convergence and cooperation.

- To what extent do trends in other subregional integration schemes like the Pacific Alliance have an impact on Mercosur's agenda? Is there a possibility of cooperation between the two regional blocs?
- Do the 21st century trade agreements covering new topics influence the Mercosur integration process?
- What is the influence of the stalemate of the multinational trade negotiations agenda?
- What is the likely impact of the Trump administration and its protective trade policy on Mercosur?
- Can you mention other regional and global trends that have affected the bloc?

Other specific questions

1) Negotiating Agenda:

- The trade talks with the EU began to balance the FTAA negotiations. What is the rationale now?
- How will the negotiations with the EU change after the Brexit, especially given how the United Kingdom was a big supporter of the agreement?
- What is the rationale for signing agreements with Morocco, Jordan, SACU, Israel, Turkey and India?
- Chile was intended to be a permanent member of Mercosur. What went wrong?

- Mercosur is often compared to the European Union. How similar (or dissimilar) are the institutional structures of the two blocs?

2) Official national position:

- What is your country's position in the bloc?
- What is your country's trade policy and how is it different from Mercosur's overall agenda?
- What is the extent of harmonization of trade policies among members? What are some of the challenges faced by the members in this attempt?
- What is the scope for regional value chains?
- What is the opinion of the growth in popularity of the Pacific Alliance?
- How far has Mercosur come from its initial agenda in terms of integration, set in 1991? To what extent does your country adhere to the CET?
- What is the rationale for persistent trade wars with Brazil?
- What are some of the linkages you can identify between the internal dynamics and external trade agenda?
- How has the institutional structure evolved? What are your expectations from the bloc?

3) Mercosur -European Union relationship:

- What has been the EU's role in consolidating regional efforts in Mercosur?
- Have negotiations with the EU cemented integration efforts in Mercosur?
- It is believed that the idea of Mercosur was borrowed from the EU. How far do you think this ideology has influenced the integration efforts?
- Has their relationship affected Mercosur's external trade agenda?
- Is Brazil a "natural leader" in the bloc, given the leadership role played by Germany and France in the EU?
- Is Mercosur doing regionalism, right?

4) ALADI:

- What is the scope for regional value chains in South America?
- Is ALADI still relevant?
- Does ALADI display supranational tendencies? What is its role in the region?

ANNEXURE 3

List of Interviewees

NAME	AFFILIATION
Dr. Renato Baumann	Ministério de Planejamento, Desenvolvimento e Gustavo (MPDG), Brasília
Dr. Jorge Arbache	Ministério de Planejamento, Desenvolvimento e Gustavo (MPDG), Brasília (now, Vice-President for private sector at Development Bank of Latin America)
Ms. Elisa Ananias Fraga	Ministério do Desenvolvimento, Indústria e Comércio Exterior (MDIC), Brasília
Mr. Renato de Campos Souza	Ministério do Desenvolvimento, Indústria e Comércio Exterior (MDIC), Brasília
Mr. André Favero	Ministério do Desenvolvimento, Indústria e Comércio Exterior (MDIC), Brasília
Mr. Helder Paulo Machado Silva	Ministério do Desenvolvimento, Indústria e Comércio Exterior (MDIC), Brasília
Mr. (Diplomat) José Antonio Cury Gonçalves Braga	ITAMARATY, Brasília
Mr. (Minister) Michel Arslanian Neto	ITAMARATY, Brasília
Mr. (Ambassador) Ronaldo Costa Filho	ITAMARATY, Brasília
Ms. Paula Aguiar Barboza	Divisão de Negociações Comerciais com a Europa e América do Norte (DNEA), Brasília
Mr. Leonardo Rocha Bento	Divisão de Coordenação Econômica e Assunto Comerciais do MERCOSUL (DMC), Brasília
Ms. Anamélia Soccac Seyffarth	IPEA (now, Ministério de Planejamento, Desenvolvimento e Gustavo, MPDG), Brasília
Dr. Ivan Oliveira	IPEA, Brasília
Mr. Edison Benedito	IPEA, Brasília
Prof. Janina Onuki	University of São Paulo (USP), São Paulo
Prof. Michelle Badin Sanchez Rattón	Fundação Getúlio Vargas (FGV), São Paulo
Prof. Lucas Pedreira do Couto Ferraz	Fundação Getúlio Vargas (FGV), São Paulo (now, Ministério da Economia, Secretaria de Comércio Exterior, SECEX, Brasília)
Prof. Emanuel Ornelas	Fundação Getúlio Vargas (FGV), São Paulo
Mr. Alebe Linhares Mesquita	Fundação Getúlio Vargas (FGV), São Paulo
Prof. Carlos Melo	INSPER, São Paulo

Dr. Elena Lazarou (via skype)	Fundação Getúlio Vargas (FGV), São Paulo
Prof. Felix Peña Murray (via skype)	ICBC Fundación, Buenos Aires
Prof. Andrés Lopez (via skype)	Universidad de San Andrés, Buenos Aires
Prof. Roberto Bouzas (via skype)	Universidad de San Andrés, Buenos Aires
Prof. Marcel Vaillant	Universidad de la República de Uruguay, Montevideo
Prof. Ignacio Bartesaghi	Universidad Católica del Uruguay, Montevideo
Ms. Laura da Costa	Ministerio de Economía y Finanzas, Montevideo
Ms. Paola Benelli	Ministerio de Relaciones Exteriores (MRE), Montevideo
Mr. Marcus de Salles	Secretaría del MERCOSUR, Montevideo
Mr. Fernando Correa	Secretaría del ALADI, Montevideo
Ms. Flavia Rovira	CINVE, Montevideo
Dr. Natalia Ferreira Coimbra	Agencia de Compras y Contrataciones del Estado (ACCE), Montevideo

REFERENCES

- Abdel-Fadil, M., Cripps, F., & Wells, J. (1977). A new international economic order? *Cambridge Journal of Economics*, 1(2), 205–213. Retrieved from <https://www.jstor.org/stable/23596567>
- Ahmad, N., & Primi, A. (2017). From domestic to regional to global: factory Africa and factory Latin America? *Global Value Chain Development Report*, 69–95. Retrieved from https://www.wto.org/english/res_e/booksp_e/gvcs_report_2017_chapter3.pdf
- Alhadeff, E. T. (1995): Argentina-Brazil-Paraguay-Uruguay: Additional Protocol to The Treaty of Asuncion On The Institutional Structure Of Mercosur ("Protocol Of Ouro Preto"); *International Legal Materials* 34.5 (1995): 1244–1259.
- Alimonda, H. and Steiger, B. (1994). Mercosur, Democracy and Labor. *Latin American Perspectives*, Vol. 21, No. 4. Pp.21-33. Retrieved from <https://www.jstor.org/stable/2634007>
- Alvarez, M., (2011): Los 20 anos del Mercosur: Una Integracion a dos velocidades; CEPAL, Division of International Commerce and Integration
- Amjadi, A, and Winters, A. (1999): Transport Costs and "natural" Integration in Mercosur. *Journal of Economic Integration* Vol. 14 (4). pp. 497–521. Retrieved from <http://www.jstor.org/stable/23000445>.
- Andersen, M. (2003). Empirical intra-industry trade: What we know and what we need to know? NBER Working Paper No.5221
- Arndt, S. W. (2001). Production Networks in an Economically Integrated Region. *ASEAN Economic Bulletin*, Vol. 18 No. 1, *ECONOMIC GLOBALIZATION AND ASIA: Trade, Finance, and Taxation*. pp. 24-34. Retrieved from <https://www.jstor.org/stable/25773652>
- ASCOMA (2017). Auto Sales 0km 2017. Retrieved from <https://www.ascoma.com.uy/index.php/documentos-ascoma/download/11-estadisticas-de-ventas-de-autos-y-comerciales-livianos/1131-ventas-automoviles-0km-2017>
- ASEAN. (2013). ASEAN strategic plan for SME development (2010-2015). Jakarta. Retrieved from http://www.aseansme.org/dbfile/kc/kc_sap/SAP_SMED_Final.pdf

- (2015). ASEAN Strategic Action Plan for SME Development 2016-2025. Retrieved from <https://asean.org/wp-content/uploads/2015/12/SAP-SMED-Final.pdf>

Athukorala, P.C. (2005). Product Fragmentation and Trade Patterns in East Asia. *Asian Economic Papers* Vo. 4, No. 3. Pp. 1-27

Averbug, A. (1998). Mercosul: Economic Trends and Outlook *. *Revista Do BNDES*, 10(December). Retrieved from https://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_en/Galerias/Download/studies/rev101.pdf

- (2002). The Brazilian economy in 1994-1999: From the real plan to inflation targets. *World Economy*, 25(7), 925-944. <https://doi.org/10.1111/1467-9701.00472>

Baer, W. (1984). Industrialization in Latin America: Successes and Failures. *The Journal of Economic Education*. Vol. 15, No. pp.124- 135. Retrieved from <https://www.jstor.org/stable/1182052>

Balassa, B. (1961). *The Theory of Economic Integration*. Homewood: George Allen and Unwin Ltd. London. Pp.316

Baldwin, R. (1993). A domino theory of regionalism. NBER Working Paper 4465. Retrieved from <https://www.nber.org/papers/w4465.pdf>

- (1996): Alternate approaches to the political economy of endogenous trade liberalization: *European Economic Review* 40 pp. 775-782

- (2008): Big-Think Regionalism: A Critical Survey. NBER Working Paper No. 14056, June 2008

Baldwin, R. and Freund, C (2009): Preferential trade agreements and multilateral liberalization: World Bank, Chap.6

Baldwin, R. and Robert-Nicoud, F. (2008). A Simple Model of the Juggernaut Effect of Trade Liberalization. *CEP Discussion Papers* dp0845, Centre for Economic Performance, LSE. Retrieved from <http://cep.lse.ac.uk/pubs/download/dp0845.pdf>

Baldwin, R. and Seghezza, E. (2010). Are Trade Bloc Building or Stumbling Blocs?. *Journal of Economic Integration*, Vol. 25, No. 2 pp. 276-297. Retrieved from www.jstor.org/stable/23000977

Baldwin, R. and Venables, A. J. (1995). Regional Economic Integration. in Grossman, G. and Rogoff, K. (eds). *Handbook of International Economic* Vol.3,

pp. 1597-1644. Retrieved from https://s3.amazonaws.com/academia.edu.documents/6388762/baldwin_venables_handbook_1995_.pdf?response-content-disposition=inline%3B%20filename%3DRegional_economic_integration.pdf

Bambaci, J., Saront, T. and Tommasi, M. (2002). The political economy of Economic Reforms in Argentina. *Policy Reform*, 2002, Vol. 5(2), pp. 75–88. Retrieved from http://www1.worldbank.org/publicsector/decentralization/March2003Seminar/pol_econofreformsinArg.pdf

Baptista, L. O. (1998). *Mercosur: Its Institutions and Judicial Structure*. Foreign Trade Information System (www.sice.oas.org) pp 135 Retrieved from http://ctrc.sice.oas.org/geograph/south/mstit2_e.pdf

Bastos, L. A. (2004). *Mercosur: An Analysis of Economic Indicators for the Period from 1990 to 2004*. Retrieved from <http://www.tnc-online.net/pic/20130711080705779.pdf>

Baumann, R. (2008). Integration in Latin America - Trends and Challenges. *ECLAC Office in Brazil, LC/BRS/R.1*. Retrieved from <https://pdfs.semanticscholar.org/9a9b/5f745be94254d540c12011736450c3cd68cd.pdf>

- (2011). Integration in Latin America - trends and challenges. In *Regional Integration, Economic Development and Global Governance* (Vol. LC/BRS/R.1, pp. 76–102). <https://doi.org/10.4337/9781849809153.00013>

- (2013). *Regional Integration- Theory and Latin American experience*. Rio de Janeiro: LTC. 268 pp.

Beckerman, P. (1995). Central-Bank “Distress” and Hyperinflation in Argentina, 1989-90. *Journal of Latin American Studies*, (27(3)), 663–682. Retrieved from <http://www.jstor.org/stable/158487>

Beittel, J. S. (2010). Paraguay: Political and Economic Conditions and U.S. Relations. Congressional Research Service. Retrieved from <https://fas.org/sgp/crs/row/R41067.pdf>

Bergsten, Fred (1991). “Commentary: The Move toward Free Trade Zones”, *Economic Review*, Federal Reserve Bank of Kansas City, issue Nov, pages 27-35.

Bhagwati, J. (1990): Departures from Multilateralism: Regionalism and Aggressive Unilateralism: *The Economic Journal*, Vol. 100, No. 403, pp. 1304-1317

- (1991). *The World Trading System at Risk*, Harvester Wheatsheaf, Hemel

Hempstead.

- (1992). Regionalism versus Multilateralism: *The World Economy*, Vol. 15 (5), pp. 535-556

- (1993). Regionalism and Multilateralism. in de Melo, J. and Panagariya, A. (eds.). *New Dimensions in Regional Integration*. Cambridge: Cambridge University Press,

- (1995). U.S. Trade Policy: The Infatuation with Free Trade Agreements, Columbia University, April 1995, Discussion Paper Series No. 726; Also, in: Claude Barfield (ed.), *The Dangerous Obsession with Free Trade Areas*, AEI, 1995.

Bhagwati, J. and Panagariya, A. (1996) "Preferential Trading Areas and Multilateralism: Strangers, Friends or Foes?," in Bhagwati and Panagariya (eds.) *Free Trade Areas or Free Trade? The Economics of Preferential Trading Agreements*, AEI Press, Washington D.C.

(1999): *Alternative Approaches to analyzing Preferential Trade Agreements*, The MIT Press Cambridge, England

Bhagwati, J. N., Greenaway, David and Panagariya, Arvind (1998): Trading Preferentially: Theory and Policy: *The Economic Journal*, Vol. 108, No. 449, pp. 1128-1148

Birch, M. H. (2014). Paraguay and Mercosur: The Lesser of Two Evils? *Latin American Business Review*, 15(3-4), 269-290.
<https://doi.org/10.1080/10978526.2014.931791>

[Blejer, M. I. and Leiderman, L \(1981\)](#). A Monetary Approach to the Crawling-Peg System: Theory and Evidence. *Journal of Political Economy* Vol. 89, No.1 (Feb. 1981), pp. 132-151. Retrieved from https://www.jstor.org/stable/1837356?seq=10#metadata_info_tab_contents

Blockman, S. (ed) (2014). *Differentiated Integration in the EU: From the Inside Looking Out*

Blyde, J. S. (2006): Convergence Dynamics in Mercosur; *Journal of Economic Integration* 21 (4). Center for Economic Integration, Sejong University: 784-815.
<http://www.jstor.org/stable/23001137>.

Bouzas, R. (1995). Preferential Trade Liberalization in the Western Hemisphere: NAFTA and Beyond. In FONDAD, the Hague. *Regionalism and the Global Economy: The Case of Latin America and the Caribbean*. Retrieved from <http://www.fondad.org/uploaded/LAC%20Regionalism/LAC%20Regionalism-Bouzas.pdf>

- (2002) MERCOSUR: ¿Crisis Económica o crisis de la integración? paper presented at Foro de Política ‘Los nuevos desafíos para la integración regional’, Bolsa de Comercio de Buenos Aires, CEI-INTAL, Buenos Aires, 2 – 3 October.

- (2006). *Domestic determinants of national trade strategies: a comparative analysis of Mercosur countries, Mexico and Chile*. (R. Bouzas, Ed.). [Paris]: Chaire Mercosur de Sciences Po. Retrieved from <https://www.worldcat.org/title/domestic-determinants-of-national-trade-strategies-a-comparative-analysis-of-mercotur-countries-mexico-and-chile/oclc/76944785>

- (2011). MERCOSUR After Ten Years: Learning Process or Déjà-vu? in Tuchlin, J, Espach, R. and Golding, H. (eds). *Paths to Regional Integration: The Case of Mercosur*. Woodrow Wilson Center Reports on the Americas #5, Washington D.C.

Bouzas, R., & Fanelli, J. M. (2001). *Mercosur: integración y crecimiento*. Buenos Aires, Argentina: Fundación OSDE. Retrieved from <https://www.fundacionosde.com.ar/pdf/biblioteca/Mercosur.pdf>

Bown, C. P., Daniel Lederman, Samuel Pienknagura, & Raymond Robertson. (2017). *Better Neighbors: Toward a Renewal of Economic Integration in Latin America*. Washington, DC. Retrieved from <https://openknowledge.worldbank.org/bitstream/handle/10986/25736/210977ov.pdf?sequence=4&isAllowed=y>

Brainard, L. (2001). Trade Policy in the 1990s. Brookings Report. Retrieved from <https://www.brookings.edu/research/trade-policy-in-the-1990s/>

Brand, D. (1992). Regional bloc formation and world trade. *Intereconomics*, 27(6), 274–281. <https://doi.org/10.1007/BF02928060>

Braun, M. (2006). The Political Economy of Debt in Argentina, or Why History Repeats Itself. *The World Bank Group*.

Bresser-Pereira, L. C. (1990). Brazil's inflation and the Cruzado Plan, 1985-1988 in Pamela S. Falk *Inflation: Are we Next? Hyperinflation and Solutions in Argentina, Brazil and Israel*, Boulder: Lynne Rienner, 1990: 57-74. First published in Portuguese, 1988, with the title, “Dois Congelamentos de Preço”. Retrieved from <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.505.4515&rep=rep1&type=pdf>

Briceño Ruiz, J. (2006). “Regionalismo estratégico e interregionalismo en las relaciones externas del MERCOSUR.” *Aportes para la Integración Latinoamericana* (15): 30-45. Retrieved from http://sedici.unlp.edu.ar/bitstream/handle/10915/11350/Documento_completo.pdf?sequence=1

Brown, K. L. (2010). Venezuela joins Mercosur: The impact felt around the Americas. *Law and Business Review of the Americas*, Vol. 16(1), pp. 85-94.

Bruhn, D. (2014). Global Value Chains and Deep Preferential Trade Agreements: Promoting Trade at the Cost of Domestic Policy Autonomy? *DIE Discussion Paper* No. 23/2014, Bonn. Retrieved from https://www.die-gdi.de/uploads/media/DP_23.2014_01.pdf

Bruner, C. (2002). Hemispheric Integration and the Politics of Regionalism: The Free Trade Area of the Americas (FTAA). *InterAmerican Law Review* Vol. 33:1. University of Miami.

Bucheli, M. and Gustafsson, B. (1996). The development and structure of poverty in Montevideo, Uruguay (1983-1992). *The Developing Economies*. Vol. XXXIV-2. Retrieved from <https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1746-1049.1996.tb00736.x>

Caballero Santos, S., (2015): Identity in Mercosur: Regionalism and Nationalism; Global Governance: A Review of Multilateralism and International Organizations: January-March 2015, Vol. 21, No. 1, pp. 43-59.

Caichiolo, C. R. (2017). The Mercosur Experience and Theories of Regional Integration. *Contexto Internacional*, 39(1), 117–134. <https://doi.org/10.1590/s0102-8529.2017390100006>

Cammack, P. (1999): MERCOSUR: From Domestic Concerns to Regional Influence; in G. Hook and I. Kearns (eds) *Sub-regionalism and World Order*, London: Macmillan Press

[Canuto, O., Fleischhaker, C. and Schellekens, P. \(2015\). The curious case of Brazil's closedness to trade. Voxeu Article. Retrieved from https://voxeu.org/article/brazil-s-closedness-trade](https://voxeu.org/article/brazil-s-closedness-trade)

Cardoso, E. (2009). A Brief History of Trade Policies in Brazil: From ISI, Export Promotion and Import Liberalization to Multilateral and Regional Agreements, (March), 1–33. Retrieved from <http://www.tulane.edu/~dnelson/PEBricsConf/cardoso-trade.pdf>

Carranza, M. (2000): *South American Free Trade Area or Free Trade Area of the Americas? Open regionalism and the future of regional economic integration in South America*; Aldershot: Ashgate

- (2003a): *Can Mercosur Survive? Domestic and International Constraints on Mercosur; Latin American Politics and Society*, Wiley: 67–103. <http://www.jstor.org/stable/3176980>

- (2003b). Mercosur, The Free Trade Area of the Americas and the Future of the U.S. Hegemony in Latin America. *Fordham International Law Journal*. Vol. 27, Issue. 4, Article 14. Pp. 1028-1065. Retrieved from <https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=2270&context=ilj>

- (2004). Mercosur and the End Game of the FTAA Negotiations: Challenges and Prospects after the Argentine Crisis. *Third World Quarterly* Vol. 25, No. 2 (2004), pp. 319-337. Retrieved from <https://www.jstor.org/stable/3993684>

- (2006): Clinging Together: Mercosur's Ambitious External Agenda, Its Internal Crisis, and the Future of Regional Economic Integration in South America. *Review of International Political Economy* Vo. 13.5 pp.802–829

- (2010). Mercosur, the Global economic crisis, and the new architecture of regionalism in the Americas. *Latin American Trade Network Working Paper* No. 12. Retrieved from <http://latn.org.ar/wp-content/uploads/2015/01/wp-125.pdf>

Carrasco, L. (1986). *The Austral and Cruzado Plans: wrecking the economy to be popular. Click here for Full Issue of EIR* (Vol. 13). Retrieved from https://larouchepub.com/eiw/public/1986/eirv13n21-19860523/eirv13n21-19860523_009-argentinabrazil_the_austral_and.pdf

Casaburi, G. (1998). Trade and Industrial Policies in Argentina since the 1960s. *Documento de Trabajo* No. 16, IERAL, Buenos Aires. Retrieved from http://www.ieral.org/images_db/noticias_archivos/12-53877187.pdf

Casacuberta, C. and Vaillant, M. (2004). Trade and Wages in Uruguay in the 1990s. *Revista de Economía - Segunda Época* Vol. XI N° 2 - Banco Central del Uruguay - Noviembre 2004

Cason, J., (2000): On the Road to Southern Cone Economic Integration; *Journal of Inter-American Studies and World Affairs* 42

Causa, O., & Cohen, D. (2006). *The ladder of competitiveness: how to climb it*. Development Centre of the Organization for Economic Co-operation and Development. Retrieved from <https://books.google.co.in/books?id=ObZHDwd-i7EC&printsec=frontcover#v=onepage&q&f=false>

Celli, U., Tussie, D., Salles, M. M. de, & Peixoto, J. (2010). MERCOSUR in South-South Agreements: in the middle of two models of regionalism. UNCTAD Virtual Institute. Retrieved from https://www.academia.edu/7833009/MERCOSUR_in_South-South_Agreements_in_the_middle_of_two_models_of_regionalism

Central Bank, E. (2016). Box 1 What is driving Brazil's economic downturn? *ECB Economic Bulletin*, (1). Retrieved from https://www.ecb.europa.eu/pub/pdf/other/eb201601_focus01.en.pdf?64a2cdbc9c4a9c254445668338164746

Cepal. (2011). *Argentina*. Retrieved from https://repositorio.cepal.org/bitstream/handle/11362/1075/Argentina_en.pdf?sequence=10

- (2015). *Preliminary Overview of the Economies of Latin America and the Caribbean*. Retrieved from https://repositorio.cepal.org/bitstream/handle/11362/39559/67/1501279BPI_Brazil_en.pdf

- (2017a). *Economic Survey of Latin America and the Caribbean: ARGENTINA*. Retrieved from https://repositorio.cepal.org/bitstream/handle/11362/42002/23/EEI2017_Argentina_en.pdf

- (2017b). *Economic Survey of Latin America and the Caribbean: URUGUAY*. Santiago de Chile. Retrieved from https://repositorio.cepal.org/bitstream/handle/11362/42002/4/EEI2017_Uruguay_en.pdf

Chaddad, F. R., & Jank, M. S. (2006). The Evolution of Agricultural Policies and Agribusiness Development in Brazil. *American Agricultural Economics Association*, 21(2), 85–90. Retrieved from <http://www.choicesmagazine.org>.

Chaney, T. (2011). *The Gravity Equation in International Trade: An Explanation* *. Retrieved from <https://www.tse-fr.eu/sites/default/files/medias/doc/by/chaney/distance.pdf>

Christensen, S. F. (2007). The influence of nationalism in Mercosur and in South America – can the regional integration project survive? *Revista Brasileira de Política Internacional* Vol 50 No. 1, Brasilia

Chudnovsky, D. and Porta, F. (1989): On Argentine-Brazilian Economic Integration; CEPAL Review 39: 115-134

[Ciravegna, L. \(2003\). Global and regional integration of production in the Mercosur automotive value chains: the case of Fiat in *Automotive value chains in developing countries*. Fondazione Einaudi, Torino. Retrieved from https://pdfs.semanticscholar.org/4bec/a027ccb7cbcea88da343c61e4ae66476e3f.pdf](https://pdfs.semanticscholar.org/4bec/a027ccb7cbcea88da343c61e4ae66476e3f.pdf)

Coe, N. M., Hess, M., Yeung, H. W., Dicken, P., & Henderson, J. (2004). Globalizing regional development: a global production networks perspective. *Transactions of the Institute of British Geographers*, 29(4), 468–484. doi:10.1111/j.0020-2754.2004.00142.x

Collier, P., & Gunning, J. W. (1995). Trade Policy and Regional Integration: Implications for the Relations between Europe and Africa. *The World Economy*, 18(3), 387–410. <https://doi.org/10.1111/j.1467-9701.1995.tb00221.x>

[Cooke, P. \(2013\). *Growth Cultures: The Global Bioeconomy and Bioregions*. Routledge](#)

Cortes, M. (1993). *Mercosur and Paraguay's Growth Prospects*. Retrieved from <http://documents.worldbank.org/curated/en/268101468285318021/pdf/multi0page.pdf>

Cortez, L. A. B., Nogueira, L. A. H., Leal, M. R. V. L., & Junior, R. B. (n.d.). *40 Years of the Brazilian Ethanol Program (Proálcool): Relevant Public Policies and Events Throughout Its Trajectory and Future Perspectives*. Retrieved from http://bioenfapesp.org/gsb/lacaf/documents/papers/05_ISAF_2016_Cortez_et_al.pdf

Coxhead, I., & Jayasuriya, S. (2010). China, India and the Commodity Boom: Economic and Environmental Implications for Low-income Countries. *World Economy*, 33(4), 525–551. <https://doi.org/10.1111/j.1467-9701.2009.01232.x>

Crawford, J. and Fiorentino, R. (2005). The Changing Landscape of Regional Trade Agreements. *WTO Discussion Paper No. 8*, Geneva.

Crawley, A. (2004): Mercosur: In Search of a New Agenda - Rapporteur's Report, INTALITD Working Paper SITI-06A, Washington, DC.

Curran, L., Nilsson, L., & Brew, D. (2008). The Economic Partnership Agreements: Rationale, Misperceptions and Non-trade Aspects. *Development Policy Review*, 26(5), 529–553.

Damill, M., & Frenkel, R. (2004). The crisis of the convertibility regime in Argentina: Main controversies and some evidence 1. *Journal of Iberian and Latin American Studies (JILAS)*, 10(2). Retrieved from https://www.researchgate.net/publication/264999498_The_crisis_of_the_convertibility_regime_in_Argentina_Main_controversies_and_some_evidence_1

Daseking, C., Ghosh, A., Lane, T., & Thomas, A. (2004). Lessons from the crisis in Argentina. *IMF Occasional Papers*. Retrieved from <https://www.imf.org/external/np/pdr/lessons/100803.pdf>

de Andrade Alves, E. R., & Pastore, A. C. (1978). Import Substitution and Implicit Taxation of Agriculture in Brazil. *American Journal of Agricultural Economics*, 60(5), 865. <https://doi.org/10.2307/1240108>

de Azambuja, M. S. (1996): Mercosur: A Pragmatic Regional Building Block; Proceedings of the Annual Meeting (American Society of International Law), Vol. 90, ARE INTERNATIONAL INSTITUTIONS DOING THEIR JOB? (MARCH 27-30, 1996), pp. 514-516

de Azevedo, A.F. (2003): Mercosur: Ambitious Policies, Poor Practices; Porto Alegre: Federal University of Rio Grande do Sul, Working Paper (4)

de Ferranti, D. M. (2002). Comparative Advantage, Diversification, and Intra-Industry Trade: Determinants and Consequences. In *FROM NATURAL RESOURCES TO THE KNOWLEDGE ECONOMY: TRADE AND JOB QUALITY* (pp. 13–48). World Bank. Retrieved from http://web.worldbank.org/archive/website00960A/WEB/PDF/02_CH-2.PDF

de Gouvea Neto, R. (1998): Mercosur: Fostering Regional Economic Integration. *Thunderbird Int'l Bus Rev*, 40: 585–604

De Lombaerde, P. (2006). *Assessment and measurement of regional integration*. Routledge. London.

de Lombaerde, P. and Pineda, G. (2002): Diferencias culturales e integracion economica regional, Bogota, Universidad Nacional de Colombia

De Lombaerde, P. and Van Langenhove, L. (2006). Indicators of regional integration: conceptual and methodological aspects. in de Lombaerde, P. (ed.) *Assessment and Measurement of Regional Integration*. Routledge, London.

de Moura, A. B. (2018). The Mercosur Citizenship Statute: is it possible for regional citizenship? *Brazilian Journal of Law*, 14(2), 135–153. <https://doi.org/10.18256/2238-0604.2018.v4i2.1783>

de Oliveira, G. (2005): Mercosur: Political Development and Comparative Issues with the European Union; Jean Monnet/Robert Schumann Paper Series 19

de Paiva Abreu, M. (1998). Brazil, the GATT, and the WTO: History and prospects. *Prospects*, 1–38. Retrieved from <http://www.econ.puc-rio.br/uploads/adm/trabalhos/files/td392.pdf>

- (2006). The FTAA and the Political Economy of Protection in Brazil and the US. IDB- INTAL- ITD *Special Initiative on Trade and Integration. Working Paper* SITI- 12. Retrieved from

<https://publications.iadb.org/publications/english/document/The-FTAA-and-the-Political-Economy-of-Protection-in-Brazil-and-the-US.pdf>

Department of Commerce, India (2019). MERCOSUR Preferential Trade Agreement (PTA) Negotiations.

Derooij, M. (2014). Commodity super cycles: A reality check. *Asian Management Insights*, (1), 70–75. Retrieved from <https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=1046&context=ami>

Doctor, M., (2013): Prospects for deepening Mercosur integration: Economic asymmetry and institutional deficits; *Review of International Political Economy*, 20:3, 515-540, DOI: 10.1080/09692290.2012.671763

Dornbusch, R., Park, Y. C. and Claessens, Stijn (2000). Contagion: How it spreads and How it can be stopped. *World Bank Research Observer*

Draper, P., Khumalo, N. and Tigere, F. (2017). Sustainability Provisions in Regional Trade Agreements: Can they be multilateralised? RTA Exchange. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and the Inter-American Development Bank (IDB). Retrieved from <http://e15initiative.org/wp-content/uploads/2015/09/RTA-Exchange-Sustainability-Provisions-Draper-Khumalo-Tigere-Final.pdf>

Duina, F. (2006). Varieties of Regional Integration: The EU, NAFTA and Mercosur. *Journal of European Integration*. Vol. 28, No. 3. pp. 247-275. Retrieved from https://www.tandfonline.com/doi/pdf/10.1080/07036330600744456?casa_token=ExjoCSveDdUAAAAA:REcJDBCc09YwmC_1lZdAyC6eKA0SjDS33m9G6HjXNeyJ9glYKJDb8sOljk4p-kePvzOWOAxmJ_OzQw

- (2015): Latin American Unification: A History of Political and Economic Integration Efforts. Rivera, Salvador. *Bulletin of Latin American Research* Vol 34. Pp. 544–545

ECLAC (1994). *Open Regionalism in Latin America and the Caribbean*. Santiago, Chile

- (2015). *Preliminary Overview of the Economies of Latin America and the Caribbean: Brazil*. Retrieved from https://repositorio.cepal.org/bitstream/handle/11362/39559/67/1501279BPI_Brazil_en.pdf

Edwards, S. (1995). *Crisis and Reform in Latin America: From Despair to Hope*. A World Bank Book. Retrieved from

<http://documents.worldbank.org/curated/en/639531468743177547/pdf/multi0page.pdf>

Egger, H., Greenaway, D., & Egger, P. (2011). Intra-Industry Trade with Multinational Firms: Theory, Measurement and Determinants. *SSRN Electronic Journal*. <https://doi.org/10.2139/ssrn.715967>

Ernst, C. (2005). *Trade liberalization, export orientation and employment in Argentina, Brazil and Mexico*. Retrieved from https://www.researchgate.net/profile/Christoph_Ernst3/publication/5115598_Trade_liberalization_export_orientation_and_employment_in_Argentina_Brazil_and_Mexico/links/54ec7b0a0cf27bfd770d5ed/Trade-liberalization-export-orientation-and-employment-in-Argent

Ernst D. (2004) How Sustainable are Benefits from Global Production Networks? Malaysia's Upgrading Prospects in the Electronics Industry. In: Kidd J., Richter FJ. (eds) *Trust and Antitrust in Asian Business Alliances*. Palgrave Macmillan, London

Esteradeordal, A., Freund, C. and Ornelas, E. (2008). Does Regionalism affect trade liberalization towards non-members? *Center for Economic Performance Discussion Paper* No. 868

Esteradeordal, A., Junichi G., and Raul S., (2001): The New Regionalism in the Americas: The Case of Mercosur; *Journal of Economic Integration* 16.2 (2001): 180–202

Ethier, W. J. (1998). Regionalism in a multilateral world. *Journal of Political Economy*, 106(6). Retrieved from 1214–1245. http://www4.congreso.gob.pe/historico/cip/tlc/4_DOSSIER_TEMATICO/4_5/4_5_1/12.pdf

- (2008). Country Strategy paper 2008-2013. Retrieved from https://cdn1-eeas.fpfs.tech.ec.europa.eu/cdn/farfuture/togKyK_Kq7vxCWuqE3gg3xonm89TUIOx2XcARyz3Jo4/mtime:1479480882/sites/eeas/files/07_13_en_4.pdf

- (n.d.). Trade Sustainability Impact assessment (SIA) of the Association Agreement under negotiation between the European Community and Mercosur. Consultation Draft. Manchester. Retrieved from https://trade.ec.europa.eu/doclib/docs/2008/november/tradoc_141396.pdf

- (2018). *The EU Customs Union at 50: Concept to Continuum*. Gutenberg Press, Malta. Muscat, I. (ed.)

- (2019a). Counties and Regions: Argentina. Retrieved from <https://ec.europa.eu/trade/policy/countries-and-regions/countries/argentina/>

- (2019b). EU and Mercosur reach agreement on trade. News Archive, Brussels.
- Fabbrini, S. (2008). European Regionalism in a Comparative Perspective- Features and Limits of the New Medievalist Approach to World Order. paper submitted at the *third Pan Hellenic Conference on International Political Economy*, Charokopeion University, Athens
- FAO (2017). The key to the dairy conflict between Brazil and Uruguay. *Feature: Southern Cone*. Retrieved from <http://www.fao.org/in-action/agronoticias/detail/en/c/1045720/>
- Feinberg, R. E. (2003). The Political Economy of the United States' Free Trade Arrangements. Presented at 'Bilateral trade arrangements in the Asia-Pacific region- Origins, Evolution and Implications' sponsored by the Berkeley APEC Study Center (BASC). University of California, Berkeley. Retrieved from <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.134.9641&rep=rep1&type=pdf>
- Ferguson, C. C. (1977). The Politics of the New International Economic Order. *Proceedings of the Academy of Political Science*, 32(4), 142. <https://doi.org/10.2307/1173998>
- Ferraz, L., Gutierrez, L. and Cabral, R. (2015). The Manufacturing Industry in Brazil in the era of Global Value Chains. *FGV Working Paper Series CCGI* No. 4
- Ferrer, A. (1997): Two Models of Mercosur: Sustainable Integration or the Washington Consensus? Encrucijadas, University of Buenos Aires. 9-25
- Filho, T.F. M., Lixinski, L., Giupponi, B. O.M. (2010): *The Law of Mercosur*; Bloomsbury Publishing
- Flynn, P. (1996). Brazil: the politics of the 'Plano Real'. *Third World Quarterly* Vol. 1, No. 3, pp.401-426. Retrieved from https://www.jstor.org/stable/3993198?seq=1#metadata_info_tab_contents
- Foxley, A. (2010). *Regional Trade Blocs: The way to the future?* Carnegie Endowment for International Peace, Washington D.C. Retrieved from http://carnegieendowment.org/files/regional_trade_blocs.pdf
- Free Zones in Uruguay. (2015), 1–24. Retrieved from [https://www.uruguayxxi.gub.uy/guide/descargas/Zonas Francas - Uruguay XXI.pdf](https://www.uruguayxxi.gub.uy/guide/descargas/Zonas_Francas_-_Uruguay_XXI.pdf)
- Freymann, C. (2007): Venezuela is thorn in Mercosur's future; San Antonio Business Journal, Apr 8, 2007

Frischtak, C. R. (1989). *The Protection of Intellectual Property Rights and Industrial Technology Development in Brazil* (Industry and Energy Department Working Paper Industry Series No. 13). Retrieved from <http://documents.worldbank.org/curated/en/934491468769165476/pdf/multi0page.pdf>

Galiani, S., & Somaini, P. (2018). Path-dependent import-substitution policies: the case of Argentina in the twentieth century. *Latin American Economic Review*, 27(5).

Galiani, S., Heymann, D., & Tommasi, M. (2003). Great Expectations and Hard Times: The Argentine Convertibility Plan. *Economía*, 3(2), 109–147. <https://doi.org/10.1353/eco.2003.0005>

García, E. C., Pabsdorf, M. N. and Herrera, E. G. (2013): The gravity model analysis: an application on MERCOSUR trade flows; *Journal of Economic Policy Reform*, 16:4, 336-348

Gárriz, A., Panigo, D. and Galo, P. (2014). Common Automotive Policy of Argentina and Brazil: its impact on local and regional auto part industries. Retrieved from https://www.researchgate.net/profile/Demian_Panigo/publication/303471204_Common_Automotive_Policy_of_Argentina_and_Brazil_its_impact_on_local_and_regional_auto_part_industries/links/57446dd308aea45ee851d903.pdf

GATT (1991). Trade Policy Review Mechanism, Argentina, Report by the Secretariat, C/RM/S/18A, C/RM/S/18B and C/RM/G/18, dated Nov. 8th, 1991; C/RM/M/18 dated May 14th, 1992

- (1992a). Trade Policy Review Mechanism, Uruguay, Report by the Secretariat, C/RM/S/26A, C/RM/S/26B and C/RM/G/26, dated June 12th, 1992.

- (1992b). Southern Common Market (Mercosur). L/7044. Retrieved from https://www.wto.org/gatt_docs/English/SULPDF/91630185.pdf

- (1994). Text of Article XXIV: The Original Mandate. Retrieved from https://www.wto.org/english/tratop_e/region_e/region_art24_e.htm

Gerschenkron, A. (1962). *Economic Backwardness in Historical Perspective: A book of Essays*. Cambridge, Massachusetts: Harvard University Press.

Giacomazzi, E. (2012). A Brief History of Brazilian Proálcool Program and developments of Biofuel and Bio-based products in Brazil. Prepared for OECD-Global Forum Biotechnology, Paris, Retrieved from <http://www.oecd.org/sti/emerging-tech/Giacomazzi.pdf>

Ginsberg, R.S., (2007): *Demystifying the European Union: The Enduring Logic of Regional Integration*; New York: Rowman and Littlefield

Giudice, L., Leon, G. and Molteni, G. (2011): 20 Years On: The Achievements and Pending Challenges of Mercosur; IDB-INTAL

Glaeser, E. L., Di Tella, R., & Llach, L. (2018). Introduction to Argentine exceptionalism. *Latin American Economic Review*. <https://doi.org/10.1007/s40503-017-0055-4>

Gnidchenko, A. and Salnikov, V. (2015). Net Comparative Advantage Index: Overcoming the Drawbacks of the Existing Indices. *Higher School of Economics Research Paper* No. WP BRP 119/EC/2015

Gomez- Mera, L. (2005): Explaining Mercosur's Survival: Strategic Sources of Argentine-Brazilian Convergence; *Journal of Latin American Studies*, Vol. 37, No. 1 (Feb., 2005), pp. 109-140

- (2009): Domestic constraints on regional cooperation: Explaining trade conflict in MERCOSUR; *Review of International Political Economy*, 16:5, 746-777, DOI: 10.1080/09692290802454216

Gonzalez Duarte, R., & Braga Rodrigues, S. (2017). Co-evolution of Industry Strategies and Government Policies: The Case of the Brazilian Automotive Industry. <https://doi.org/10.1590/1807-7692bar2017160100>

González, A. (2019). The EU-Mercosur Trade Accord Sends a Signal to the World's Protectionists | PIIE. *Peterson Institute for International Economics*. Retrieved from <https://www.piie.com/blogs/trade-investment-policy-watch/eu-mercosur-trade-accord-sends-signal-worlds-protectionists>

Gordon, R. (2009). The dawn of a new, new international economic order? *Law and Contemporary Problems*, 72(4), 131–162. Retrieved from <https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1548&context=lcp>

Graham, D. H., Gauthier, H., & Mendonça de Barros, J. R. (1987). Thirty Years of Agricultural Growth in Brazil: Crop Performance, Regional Profile, and Recent Policy Review. *Economic Development and Cultural Change*, 36(1), 1–34. Retrieved from <http://www.jstor.org/stable/1153990>

Greenaway, D. and Milner, C. (1990). South-South Trade: Theory, Evidence and Policy. *The World Bank Research Observer*, Vol. 5, No. 1. pp. 47-68. Retrieved from <https://www.jstor.org/stable/3986599>

Grossman, G. M. and Horn, H. (2012). Why the WTO? An introduction to the economics of trade agreements. *Research Institute of Industrial Economics (IFN) Working Paper* no. 916, Stockholm Retrieved from. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2094285

Grugel, J. (2007): 'Democratization and Ideational Diffusion: Europe, Mercosur and Social Citizenship'; *Journal of Common Market Studies*, 45(7): 43–68

Gullstrand, J. (2002). Demand patterns and vertical intra-industry trade with special reference to North-South trade. *Journal of International Trade and Economic Development*, 11(4), 429–455. <https://doi.org/10.1080/0963819022000014249>

Hafner, M., Enora R. and Stijn H. (2014): The Cost of Non-Europe in the Single Market: Free Movement of Goods. Santa Monica, CA: RAND Corporation, 2014. https://www.rand.org/pubs/research_reports/RR862.html .

Hafner-Burton, E. M. and Montgomery, A. H. (2012). War, Trade, and Distrust: Why Trade Agreements Don't Always Keep the Peace. *Conflict Management and Peace Science* Vol. 29, No. 3 pp. 257-278

Hanson, J. and de Melo, J. (1983). The Uruguayan Experience with Liberalization and Stabilization, 1974-1981. *Journal of Interamerican Studies and World Affairs*. Vol 25, No. 5. pp. 477-508. Retrieved from <https://www.jstor.org/stable/165633>

Harberger, A. (1975). El rol de los factores fiscales en la inflación de Uruguay. *Cuadernos de la Economía de la Universidad Católica de Chile*. Vol. 12, No. 37. Pp. 33-46.

Hardt, B. (2008): *A Comparative Analysis of Regional Integration Efforts in Europe and South America*.

Heydon, K. (2016). *The Ashgate Research Companion to International Trade Policy*. Woolcock, S. (ed)

Heymann, D. and Ramos, A. (2008): Deepening Integration of MERCOSUR: Dealing with Disparities- Mercosur in Transition: Macroeconomic Perspective; Inter-America Development Bank/ ECLAC

Hirschman, A. O. (1968). The Political Economy of Import-Substituting Industrialization in Latin America. *The Quarterly Journal of Economics*, 82(1), 1. <https://doi.org/10.2307/1882243>

Hirst, M. (1992): Avances y desafíos en la formación del Mercosur; Buenos Aires: FLACSO

Hoffmann, A. R. (2015). At last: Protection and Promotion of Human Rights by Mercosur. In Börzel, T. A. and van Hüllen, V. (Eds.). *Governance Transfer by Regional Organizations*. doi:10.1057/9781137385642

Hofstede, G. (2001): *Culture's Consequence, Comparing Values, Behaviors, Institutions and Organizations across Nations* (Thousand Oaks, CA, Sage Publications)

Holden, M. (2003). *Stages of Economic Integration: From Autarky to Economic Union* (Vol. PRB 02). Retrieved from <http://publications.gc.ca/Collection-R/LoPBdP/inbrief/prb0249-e.htm>

Hopewell, K. (2015). Different Paths to Power: The Rise of Brazil, India and China at the WTO. *Review of International Political Economy* 22(6), pp. 1128-58. Retrieved from <http://www.tandfonline.com/doi/full/10.1080/09692290.2014.927387#.U6DEm01OU5s>

Hugon, P. (2002). *Les economies en development a l'heure de la regionalization*; Paris, Karthala

Hurrell, A. (1995). Regionalism in Theoretical Perspective. in Fawcett, L. and Hurrell, A. (eds) *Regionalism in World Politics*, pp. 37–73. Oxford: Oxford University Press

Iapadre, P.L and Tajoli, L. (2014). Emerging countries and trade regionalization: a network analysis. *Journal of Policy Modeling* Elsevier Vol. 36(S1). Pp. 89-110. DOI: 10.1016/j.jpolmod.2013.10.010

IDB- INTAL (2000). *Mercosur Report No. 6*, Buenos Aires. Retrieved from [https://publications.iadb.org/publications/english/document/MERCOSUR-Report-No-6-\(1999-2000\).pdf](https://publications.iadb.org/publications/english/document/MERCOSUR-Report-No-6-(1999-2000).pdf)

IDB- INTAL (2008). *Mercosur Report No. 13*, Buenos Aires. Retrieved from [https://publications.iadb.org/publications/english/document/MERCOSUR-Report-No-13-\(2007-2008\).pdf](https://publications.iadb.org/publications/english/document/MERCOSUR-Report-No-13-(2007-2008).pdf)

International Monetary Fund (IMF). (1991). *International Monetary Fund Annual Report*.

- (2003a). Lessons from the Crisis in Argentina. Retrieved from <https://www.imf.org/external/np/pdr/lessons/100803.pdf>

- (2003b). *The IMF and Recent Capital Account Crises: Indonesia, Korea, Brazil*. Washington D.C. Retrieved from <https://www.imf.org/external/np/ieo/2003/cac/pdf/all.pdf>

- (2017). Uruguay: Staff Concluding Statement of the 2017 Article IV Mission. Retrieved January 22, 2019, from <https://www.imf.org/en/News/Articles/2017/12/07/ms120717-uruguay-staff-concluding-statement-of-the-2017-article-iv-mission>

International Trade Center Trade Map Data

Jenkins, B. (1999): Assessing the "New" Integration: The MERCOSUR Trade Agreement. In *Racing to Regionalize: Democracy, Capitalism, and Regional Political Economy*; ed. Kenneth P. Thomas and Mary Ann Tetrault. Boulder: Westview Press. 33-56

Jenkins, R. (2015). Is Chinese Competition Causing Deindustrialization in Brazil?. *Latin American Perspectives* Vol. 42 issue No. 6, pp. 42-63. Retrieved from <https://journals.sagepub.com/doi/abs/10.1177/0094582X15593553>

Jensen, L., & Lüthje, T. (2009). Driving forces of vertical intra-industry trade in Europe 1996-2005. *Review of World Economics*, 145(3), 469-488. <https://doi.org/10.1007/s10290-009-0022-5>

Jorge Ramalho, A. (2013). Brazil in the Global Security Order: Principled Action and Immediate Responses to Long-Term Challenges. In Dane. F. (ed). *Brazil Emerging in the Global Security Order*. Konrad-Adenauer-Stiftung, Rio de Janeiro
Joseph, K. (2017). *Uruguay: Livestock and Products- Annual Report*. Retrieved from http://agriexchange.apeda.gov.in/marketreport/Reports/Livestock_and_Products_Annual_Buenos_Aires_Uruguay_9-5-2017.pdf

Jurn, I., & Park, H. (2002). The Trade Effects on the Non-Member Countries of the Regional Integration: The Case of the Mercosur. *Multinational Business Review*, 10(2), 23. Retrieved from https://www.iatp.org/sites/default/files/Trade_Effects_on_the_Non-Member_Countries_of_t.htm

Kaltenthaler, K. and Mora, F. O., (2002): Explaining Latin American Economic Integration: The Case of Mercosur; *Review of International Political Economy*, Vol. 9, No. 1 (Mar., 2002), pp. 72-97

Katz, C. (2002). Free Trade Area of the Americas-NAFTA marches south. *NACLA Report on the Americas* No. 35:4. pp. 27-28. DOI:10.1080/10714839.2002.11722544

Kessler, G. (2018). The Chinese 'Jeitinho': A Case of Sino-Brazilian Trade Relations. *Independent Student Journal: International Relations* 2018 Vol 1 pp 44-49

Kiguel, M. a., & Liviatan, N. (1995). Stopping Three Big Inflations: Argentina, Brazil, and Peru. *Reform, Recovery, and Growth: Latin America and the Middle East*, (January 1995), 369-414. Retrieved from http://siteresources.worldbank.org/BRAZILINPOREXTN/Resources/3817166-1185895645304/4044168-1186403960425/62pub_br156.pdf

Kim, C-S. and K-E. Lee, 2003. Regional trade arrangements and intra-industry trade: The case of Mercosur. *Asian Journal of Latin American Studies*. Vol. 16(1) pp. 95-113. Retrieved from <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.516.976&rep=rep1&type=pdf>

Kim, H and Smith, D (1997). Blocs or Rounds? An analysis of two approaches to trade liberalization. *Canadian Journal of Political Science* Vol. 30, No. 3. Pp. 427-444

Kim, J., Kwon, K., Ko, H., Park, M. and Kim, H. (2011). The 20 Years of MERCOSUR: Performance and its Implications. *Korean Institute of International Economic Policy Analyses* 11-30. Retrieved from <http://www.kiep.go.kr/eng/sub/view.do?bbsId=policyAnalyses&nttId=185607>

Klonsky, J., Hanson, S. and Lee, B. (2012): Mercosur: South America's Fractious Trade Bloc; CFR.org. *Council on Foreign Relations* (later updated as Felter, C, Renwick, D and Chatzky, A. (2019).

Kormann, L. (2015). *Big Business and Brazil's Economic Reforms*. Routledge

Kose, A., & Riezman, R. (1997). *Small countries and regionalism*. Retrieved from http://www.biz.uiowa.edu/faculty/rriezman/papers/small_country-Cyprus.pdf

Kronberger, R. (2004). A Cost-Benefit Analysis of a Monetary Union for MERCOSUR with Particular Emphasis on the Optimum Currency Area Theory? *Macroeconomics* 0407010, University Library of Munich, Germany.

Krugman P. (1991a). "Is Bilateralism Bad?" in Helpman and Razin. (eds) *International Trade and Trade Policy*. Cambridge MA, MIT Press.

- (1991b). Scale economies, Product Differentiation, and the Pattern of Trade. *The American Economic Review*, Vol. 70, No. 5 pp.950-059. Retrieved from <https://www.jstor.org/stable/1805774>

- (1991c). The Move toward Free Trade Zones. *Economic Review*. Retrieved from <https://www.kansascityfed.org/publicat/sympos/1991/S91krugm.pdf>

Laird, S. (1997). MERCOSUR: Objectives and Achievements. The World Bank Country Department 1, Latin America and the Caribbean Region *Economic Notes* No. 2. Geneva.

Latin American Regional Report: Brazil & Southern Cone (LARR). (2005). Brazil: Isolated or Mediating?

Latin American Weekly Report (LAWR). (1999a): Brazilian Threat is Changing Stances of Argentine Businessmen on Key Policies; August 24: 385

- (1999b): Brazil Escalates Tit-for-Tat Measures: Latest Restriction Affects 400 Argentine Products; September 21: 434

Lazarou, E., and Luciano, B.T., (2015): Regionalism as an Instrument: Assessing Brazil's Relations with its Neighborhood, *Global Society*, 29:3, 390-408, DOI: 10.1080/13600826.2015.1039500

Leipziger, D. M., Frischtak, C., Kharas, H. J. and Normand, J. F. (1997). Mercosur: Integration and Industrial Policy. *The World Economy* Vol. 20 No.5 pp.585–603. Retrieved from http://www.dannyleipziger.com/documents/dl_mercosur.pdf

Lenz, T. (2011). The EU's Inescapable Influence on Global Regionalism. Doctoral Thesis, University of Oxford, Trinity Term 2011

- (2016). Frame Diffusion: How European Union-Type Common Markets Have Spread Around the World. *EUI Working Paper MWP 2016/06*. Retrieved from https://cadmus.eui.eu/bitstream/handle/1814/40784/MWP_2016_06.pdf

Limão, N. (2016). Preferential Trade Agreements. NBER Working Paper No. 22138. Retrieved from <https://www.nber.org/papers/w22138.pdf>

Linder, S.B. (1961) An Essay on Trade and Transformation. Almqvist & Wiksells, Stockholm.

Lindberg, L. (1963). *The Political Dynamics of European Economic Integration*. Stanford

Lipsey, R. G. (1960). The Theory of Customs Union: A General Survey. *The Economic Journal*. Vol. 70, No. 279, pp. 496-513. Retrieved from <http://www.jstor.org/stable/2228805>

Lipsey, R. G. and Lancaster, K. (1957). The General theory of Second Best. *The Review of Economic Studies* Vol. 24, No. 1, pp. 11-32. Retrieved from <http://www.jstor.org/stable/2296233>

Lorenzo, J. (2006). Obstacles to Total Economic Integration in Regional Trade Blocs: The Case of Mercosur. *Honors College Theses*. Paper 43. Retrieved from http://digitalcommons.pace.edu/honorscollege_theses/43

Lorenzo, F. and Vaillant, M. (2003). *MERCOSUR and the Creation of the Free Trade Area of the Americas*. Woodrow Wilson International Center for Scholars. Washington DC. Retrieved from www.wilsoncenter.org/sites/default/files/Mercosur_rpt_amer_14.pdf

Low, P., & Pasadilla, G. O. (2015). Services in Global Value Chains: Manufacturing-Related Services. *SSRN Electronic Journal*. <https://doi.org/10.2139/ssrn.2698977>

Lowinger, T. C. (2007). Import substitution, export promotion and the structure of Brazil's protection. *The Journal of Development Studies*, 10(3-4), 430-444. <https://doi.org/10.1080/00220387408421502>

Machinea, J. L., (2004): Mercosur- In search of a New Agenda, Exchange Rate stability in Mercosur: Causes, Problems, and Possible Solutions; INTAL-ITD Working Paper- SITI- 06D

Machinea, J. L. and Rozenwurcel, G. (2005). Macroeconomic Coordination in Latin America: Does it have a future? *CEPAL Serie Informes y estudios especiales*, Vol. 15 ISSN 1682-0010

Maizels, A. (2003a). Economic dependence on commodities. In *Trade and Development: Directions for the 21st Century* (pp. 169-184). <https://doi.org/10.4337/9781843767473.00013>

Malamud, A. (2003): Presidentialism in Mercosur, A Hidden Cause for a Successful Experience; in Flaursen (ed) *Comparative Regional Integration: Theoretical Perspective* (Aldershot, Ashgate)

- (2005): Mercosur Turns 15: Between Rising Rhetoric and Declining Achievement. *Cambridge Review of International Affairs*. Vol. 18, Issue 3, 2005

- (2010). Theories of Regional Integration and the Origins of Mercosur. in Filho,

T.F. M., Lixinski, L., Giupponi, B. O.M. (eds). *The Law of Mercosur*; Bloomsbury Publishing

Malamud, A. and Schmitter, P. C. (2006). The experience of the European Integration and the Potential for Integration in Mercosur. Prepared for delivery at the 2006 Joint Sessions of Workshops of the European Consortium for Political Research (ECPR), Nicosia, Cyprus, 25-30 April, 2006

Mansfield, E. D. and Milner, H. V. (2014). The Domestic Politics of Preferential Trade Agreements in Hard Times. Stanford University. Retrieved from <https://web.stanford.edu/group/ssl/cgi-bin/wordpress/wp-content/uploads/2014/03/Mansfield-and-Milner-PTAhard-times-03292014.pdf>

Mansfield, E. D and Reinhardt, E. (2003). Multilateral Determinants of Regionalism: The effects of GATT/WTO on the formation of preferential trading arrangements. *International Organization* Vol. 57, No. 4, pp. 829-862. Retrieved from <https://www.jstor.org/stable/3594848>

Mansfield, E.D. and Solingen, E. (2010). Regionalism. *The Annual Review of Political Science*. No. 13.2010. pp. 145-163. Retrieved from 10.1146/annurev.polisci.13.050807.161356

Mántey, G. (2006). *Inflation Targeting and Exchange Rate Risk in Emerging Economies Subject to Structural Inflation: Economic and Financial Developments in Latin America*. (S. Motamen-Samadian, Ed.), *Palgrave Macmillan*.

Manzetti, L. (1994) 'The Political Economy of Mercosur', *Journal of Inter-American Studies and World Affairs* 35(4): 101-42

Manzini, A. (2019). The “new” MERCOSUR Protocol on Public Procurement and its role for the EU-MERCOSUR FTA. *EU Trade and Investment Policy, University of Birmingham*. Retrieved from <https://more.bham.ac.uk/eutip/the-new-mercotur-protocol-on-public-procurement-and-its-role-for-the-eu-mercotur-fta/>

Manzoni, M. (2018). Argentina’s century long inflationary tale. *The McGill International Review*. Retrieved from <https://www.mironline.ca/argentinas-century-long-inflationary-tale/>

Maristela, F. de P., Humberto, A., Anadalvo, J. S., Alexandre, N. de A., Pedro, G. de A. V., Ari, S., ... Ademir, J. F. R. (2018). Competitiveness of Brazilian soybean exports. *African Journal of Agricultural Research*, 13(44), 2499–2509. <https://doi.org/10.5897/ajar2018.13398>

Markwald, R., and Machado, J., B. (1999): Establishing an Industrial Policy for Mercosur; In Roett 1999. 63-80

Martinez-Zarzoso, I. (2003). Gravity model: An application to trade between regional blocs. *Atlantic Economic Journal*, 31(2), 174–187. <https://doi.org/10.1007/bf02319869>

Martinez-Zarzoso, I., & Nowak-lehman, F. (2003). Augmented Gravity Model: an Empirical Application. *Journal of Applied Economics*, VI(2), 291–316. Retrieved from <https://ucema.edu.ar/publicaciones/download/volume6/martinez.pdf>

Mashayekhi, M. and Ito, T. (2005). *Multilateralism and Regionalism: The New Interface*. UNCTAD/DOTC/TNCD/2004/7. Retrieved from https://unctad.org/en/docs/ditctncd20047_en.pdf

Mateos y Lago, I., Takagi, S., Martin, R., Takebe, M. and Cohen, B. (2004). *The IMF and Argentina, 1991-2001*. *The IMF and Argentina, 1991-2001*. <https://doi.org/10.5089/9781589063808.017>

Matthew, A. (2003). Economic Aspects of Regional Integration. Chapter 2 in *Regional Integration and Food Security in Developing Countries*. FAO, Rome.

Matthey, H., Fabiosa, J. F., & Fuller, F. H. (2004). Brazil: The Future of Modern Agriculture? *MATRIC Briefing Papers*, 8. Retrieved from https://lib.dr.iastate.edu/matric_briefingpapers/8

Mattoo, A., Mulabdic, A. and Ruta, M. (2019). Trade Creation and Trade Diversion in Deep Agreements. World Bank Group, Washington D.C. Retrieved from <http://pubdocs.worldbank.org/en/328491559591517896/Trade-Creation-and-Trade-Diversion.pdf>

McCornick, J., (1999): *Understanding the European Union, A Concise Introduction*; New York: Palgrave Press

McDougall, R (2018). Crisis in the WTO- Restoring the WTO Dispute Settlement Function. *CIGI Working Paper* No. 194. Retrieved from <https://www.cigionline.org/sites/default/files/documents/Paper%20no.194.pdf>

McGillivray, F., Woolcock, S., Sampson, Gary P. (2003): *Regionalism, Multilateralism, and Economic Integration: The Recent Experience*; Edited by Gary P. Sampson and Stephen Woolcock, Tokyo and New York: UN University Press, 2003. xiv, 304pp, US\$37.95 paper (ISBN 92-808-1083-9)

Mecham, M. (2003): Mercosur: A Failing Development Project?; *International Affairs*, 79: 369–387

Medeiros, M. D. A., Meunier, I., Onuki, J., & Ventura, D. (2013). Compliance in Mercosur: Brazil Formal Commitments and Interests. *Unpublished Manuscript*, 4(45), 1–16. Retrieved from <http://web.isanet.org/Web/Conferences/FLACSO-ISA-BuenosAires2014/Archive/d120e65a-5f81-4928-a0d1-94611e9bbfef.pdf>

Medvedev, D. (2006). Beyond Trade: The impact of Preferential trade agreements on foreign direct investment inflows. *World Bank Working Paper Series* No. 4065. Retrieved from <https://openknowledge.worldbank.org/bitstream/handle/10986/8868/wps4065.pdf?sequence=1&isAllowed=y>

Menon, J. (2014). From Spaghetti bowl to Jigsaw Puzzle? Addressing the Disarray in World trading system. *ADB Working Paper Series on Regional Economic Integration*. No. 140. Retrieved from <https://www.adb.org/sites/default/files/publication/148823/reiwp-140-spaghetti-bowl-jigsaw-puzzle.pdf>

Mikic, M. (2007). Preferential trade agreements and agricultural trade liberalization in Asia and the Pacific. Paper presented at the APO Study Meeting on Implications of Trade Liberalization under WTO-Doha Development Agenda for Small Farmers and Agricultural Trade, 21 to 26 March 2007, New Delhi

Miranda, A. de. (2018). The Roots of the Brazilian Economic and Political Crisis of 2015/16. Retrieved from https://www.academia.edu/38220835/The_Roots_of_the_Brazilian_Crisis.pdf

Monteagudo, M. (1994). The Debt Problem: The Baker Plan and the Brady Initiative: A Latin American Perspective. Retrieved from <https://scholar.smu.edu/cgi/viewcontent.cgi?article=3016&context=til>

Moraal, W. (2018). *Mining Sector, BRAZIL*. Retrieved from <https://www.rvo.nl/sites/default/files/2018/06/sectorschets-mining-nbso-brazil-belo-horizonte.pdf>

Moser, P. (1997). Reasons for regional integration agreements. *Intereconomics*, 32(5), 225–229. <https://doi.org/10.1007/BF02929831>

Mukhametdinov, M. (2007): Mercosur and the European Union, Variation among the Factors of Regional Cohesion; Cooperation and Conflict: *Journal of the Nordic International Studies Association* Vol. 42(2): 207–228. Retrieved from https://journals.sagepub.com/doi/pdf/10.1177/0010836707076690?casa_token=P1RnRIOZ2jkAAAAA:ofMLgFwpQzreVGVCLvbR9b8e4zbPmA3Y5LXIT8xjfreCynShIqCUQxMzJKQ3DUDJIKb0zLIDYMvDEA

(2018). *MERCOSUR and the European Union: Variation and Limits of Regional Integration*. Springer. pp. 228

Musacchio, A. and Lazzarini, S. G. (2014). State-Owned Enterprises in Brazil: History and Lessons. Prepared for The Working Group on State-owned enterprises and Privatization practices, OECD. Retrieved from https://www.oecd.org/daf/ca/Workshop_SOEsDevelopmentProcess_Brazil.pdf

Mutimer, D. (1994). Theories of Political Integration. in Michelmann, H. and Soldatos, P (eds). *European Integration: Theories and Approaches*. University Press of America. Pp.112

Nassif, A. (2008). Are there evidences of deindustrialization in Brazil? *Revista de Economia Política*. <https://doi.org/10.1590/S0101-31572008000100004>

Nelson, M. (2015). Brazil and the FTAA Negotiations. In *A History of the FTAA* (pp. 147–180). New York: Palgrave Macmillan US. https://doi.org/10.1057/9781137412751_5

Nicholls, W. H. (1970). The Transformation of Agriculture in a Semi-Industrialized Country: The Case of Brazil. In ed. Erik Thorbecke (Ed.), *The Role of Agriculture in Economic Develop* (pp. 311–385). NBER. Retrieved from <https://www.nber.org/chapters/c11887.pdf>

Nofal, M. (1994): Mercosur and Free Trade in the Americas. In *Integrating the Americas: Shaping Future Trade Policy*; ed. Sidney Weintraub. New Brunswick: Transaction. 137-67

O'Keefe, T. A. (2003): A Resurgent Mercosur: Confronting Economic Crises and Negotiating Trade Arrangements; North-South Center Working Paper, No. 60, Miami, FL: University of Miami

Odell, J. (2013). A Grand Bargain to Save the WTO from Declining Relevance. Published by ICTSD and WEF, Geneva.

OECD Trade in Value Added (TiVA) Database

OECD (2013). *Interconnected Economies: Benefitting from Global Value Chains*. Retrieved from <https://www.oecd.org/sti/ind/interconnected-economies-GVCs-synthesis.pdf>

- (2018). *Trade Facilitation and the Global Economy*. OECD Publishing, Paris. DOI: <https://dx.doi.org/10.1787/9789264277571-en>

OECD, WTO and World Bank Group (2014). Global Value Chains: Challenges, Opportunities and Implications for Policy

OECD and World Bank Group (2015). Inclusive Global Value Chains: Policy options in trade and complementary areas for GVC Integration by small and medium enterprises and low-income developing countries. Report prepared for G20 Trade Ministers Meeting Istanbul, Turkey, 6 October 2015

OECD-UNIDO. (2019). *Integrating Southeast Asian SMEs in Global Value Chains: Enabling Linkages with Foreign Investors*. Paris. Retrieved from <https://www.oecd.org/investment/Integrating-Southeast-Asian-SMEs-in-global-value-chains.pdf>

Ovádek, M. and Willemyns, I. (2019). International Law of Customs Unions: Conceptual Variety, Legal Ambiguity and Diverse Practice. *The European Journal of International Law* Vol. 30 No. 2. Pp. 361-389 Retrieved from <https://academic.oup.com/ejil/article/30/2/361/5536733>

Panagariya, A. (1999). The regionalism debate: An Overview. *The World Economy*. Vol 22, No. 4. pp. 477-512

- (2000). Preferential Trade Liberalization: The Traditional Theory and New Developments. *Journal of Economic Literature*. Vol. 38, No. 2. Pp. 287-331

Paolera, G. della, Amorocho, X, & Musacchio, A. (2018). *The Industrialization of South America Revisited: Evidence from Argentina, Brazil, Chile and Colombia, 1890-2010*. NBER Working Paper Series.

Peña, F. (2019). Effectiveness and Credibility of Mercosur. Retrieved September 10, 2019, from <http://www.felixpena.com.ar/index.php?contenido=negotiations&neagno=report/2019-01-effectiveness-and-credibility-of-mercosur>

Pereyra, L., V. (1999): Toward the Common Market of the South: Mercosur's Origins, Evolution, and Challenges. in Roett 1999: 7-2

Perroni, C., & Whalley, J. (1994). The new regionalism: Trade liberalization or insurance? *NBER working paper* No. 4626. Retrieved from <https://www.nber.org/papers/w4626.pdf>

Pertossi, M. (2009). Argentina farmers hit hard by worst drought in decades. Retrieved January 17, 2019, from <http://articles.latimes.com/2009/feb/01/news/adfg-argentinadrought1>

Phillips, N. (2001): Regionalist Governance in the New Political Economy of

Development: "Re-launching" the Mercosur'; *Third World Quarterly*, 22(4): 565-83

- (2002). Reconfiguring Subregionalism: The Political Economy of Hemispheric Regionalism in the Americas. *Mercosur Study Group, Chatham House*. Retrieved from

https://www.chathamhouse.org/sites/default/files/public/Research/Americas/phillips_paper.pdf

- (2003a): Hemispheric Integration and Sub-regionalism in the Americas; *International Affairs* 79(2): 327-49

- (2003b): The Rise and Fall of Open Regionalism? Comparative Reflections on Regional Governance in the Southern Cone of Latin America. *Third World Quarterly*. Vol. 24, No. 2. *Governing the Asia Pacific: Beyond the 'New Regionalism'* (Apr., 2003), pp. 217-234

- (2004): *The Southern Cone Model: The Political Economy of Regional Capitalist Development in Latin America*. London: Routledge

Pineiro, A. C., Gill, I. S., Servén, L. and Thomas, M. R (2005). Brazilian Economic Growth, 1900-2000: Lessons and Policy Implications in Fernández-Arias, E., Manuelli, R., and Blyde, J. S. (eds). *Sources of Growth in Latin America: What is Missing?* Inter-American Development Bank, Washington D.C. pp. 157-273

Pont, M. L. (2011). Southern American Common Market. In G. Finizio, L. Levi, & N. Vallinoto (Eds.), *First International Democracy Report: The democratization of international organizations*. Center for Studies on Federalism. Retrieved from http://www.internationaldemocracywatch.org/attachments/461_MERCOSUR-lunapont.pdf

Potter, N. L. (2008). How Brazil Achieved Energy Independence and the Lessons the United States Should Learn from Brazil's Experience. *Washington University Global Studies Law Review*. Vol. 7, Issue No. 2, pp. 331-351. Retrieved from http://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1114&context=law_globalstudies

Prebisch, R. (1950). The Economic Development of Latin America and its principal problems. United Nations Publication. E/CN.12/89/Rev.1>>. Santiago, Chile

PWC. (n.d.). *The Pharmaceutical industry in Brazil*. Retrieved from <https://www.pwc.com.br/pt/publicacoes/setores-atividade/assets/saude/pharma-13-ingles.pdf>

Raman, S., (1997): Slow but Sure: The Continuing Growth of Mercosur; Harvard International Review: 52–73. <http://www.jstor.org/stable/42764037>.

Regúnaga, M., & Rodriguez, A. T. (2015). Argentina's Agricultural Trade Policy and Sustainable Development. *ICTSD*, (55). Retrieved from https://www.ictsd.org/sites/default/files/research/argentina_agricultural_trade_policy_and_sustainable_development.pdf

Resende-Santos, J., (2002): The Origins of Security Cooperation in the Southern Cone. *Latin America Politics and Society*. Vol. 44, 89-126

Richards, D. (1997): Dependent Development and Regional Integration: A Critical Examination of the Southern Cone Common Market. *Latin American Perspectives* 24(6): 133-55

Robinson, S., & Thierfelder, K. (2002). Trade liberalization and regional integration: the search for large numbers. *The Australian Journal of Agricultural and Resource Economics*, 46(4), 585–604. <https://doi.org/10.1111/1467-8489.t01-1-00057>

Robson, P. (1998). *The Economics of International Integration*. Fourth Edition. Routledge.

Rocha Gabriel, V. D. (2019). The New EU-Mercosur Trade Agreement: A New Breath to Free Trade. *E-International Relations*. Retrieved from <https://doi.org/10.1111/1468-2362.00032>

Roett, R. (1999): *Mercosur: Regional Integration, World Markets*; United Kingdom: Lynne Rienner Publications

Rozemberg, R. (2002). MERCOSUR: Between Skepticism and the Relaunch. in Tuchlin, J, Espach, R. and Golding, H. (eds). *Paths to Regional Integration: The Case of Mercosur*. Woodrow Wilson Center Reports on the Americas #5, Washington D.C.

Saguier, M. I. (2007). The Hemispheric Social Alliance and the Free Trade Area of the Americas Process: The Challenges and Opportunities of Transnational Coalitions against Neo-liberalism. *Globalizations*, 4(2), 251–265. doi:10.1080/14747730701345267

Salama, P. (2011). Growth and inflation in Argentina under the terms of office Kirchner. *Problèmes d'Amérique Latine*, 82(75), 13–32. <https://doi.org/http://dx.doi.org/10.3917/pal.082.0013>

- Salvia, S. P. (2015). The boom and crisis of the Convertibility Plan in Argentina. *Revista de Economía Política*, 35(2), 325–342. http://www.scielo.br/scielo.php?script=sci_arttext&pid=S0101-31572015000200325
- Sammon, P. (2005). Developing Confusion: The Economic Consequences of the EU's Development Policy. *Student Economic Review*. Vol. 19. Retrieved from https://www.tcd.ie/Economics/assets/pdf/SER/2005/Paul_Sammon.pdf
- Sandalow, D. (2006). Ethanol: Lessons from Brazil. *A High Growth Strategy for Ethanol*, Aspen Institute. Retrieved from <http://faculty.washington.edu/renatab/courses/PSE490/downloads/bioethanolbrazil.pdf>
- Sanidas, E. and Shin, Y. (2010). “Comparison of Revealed Comparative Advantage Indices with Application to Trade Tendencies of East Asian Countries.” Paper Presented at the 9th Korea and the World Economy Conference, Incheon, 2010.
- Santarcángelo, J. E., Schteingart, D., & Porta, F. (2018). Industrial Policy in Argentina, Brazil, Chile and Mexico: a Comparative Approach. *Papers in Political Economy*, 59(February), 1–42.
- Santos Lima, J. (2018). Latin America's Decentered Economic Regionalism: From the FTAA to the Pacific Alliance. *Contexto Internacional* vol. 40(2) <http://dx.doi.org/10.1590/S0102-8529.2018400200001>
- Scharpf, F. W. (2009). The Asymmetry of European Integration or why the EU cannot be a “Social Market Economy”. *Kolleg-Forschergruppe Working Paper No. 6*. Berlin. Retrieved from https://userpage.fu-berlin.de/kfgeu/kfgwp/wpseries/WorkingPaperKFG_6.pdf
- Schiff, M. W., & Winters, L. A. (2003). *Regional Integration and Development*. World Bank. Retrieved from <http://documents.worldbank.org/curated/en/263681468780873762/Regional-integration-and-development>
- Schleifer, P. (2017). Private regulation and global economic change: The drivers of sustainable agriculture in Brazil. *Governance*, 30(4), 687–703. <https://doi.org/10.1111/gove.12267>
- Schnepf, R. D., Dohlman, E., and Bolling, C. (2001). Agriculture in Brazil and Argentina: Developments and Prospects for Major Field Crops. Market and Trade Economics Division, Economic Research Service, U.S. Department of Agriculture, Agriculture and Trade Report. WRS-01-3. Retrieved from https://www.ers.usda.gov/webdocs/publications/40339/15081_wrs013_1_.pdf?v

Schott, J (2005). Does the FTAA have a Future? Peterson Institute for International Economic. Retrieved from www.piie.com/sites/default/files/publications/papers/schott1105.pdf

Schunck, R. (2013). Within and between estimates in random-effects models: Advantages and drawbacks of correlated random effects and hybrid models. *Stata Journal*, 13(1), 65–76. Retrieved from <https://journals.sagepub.com/doi/pdf/10.1177/1536867X1301300105>

Schwartz, G. (1996): Brazil, MERCOSUR, and SAFTA: Destructive Restructuring or Pan-American Integration? In Cooperation or Rivalry? Regional Integration in the Americas and the Pacific Rim; ed. Shoji Nishijima and Peter H. Smith. Boulder: Westview Press. 129-49

Selcher, W. A. (1985). Brazilian-Argentine Relations in the 1980s: From Wary Rivalry to Friendly Competition. *Journal of Interamerican Studies and World Affairs*, 27(2), 25–54. <https://doi.org/10.2307/165717>

Seoul, C. K. (2003). Regional trade arrangements and intra-industry trade: The case of Mercosur, 95–113. <https://doi.org/10.1.1.516.976>

SICE. (n.d.). Chapter 8. Trade Blocs and The Rest of The World, 187–235. Retrieved from http://ctrc.sice.oas.org/TRC/Articles/Regionalism/sw_ch8.pdf

(1991). Treaty of Asuncion, 1991 Retrieved from <http://www.sice.oas.org/trade/mrcsr/mrcsrtoe.asp>

(1994). Protocol of Ouro Preto, 1994. Retrieved from http://www.sice.oas.org/trade/mrcsr/ourop/ourop_e.asp

(2002). Mercosur- European Community Regional Strategy Paper 2002-2006. Santiago de Chile. Retrieved from http://www.sice.oas.org/TPD/MER_EU/Studies/Regionalpaper_e.pdf

Singer, H. W. (1948). Economic Progress in Underdeveloped Countries. *Social Research* Vol. 16, No. 1. pp 1-11. Retrieved from <http://www.jstor.org/stable/40982245>

Slany, A (2017). The role of trade policies in building regional value chains- some preliminary evidence from Africa. *UNCTAD Research Paper No. 11* UNCTAD/SER.RP/2017/11. Retrieved from https://unctad.org/en/PublicationsLibrary/ser-rp-2017d11_en.pdf

Soares de Lima, M. R., & Santos, F. (1998). *Brazilian Congress and Foreign Trade Policy*. Retrieved from <https://pdfs.semanticscholar.org/9dc1/f6d6aae59b3441b7b9b1739ada1335143cb4.pdf>

Solimano, A. (1990). Inflation and the Costs of Stabilization: Historical and Recent Experiences and Policy Lessons. *The World Bank Research Observer* Vol.5, No.2, pp.167-185. Retrieved from http://documents.worldbank.org/curated/en/557541468327561601/pdf/770020JR_N0WBRO0Box0377291B00PUBLIC0.pdf

Sturgeon, Timothy; Chagas, Leonardo Lima; Barnes, J. (2017). Inovar Auto: Evaluating Brazil's Automotive Industrial Policy to Meet the Challenges of Global Value Chains, 148. Retrieved from <http://documents.worldbank.org/curated/en/100851511798447023/pdf/121667-REVISED-Brazil-Public-Expenditure-Review-Brazil-in-Automotive-Globa.pdf>

Summers, L. (1991), "Regionalism and the World Trading System." *Economic Review*, Federal Reserve Bank of Kansas City, issue Nov, pages 295–302. Retrieved from <https://www.kansascityfed.org/PUBLICAT/SYMPOS/1991/S91summe.pdf>

Taccone, J. and Nogueira, U. (eds) (2001) *Mercosur Report No. 7: 2000-2001*, Buenos Aires: IADB/INTAL Retrieved from [https://publications.iadb.org/publications/english/document/MERCOSUR-Report-No-7-\(2000-2001\).pdf](https://publications.iadb.org/publications/english/document/MERCOSUR-Report-No-7-(2000-2001).pdf)

- (eds) (2004) *Mercosur Report No. 9: 2003-2004*, Buenos Aires: IADB/INTAL. Retrieved from [https://publications.iadb.org/publications/english/document/MERCOSUR-Report-No-9-\(2003-2004\).pdf](https://publications.iadb.org/publications/english/document/MERCOSUR-Report-No-9-(2003-2004).pdf)

Teitel, S., & Thoumi, F. E. (1986). From import substitution to exports: the manufacturing exports experience of Argentina and Brazil. *Economic Development & Cultural Change*, 34(3), 455–490. <https://doi.org/10.1086/451545>

The Economist. (2002). Argentina's collapse: A decline without parallel. Retrieved April 4, 2019, from <https://www.economist.com/special-report/2002/02/28/a-decline-without-parallel>

- (2014). A century of decline - The tragedy of Argentina. Retrieved April 8, 2019, from <https://www.economist.com/briefing/2014/02/17/a-century-of-decline>

- (2016). Brazil's fall. *The Economist*.

Toye, J. (2014). Assessing the G77: 50 years after UNCTAD and 40 years after the NIEO. *Third World Quarterly*, 35(10), 1759–1774. <https://doi.org/10.1080/01436597.2014.971589>

UN-ESCAP. (2015). Global Value Chains and Interconnectedness of Asia-Pacific Economies. In *Asia-Pacific Trade and Investment Report 2015* (pp. 103–138). Retrieved from <https://www.unescap.org/sites/default/files/Chapter-7-GVCs-in-the-Asia-Pacific.pdf>

UNCTAD (2013a). Local Content Requirements and the Green Economy. *United Nations Publication UNCTAD/DITC/TED/2013/7*. Retrieved from https://unctad.org/en/PublicationsLibrary/ditcted2013d7_en.pdf

- (2013b). Prospects for building resilience to external shocks and mitigating their impact on trade and development. *Trade and Development board, UNCTAD Secretariat TD/B/C.I/MEM.5/2*. Retrieved from https://unctad.org/meetings/en/SessionalDocuments/cimem5d2_en.pdf

- (2016). *Non-Tariff Measures in Mercosur: Deepening Regional Integration and Looking Beyond*. UNCTAD/DITC/TAB/2016/1 Retrieved from https://unctad.org/en/PublicationsLibrary/ditctab2016d1_en.pdf

UNCTAD Information Note on Global System of Trade Preferences

USDA Foreign Agricultural Services (2017a). Argentina: Biofuels Annual. Retrieved from <https://apps.fas.usda.gov/newgainapi/api/report/downloadreportbyfilename?filename=Biofuels%20Annual%20Buenos%20Aires%20Argentina%207-17-2017.pdf>

- (2017b). Paraguay: Livestock and Products Annual. Retrieved from [http://agriexchange.apeda.gov.in/marketreport/Reports/Livestock and Products Annual Buenos Aires Paraguay 9-5-2017%20\(1\).pdf](http://agriexchange.apeda.gov.in/marketreport/Reports/Livestock%20and%20Products%20Annual%20Buenos%20Aires%20Paraguay%209-5-2017%20(1).pdf)

- (2017c). The Economic Impacts of U.S. Tariffs for Ethanol and Biodiesel. Office of Energy Policy and New Uses. December 2017. Retrieved from [https://www.usda.gov/oce/reports/energy/The Economic Impacts of U.S. Tariffs for Ethanol and Biodiesel.pdf](https://www.usda.gov/oce/reports/energy/The%20Economic%20Impacts%20of%20U.S.%20Tariffs%20for%20Ethanol%20and%20Biodiesel.pdf)

US Department of Commerce, International Trade Administration (2015a). Brazil Market Overview: Mining Equipment and Supplies. Retrieved from https://build.export.gov/build/idcplg?IdcService=DOWNLOAD_PUBLIC_FILE&RevisionSelectionMethod=Latest&dDocName=eg_br_089863

- (2015b). Compilation of Foreign Motor Vehicle Import Requirements. Retrieved from <https://www.trade.gov/td/otm/assets/auto/TBR2015Final.pdf>

Utkulu, U. and Seymen, D. (2004). Revealed Comparative Advantage and Competitiveness: Evidence for Turkey vis-à-vis the EU/15. Presented at the European Trade Study Group 6th Annual Conference, ETSG 2004, Nottingham, September 2004

Vaillant, M., (2005): MERCOSUR: Southern Integration under Construction; *Internationale Politik und Gesellschaft*, 2(2005), 52-71

Valdes, C. (2006). Brazil's Booming Agriculture Faces Obstacles. *Amber Waves*, 4(5), 28. Retrieved from <https://www.ers.usda.gov/amber-waves/2006/november/brazils-booming-agriculture-faces-obstacles/>

Veiga, P. (1999): Brazil in Mercosur: Reciprocal Influence; In Roett 1999. 25-33

Venables, A. J. (2003), Winners and Losers from Regional Integration Agreements; *The Economic Journal*, 113: 747–761, Doi: 10.1111/1468-0297.t01-1-00155

Vervaele J. A. E., (2005): Mercosur and Regional Integration in South America; *The International and Comparative Law Quarterly*, 54(2), 387–409. Retrieved from <http://www.jstor.org/stable/3663254>

Viguera, A. (2000). La trama política de la apertura económica (1987-1996). La Plata, Ediciones Al Margen, UNLR FLACSO

Viner, J. (1950): *The Customs Union Issue*. Carnegie Endowment for International Peace, New York. also in Oslington, P. (2014) (ed). Oxford University Press, New York. pp. 258

Viola, E., & Lima, J. S. (2017). Divergences Between New Patterns of Global Trade and Brazil/Mercosur. *Brazilian Political Science Review*, 11(3), 11. <https://doi.org/10.1590/1981-3821201700030001>

Whalley, J (1998). Why do Countries Seek Regional Agreements? in Frankel, J. A. (ed). *The Regionalization of the World Economy*. Retrieved from <https://www.nber.org/chapters/c7820>

Willenbockel, D. (2011). The Impact of China's Import Demand Growth on Sectoral Specialization in Brazil: A CGE Assessment. *SSRN Electronic Journal*. <https://doi.org/10.2139/ssrn.1068361>

Williamson, J. (2004). A Short History of the Washington Consensus. Peterson Institute for International Economics. Retrieved from <https://www.piie.com/publications/papers/williamson0904-2.pdf>

World Bank (1994). Brazil: An Agenda for Stabilization. Report No. 13168-BR. Retrieved from <http://documents.worldbank.org/curated/en/633981468743793621/pdf/multi0page.pdf>

- (2001). Paraguay- Country Assistance Evaluation. Report No. 22874. Washington D. C. Retrieved from <http://www.oecd.org/countries/paraguay/35294497.pdf>

- (2005). Regional Trade agreements: Effects on Trade in *Global Economic Prospects 2005*. Chapter 3. Retrieved from http://siteresources.worldbank.org/INTGEP2005/Resources/GEP107053_Ch03.pdf

- (2009). *Global Commodity Markets: review and price forecast*. Retrieved from <http://pubdocs.worldbank.org/en/827471462307045303/CMO-2009-GDF.pdf>

- (2010). How to Decrease Freight Logistics Costs in Brazil. Report No. 46885-BR

World Bank - World Integrated Trade Solutions.

World Economic Forum (2013). Enabling Trade Valuing Growth Opportunities. Geneva. Retrieved from http://www3.weforum.org/docs/WEF_SCT_EnablingTrade_Report_2013.pdf

WTO: Legal Text of the GATT Enabling Clause, 1979/1994.

WTO. (2008). Protocol of Montevideo on Trade in Services in the MERCOSUR: Report by the Secretariat. WT/REG238/1, 9 May 2008. Geneva. Retrieved from https://docs.wto.org/dol2fe/Pages/FE_Search/ExportFile.aspx?id=87515&filename=Q/WT/REG/238-1.pdf

- (2011a). World Trade Report 2011, Section B: Historical Background and Current Trends. https://www.wto.org/english/res_e/booksp_e/anrep_e/wtr11-2b_e.pdf

- (2011b). World Trade Report 2011, Section C: Causes and effects of PTAs: Is it all about preferences? https://www.wto.org/english/res_e/booksp_e/anrep_e/wtr11-2c_e.pdf

- (2011c). World Trade Report 2011, Section E: The multilateral trading system and PTAs. https://www.wto.org/english/res_e/booksp_e/anrep_e/wtr11-2e_e.pdf

- (2015). Regional Trade Agreements and Multilateral Trading System. Prepared in consultation with the World Bank Group and the OECD. Discussion Paper for the G20. Retrieved from http://g20.org.tr/wp-content/uploads/2015/11/8.G20-Discussion-Paper_RTAs-and-MTS.pdf

- (2017). Global Value Chain Development Report 2017. Retrieved from https://www.wto.org/english/res_e/publications_e/gvcd_report_17_e.htm

- (2019). Regional Trade Agreements Database. Available at: <http://rtais.wto.org/UI/PublicAllRTAList.aspx>

WTO and IDE-JETRO. (2010). Trade patterns and global value chains in East Asia: From trade in goods to trade in tasks World Trade Organization.

WTO Trade Policy Review (1997). Paraguay WT/TPR/S/26

-(1998). Argentina WT/TPR/S/47

-(1998). Uruguay WT/TPR/S/50

-(2000) Brazil WT/TPR/S/75

-(2004). Brazil WT/TPR/S/140

-(2005). Paraguay WT/TPR/S/146

-(2006). Uruguay WT/TPR/S/163

-(2007). Argentina WT/TPR/S/176

-(2009). Brazil WT/TPR/S/212

-(2011). Paraguay WT/TPR/S/245

-(2012). Uruguay WT/TPR/S/263

-(2013). Argentina WT/TPR/S/277

-(2013). Brazil WT/TPR/S/283

-(2017). Brazil WT/TPR/S/358

-(2017). Paraguay WT/TPR/S/360

-(2018). Uruguay WT/TPR/S/374

Yeats, A. J. (1998). Does Mercosur's trade performance raise concerns about the effects of regional trade arrangements? *World Bank Economic Review*, 12(1), 1–28. <https://doi.org/10.1093/wber/12.1.1>

