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# MERCOSUR experience in regional integration: what could Africa learn from it?

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# MERCOSUR experience in regional integration: what could Africa learn from it?

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# About CINDES

Created in March 2006, the Centre for Studies in Integration and Development (CINDES) is a research institute that seeks to contribute to the deepening of the debate about the relations between Brazilian development and its international integration. Since then CINDES has consolidated as a policy-oriented studies centre that analyses Brazilian foreign economic policy, its positions and interests in different negotiation fora, the evolution of the global scenario and its impacts on the country's economy and policies.

# Summary

MERCOSUR is almost thirty years old. The project has achieved relevant accomplishments, but it has also accumulated many unfulfilled objectives and even some setbacks. It began with a very ambitious goal: the constitution of a common market. This ambition was quickly reduced to a customs union project, still a far-reaching objective. Africa, by its side, has undergone, since many decades, relevant regional and sub-regional integration experiences, some of which share the ambitions of MERCOSUR.  This paper intends to extract from MERCOUR's experience some clues that could be useful for the African debate on the challenges faced by the regional integration projects in the continent. The most relevant criterion to evaluate the effectiveness of the integration project should be its ability to influence and shape the behavior of public and private players within and outside the bloc. MERCOSUR has become a project with a limited degree of effectiveness, except for a few number of players. This is the result of the convergence of factors that have reduced the predictability of the integration process and the relevance of its rules, especially vis à vis the national rules of the member countries. Sustained economic growth for MERCOSUR's economies will demand a reform of the bloc's integration model, and particularly of its common external policy.

# MERCOSUR experience in regional integration: what could Africa learn from it?

## 1. Introduction

MERCOSUR is a sub-regional integration project putting together a few South American developing countries with very diverse sizes and economic structures. The project has lasted for more than 25 years having gone through periods of economic instability that affected mainly the larger economies of the block (Brazil and Argentina). Governments of diverse political orientations have been in office in the different member countries and MERCOSUR has always been referred to as a priority, even if the reality did not confirm the official rhetoric.

It is a project clearly inspired by the so-called "open regionalism" of the Nineties, but contrarily to the vast majority of preferential trade agreements negotiated in this decade – geared at the building of free trade areas - MERCOSUR set for itself a more ambitious goal: the constitution of a common market. The ambition was quickly reduced to a customs union project, still a far-reaching objective with almost no successful precedent.

MERCOSUR has achieved relevant accomplishments – which seem hardly reversible – but it also accumulated problems and has proven to be unable to fulfill its major goal: becoming a customs union relying on a common trade policy. Many lessons for other preferential trade agreements between developing countries can be learned from its trajectory, although one must recognize that complex social experiences – mixing economic, political and institutional features – cannot be transposed from their original context to other ones.

Africa, by its side, has undergone, since many decades, relevant regional and sub-regional integration experiences, some of which share the ambitions of MERCOSUR: becoming a common market or, at least, a customs union. The track record of such experiences does not make room for naïve optimism, but the integration dynamics could enter a new – and more productive – phase with the recent setting of the African Continental Free Trade Agreement.

In such a context, this paper intends to extract from MERCOUR's experience some clues that could be useful for the African debate on the challenges faced by the regional integration projects in the continent, as well as on the options that can be explored by African countries to further the recently launched continental initiative.

The paper comprises three sections, in addition to this introduction. Section 2 turns to MERCOSUR's trajectory, detailing its main phases, relevant evolutions and policy tools used to foster integration. Section 3 makes a synthetic assessment of the accomplishments and failures of MERCOSUR project and identifies the main factors that explain these outputs. Section 4 draws some lessons from MERCOSUR's experiences.

# 2. A stylized description of MERCOSUR's trajectory

Trade integration initiatives in South America date back to the 60s of the XXth Century, when the Latin America Free Trade Association (ALALC) was created. Its main objective – the setting of a regional free trade area in twelve years – was not reached as member countries were pursuing at the national level development strategies based on the import substitution model and across the board trade protectionism.

In 1981, ALALC was replaced by ALADI – Latin America Association for Development and Integration – whose goals were less ambitious and whose integration methodology relied mainly on bilateral agreements negotiated at the sectoral level. In this new model, the free trade area was supposed to be reached through the progressive expansion – to all member countries and all economic sectors – of bilateral agreements.

However, the ALADI initiative failed to reinvigorate the integration dynamics in the region. On one side, the resistance to trade liberalization agreements of the public and private constituencies supporting the import substitution model of industrialization remained strong. On the other, the external debt crisis faced by many South American countries in the early 80s led them to adopt additional import restrictions to redress their eternal accounts.

Trade between South American countries was strongly impacted: between 1980 and 1985, bilateral trade between Brazil and Argentina fell by 43%. In 1985, Brazilian exports to its future Mercosur partners represented less than 4% of Brazilian total exports.

## 2.1. At the origins of MERCOSUR

During the second half of the 80s, Brazil and Argentina went through large macroeconomic crisis – inflation rates skyrocketed while economic growth rates were disappointing, to say the least – simultaneously to the transition from authoritarian to democratic political regimes. These evolutions evidenced the exhaustion of the development model adopted in the previous decade – import substitution industrialization – while generating conditions favorable to a political convergence between Brazil and Argentina. Both features had relevant consequences for each country and their bilateral relationship in the following years.

In 1986, Brazil and Argentina signed the Economic Integration and Cooperation Program (PICE), aimed at expanding the reciprocal tariff preferences on a sectoral basis and setting projects of technological cooperation. In 1988, a new – and more ambitious – bilateral agreement was signed, aiming at the setting, within ten years, of a common market encompassing both countries. Despite its ambition, the new agreement relied on the ALADI's mechanism of sectoral liberalization and did not define the means and the phases required to reach its objectives[1].

At the same time, both countries launched national programs of unilateral trade liberalization, challenging for the first time in many decades the dominant model of development. These movements produced, in the first years of the 90s, a striking convergence between the two countries, as far as the development model is concerned, making room for the deepening of the economic integration initiatives.

1. Motta Veiga, P. (2000) – O Brasil e o Mercosul o os paradoxos do regionalism no Cone Sul, February, processed.

The sectoral exchange of preferences gave place to a program of reciprocal withdrawal of the tariffs applied to all the products following a schedule to be implemented by 1994. With the Asunción Treaty (March 1991), two smaller countries - Paraguay and Uruguay - joined the liberalization program - and MERCOSUR was created with the aim of setting a four-countries common market by 1994[2]. The Treaty also set the institutional structure of the project, which main distinctive feature was the option for inter-governmental bodies, totally excluding the establishment of supranational institutions. Negotiations were to be held through the Common Market Group – supported by thematic or sectoral subgroups – and decisions to be taken at the Common Market Council – a Ministerial level body.

## 2.2. The transition towards the Customs Union (1991 – 1994)

Between 1991 and 1994, the MERCOSUR agenda concentrated on the program of tariff elimination between the member countries and the negotiation of a common external tariff (CET). These have been years marked by a strong macroeconomic divergence between Brazil – still going through a deep crisis and hyper-inflation – and Argentina – which had applied a currency board-type stabilization program. In such a scenario it comes as no surprise the fact that efforts to push an agenda geared at promoting the convergence of domestic policies related to trade and investment were frustrated[3].

The Ouro Preto Treaty, on December 1994, concluded MERCOSUR's "transition period" with the setting of a customs union – and the postponing of the common market project as a strategic objective of the integration project.

The customs union model was Brazil's policy preference and its MERCOSUR partners had no choice but to accept not only the model itself, but a CET closely based on Brazil's tariff structure and on Brazil's interests. The consequence was the proliferation of exceptions, sectoral and national ones, to accommodate the heterogeneity of economic structures and interests between member countries.

As for the CET exceptions, they derive from differences between national industrial policies as applied to capital and informatics / telecommunications goods, Brazil keeping its tariffs at higher levels than the other countries. Exceptions to the free trade regime between member countries, especially those affecting the automotive and sugar sectors, were related to competitive asymmetries between these countries, particularly between Brazil and Argentina.

The Ouro Preto Treaty also adapted the institutional framework of the project to the objective of managing the common external tariff and the broader common trade policy. Besides, new consultative bodies were created in an effort to attract private and public stakeholders: the Economic and Social Consultative Forum, putting together government officials, business and labor unions representatives, as well as the Joint Parliamentary Commission.

The adoption, in Brazil, of a new and successful macroeconomic plan, drastically bringing down inflation rates and creating the conditions of economic growth, was functional to creating new incentives for the integration project. In the following four years (1994-1998) the macroeconomic situation in Brazil and Argentina converged, producing a relative stability in the bilateral exchange

2. Motta Veiga, P. (2000), op.cit. Paraguay and Uruguay were accorded one extra year to suppress their intra-zone tariffs.
3. Motta Veiga, P. (2000), op. cit. In June 1992, the member countries agreed on such agenda, in Las Leñas, defining a detailed timetable for negotiations on the convergence of trade and industrial policies. This agenda – as such – was discretely abandoned in the following years.

rate parity, with very positive impacts on trade.

## 2.3. The golden age of MERCOSUR: outcomes and limits (1995 – 1998)

As a consequence of this favorable scenario, trade flows between MERCOSUR countries grew steadily: in 1998, the share of intra-MERCOSUR exports in the world exports of member countries had reach 25% (compared to 9%, in 1990). Foreign direct investment from third countries also accelerated and transnational companies from different sectors (automobiles, chemicals, food and beverage) implemented regional strategies to seize the opportunities created by the enlargement of the "domestic market" in the Southern Cone of South America[4].

On December 1995, the member countries agreed on an action plan to be enforced until 2000. The agenda set forth included thematic issues seen as relevant for the integration project: trade in services, government procurement, investment protection, tax policies and competition policy.

Since the transition period (1991-1994), some legal instruments had been negotiated and agreed upon, as the two agreements on investments (for extra-zone and intra-zone investments). After 1995, new agreements were signed in the areas of trade in services and competition policy. However, the majority of these agreements have never been enforced – some of them have not even been ratified by one or more member countries – or their enforcement was delayed for many years, as in the case of the Protocol on Trade in Services.

At the same time, MERCOSUR began to develop a diversified external agenda of negotiations. Within the region, two free trade agreements (concentrating on trade in goods) were signed by the bloc with Chile and Bolivia. Within the negotiations of the Free Trade Agreement of the Americas (FTAA), launched in 1996, and the negotiations with the European Union (from 1999 on), MERCOSUR acted as a negotiating bloc, presenting common proposals and positions in the different issues under discussion.

Despite the economic and political environment favoring the integration project, MERCOSUR was not able to successfully negotiate the withdrawal of the sectoral exceptions to the free trade regime. More importantly, the negotiations of the action plan set forth having the year 2000 as its horizon faced strong resistances as the issues to be addressed were perceived as potentially implying the cession of economic policy sovereignty in areas such as industrial policies, State owned enterprises etc.

By that time, the "easy" integration phase, concentrated on automatically suppressing the whole of the tariffs applied between member countries, was over and the negotiations turned to more complex issues, economically as well as institutionally .These are the so-called "beyond the border issues", where agreements depend on the existence of a reasonable degree of convergence, between member countries, as far as the goals to be reached and the means to achieve these goals are concerned.

Besides, in the case of MERCOSUR, the incentives for deepening the integration process are widely heterogeneous among member countries. In one extreme, small countries have a strong economic

4. At the same time, competition between member countries to attract greenfield investment produced some frictions between Brazil and Argentina, creating, among Brazil's partners, incentives to include in the subregional agenda the need to discipline such competition. Brazil repeatedly resisted these intents.

interest in the setting of disciplines that confer legal certainty to the market access' commitments made by the larger countries and that limit the freedom of these last ones to adopt policies that could distort competition within the bloc.

In the other, the largest country has the opposite interests, especially when the right to adopt and enforce a large variety of industrial policies – a highly valued tradition in Brazil's policy making since the 50s of the XXth Century – is at stake in international negotiations.

### 2.4. Financial crisis, exchange rate misalignments and trade conflicts (1998 – 2002)

The Asian crisis, in the second half of 1997, significantly narrowed the margins of freedom enjoyed by MERCOSUR countries, highly dependent on external financing to sustain growth. The coordinated reaction to the external choc was an across the board increase of three percentage points applied to the CET. Beyond, national responses to the choc led to the slowing of economic activity and produced new trade frictions between member countries.[5]

One of those frictions was created by the devaluation, in January 1999, of the Brazilian currency, a direct consequence of the Asian crisis. The abrupt change in Brazilian exchange rate regime led the bloc to its deepest crisis since its inception. Argentina pressed for the setting of a safeguard mechanism to be applied to its imports from Brazil – a proposal that Brazil rejected – and resorted to measures of protection against Brazilian exports.

On the external front, MERCOSUR's negotiating agenda made no progress. Frustrated with the lack of results in external trade negotiations, Uruguay began to show in a bilateral agreement with the United States.

However, MERCOSUR continued to act as a trading bloc in the negotiations of the FTAA and with the European Union and, in 2000, it issues a Resolution that reassert the commitment of the member countries to not to negotiate individually preferential trade agreements with third countries or other trade blocs.

From 1999 to 2002, MERCOSUR went through its deepest crisis, beginning with the sharp devaluation of Brazil's currency, in January 1999, which provoked a strong protectionist reaction from the Argentinian government – scared with the trade and investment impacts of the Real devaluation.

From 2000 on, the macroeconomic situation deteriorated in Argentina, pointing to the terminal crisis of the currency board experiment – whose final outcome took place in December 2001, with relevant political and economic implications for the country and the integration process.

These were years when the difficult economic situation in Brazil and Argentina did not make room for significant advancements in the integration agenda. The economic agenda in the larger countries of the bloc turned almost exclusively to the management of the domestic crisis they were going through. In spite of this, in 2002, MERCOSUR was endowed with a dispute settling mechanism and a Technical Secretariat.

5. Motta Veiga, P. (2000), op. cit.

## 2.5. MERCOSUR in "post-liberal regionalism" mode (2003 – 2015)

In the first years of the new Century, a sharp political shift took place in South America, challenging the liberal paradigm that drove the domestic and foreign economic policies in the region during the previous years. Left wing parties and groups gained presidential elections in Uruguay, Brazil, Argentina, Bolivia and Venezuela[6].Their foreign economic agenda was set according to principles of economic nationalism and a (more or less, according to the countries) loose "anti-hegemonism" targeting the relationships with the US and other developed countries[7].

In the field of regional integration, the critics addressed to the model of "open regionalism" adopted in the 90s by MERCOSUR and the Andean countries did not lead to a reversal of the commitments in place - at least in the case of MERCOSUR[8]. In this case, the main implications of the political shift observed in the majority of member countries have been:

- The de facto freezing of the trade and economic agenda of the bloc and the priority given to the political and social agenda. Contrarily to what should be expected, political convergence between the member countries did not push the internal trade agenda of the bloc. However, this is only an apparent paradox as the focus of political convergence between Brazil and Argentina was economic nationalism, a set of ideas that reject trade liberalization and "open regionalism";

- The new priority accorded to South-South negotiations and agreements within the region (MERCOSUR – Andean countries) or with third Southern countries (India, SACU). Negotiations with extra-regional partners were politically motivated and did not produce relevant economic outputs: the agreements signed by MERCOSUR with India and SACU cover only a small fraction of the tariff universe and are based on the reciprocal exchange of fixed preferences.; and

- The rejection – not formally formulated – of negotiations and agreements with developed countries. While MERCOUR countries cannot be deemed the only responsible for the failure of the FTAA negotiations (2005) and the halt of the negotiations with the EU (2004), the new political orientation of the governments of Brazil and Argentina did not contribute to the success of such processes. Trade negotiations with the EU resumed in 2010, but protectionist interests in both sides have been hindering the process.

The political convergence between Brazil and Argentina did not prevent the proliferation of bilateral trade conflicts, produced by the increase in protectionist measures adopted by Argentina in the second half of the 00s, affecting imports from all over the world (including Argentina's partners in MERCOSUR). Besides trade protectionism, regulatory uncertainty in Argentina also negatively affected Brazilian investments in this country. In such a scenario, Brazil's economic foreign policy priorities turned to the global agenda, focusing on the WTO negotiations and the BRICS coalition.

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6. In the case of Uruguay and Venezuela, the leftist governments took office in 1999. Lately, Ecuador would join the group, with the election of Rafael Correa, in 2007.
7. Motta Veiga, P. and Rios, S. (2007) – O regionalismo pós-liberal na América Latina: origens, iniciativas e dilemas, Série Comércio Internacional n. 82, CEPAL, July.
8. As for the Andean Community, the situation was more complex as some countries – Colombia and Peru - kept their liberal orientation in economic policies – while others – Bolivia and Venezuela– followed a different – post-liberal – path.

China became the first trade partner of Brazil and Argentina, importing large quantities of agricultural and mineral commodities and contributing to reduce the weight of the bloc as a destination for its member countries' exports. This economic trend acted as an additional centrifugal force on the integration process. MERCOSUR lost its priority for the economic foreign policy of Brazil, but also Argentina's at this time, the customs union agenda remained blocked and its exceptions were repeatedly extended.

While the economic incentives to deepen the integration process faded, the political dynamic of the bloc was strengthened by the entry of another country politically aligned to economic nationalism and post-liberal regionalism[9]. In 2005, Venezuela adhered to the bloc, without having previously adopted and enforced the so-called "acquis communautaire" of the bloc. This decision was approved by three member countries, but rejected by Paraguay, which questioned the Venezuelan government as non-democratic[10].

At the end of its "post-liberal" political cycle, MERCOSUR had become essentially a political device for the national governments of the member countries. The trade and economic agenda of the bloc did not register progress and the MERCOSUR's markets lost relevance to its members. In 2016, MERCOSUR was responsible for only 13.5% of its members' exports[11].

At the same time, the economy of the largest member state – Brazil – was going through a deep recession, which reduced in two years (2015 and 2016) its GDP by more than 7%. Argentina, in turn, registered, during this period, a high level of volatility in its growth rates, oscillating between negative and positive rates.

As the economic scenario in both countries deteriorated and political support to the governments in place was drastically reduced, a new political shift came into effect: in Brazil, President Rousseff was impeached in 2016 and, in late 2015, Mauricio Macri, a liberal politician and businessman was elected as President.

## 2.6. The liberal convergence is back (2016 – 2019)

Brazil slowly resumed growth in 2017, while in Argentina GDP growth continued to show, in 2016 and 2017, the same pattern of volatility: recession in 2016 (-2,3%), positive growth in 2017 (2,9%). In 2018, a new economic crisis hit Argentina and a negative growth rate is expected for this year.

This fragile economic scenario favored the adoption, in both countries, of economic agendas focused on domestic issues. In the case of Brazil, the fiscal deterioration observed under President Rousseff led the fiscal issue to the top priority position in the economic policy agenda. The same concern drove the Argentinian government in the first two years of the presidential term, but the effort was not enough to prevent the country from entering into a new episode of macroeconomic crisis.

9. At the time, Venezuela was the leader country of another cooperation and integration process, putting together some Centro American and Caribbean countries: ALBA – Bolivarian Alternative for the Americas.
10. Paradoxically, the entry of Venezuela would be formally confirmed by MERCOSUR only in 2013, during a period when Paraguay had been suspended from the bloc for political reasons (the impeachment, by the Congress, of President Lugo, a leftist politically close from the Presidents of the other member countries).
11. BID/INTAL, Informe MERCOSUR, various issues.

Despite some initiatives to update MERCOSUR's customs union agenda, the prevailing scenario did not favor any positive evolution on this side. By contrast, the external agenda of the bloc gained some impetus with the diversification of initiatives as far as the negotiation of preferential trade agreements is concerned.

Besides the continuity of the negotiations with the EU, new initiatives were launched and MERCOSUR began to negotiate, in the last few years, with the EFTA countries, Canada and, more recently, with South Korea. However, so far none of these negotiations has reached a successful conclusion.

The new government elected in Brazil at the end of 2018 has announced its intention of promoting a trade reform, whose main component would be tariff liberalization. In the wake of the debates raised by this proposal, MERCOSUR status quo, and most notably, its customs union model, has been growingly challenged by analysts and policymakers.

The preference, announced by the new government, for bilateral agreements has added new doubts about the future of the bloc as a customs union. The reversal of the customs union model – to a free trade zone – is one of the options under consideration, the other one being a negotiated tariff reform between member countries, leading to an overall reduction of the level of the CET.

# 3. MERCOSUR' trajectory: assessment and rationale

More than 25 years after being officially set, MERCOSUR´s trajectory can be assessed, based on its own goals and metrics. In political terms, MERCOSUR is a project that emerges from the re-establishment of democratic regimes in the member countries and the set of bilateral cooperation agreements signed by Brazil and Argentina in the second half of the Eighties – encompassing not only trade and economic issues, but more sensitive themes, as nuclear and military programs.

## 3.1. Achievements and flaws: a brief assessment

In this new cooperative scenario, trade was identified as one of the most promising tools for widening and deepening economic and political relationships between not only Brazil and Argentina, but also with the two smaller countries in the sub region – Paraguay and Uruguay. MERCOSUR was the instrument that made this project operational, in the trade and investment field.

Therefore, assessed as a relevant component of a broad and long lasting cooperative arrangement between its member countries, the integration project is a success case. It strongly contributed to consolidating politically and economically the new cooperative scenario and to leaving behind the hypothesis of military conflict between Brazil and Argentina – present during the military governments in both countries

It is true that the "politization" of the bloc during the post-liberal integration cycle, mainly expressed through the suspension of Paraguay and the accession of Venezuela, provoked some tensions and fissures among and within member countries and proved to be a risky bet from Brazil and Argentina governments. However, the recent evolution of the bloc indicates that these episodes have been overcome.

In economic terms, the assessment is less positive and should be qualified. The Treaty creating MERCOSUR (Asunción Treaty) sets, in its Article 1, the decision to constitute a common market – hence the name of the bloc. But in practice, the member countries worked to build a customs union, that is a free trade area plus a common trade policy (and a common external tariff) towards the rest of the world.

Despite the existence from the beginning of the process of some sectoral exceptions – namely automobiles and sugar – tariffs previously applied to the trade of goods between member countries have been eliminated, benefiting from an "automatic" methodology enforced between 1991 and 1994.

The methodology adopted by MERCOSUR as for the elimination of intra-bloc tariffs distanced itself from the one traditionally used by ALADI agreements, based on intra-sectoral exchange of preferences, which was systematically captured by the interests of domestics producers. The results of the elimination of tariffs in the intra-bloc trade rapidly appeared and its share on the total foreign trade of the member countries grew from 13.5%, in 1992, to 22%, in 2000[12].

Of course, the withdrawal of tariffs did not prevent member countries from resorting to non-tariff barriers in different situations, especially when the bilateral exchange rate parities between them were affected by unilateral devaluations. But non-tariff barriers have also been used, particularly by Argentina, as a trade policy tool against imports in general, not only against intra-bloc imports.

Besides, barriers to the free circulation of goods remained, stemming from divergent national regulations concerning standards and sanitary and phytossanitary matters. A large number of national regulations in these areas were only marginally harmonized. Even in those cases in which a MERCOSUR norm was eventually agreed upon, lack of internalization or differences in the enforcement of the agreed norms have continued to act as effective barriers to intra-regional trade.

In addition, the early progress obtained in the liberalization of trade in goods was not extended to other trade-related areas that have been covered by "open regionalism" agreements signed from the 90s on. These are the cases of investment, trade in services and government procurement, areas where agreements between member countries have indeed been signed, mainly during the 90s, but whose enforcement has been either largely delayed[13] or simply not concluded (as for the twin investment protection agreements).

Therefore, as far as the free trade area dimension of MERCOSUR is concerned, the bloc has been fairly successful in completing an FTA for goods – especially in the withdrawal of tariffs previously applied to trade between member countries, not so much in areas beyond trade in goods, as services and governmental procurement.

The customs union dimension of the project – broadly identified in the project to the setting of a common external tariff (CET) – was far less successful than the FTA's one. As argued, MERCOSUR's CET was largely based on the tariff structure that resulted from Brazil's unilateral trade liberalization in the early 90s.

12. Motta Veiga, P. (2000), op. cit.
13. In the case of the protocol of trade in services, the agreement was signed in 1995, but it entered in force only in 2006.

Brazil's trade reform had substantially reduced the levels of protection prevailing during the previous decades, but kept at relatively high levels the tariffs applied to manufacturing sectors, especially automobiles, capital goods, electronics, textiles, clothing and shoes. Brazil pressed the other member countries to opt for the customs union model and to accept a tariff structure that corresponded to its own interests, making small room for concessions.

This tariff structure did not fit the interests of the other member countries, particularly the smaller ones, and this is why MERCOSUR CET has, from its very beginning, lived with a set of exceptions that mitigates its effectiveness.

Besides exceptions covering sectors that produce capital goods as well as telecommunications and informatics goods[14], MERCOSUR legislation has made room for national lists of exceptions, contemplating a number of products that varies according to the countries demands[15] , and for CET waivers that can be invoked unilaterally for reasons of goods shortage. In addition, the member countries have preserved their national special import regimes, as the drawback regime, allowing them to import goods to be used in the production of exports without paying the CET.

As a consequence, although the whole tariff has been negotiated to set the CET, the Technical Secretariat of MERCOUR has estimated that, due to "transitory exceptions and the lists of exceptions, the CET and the national legal tariffs coincide for 70% of the tariff positions, corresponding to 50% of the bloc's imports from third countries. However, the heterogeneity of national special import regimes and trade defense policies, as well as the existence, at the national level, of different preferential trade regimes with third countries lead the share of imports for which the CET equals the national the national tariff effectively applied to 35%. In addition, if one excludes from this remaining share the imports whose tariffs are zero, only 10% of the total imports of MERCOSUR countries are processed in accordance with the CET in force"[16].

Therefore, from the point of view of the customs union model, MERCOSUR has failed to enforce a sole customs territory. This "enforcement deficit"[17] extend beyond the CET to reach other areas of negotiation where protocols or agreements have been signed, but not enforced (or enforced precariously), and schedules for national tariffs' convergence are repeatedly extended – a feature that significantly reduces the credibility of the project among economic players.

Externally, MERCOSUR acted as a bloc in almost all the preferential negotiations held since the 90s. As argued, the results have been meager: the only broad agreements signed concern two small trade partners (Israel and Egypt) and the agreements with Southern relevant partners (India and SACU) are very limited in terms of scope and tariff reductions[18].

14. MERCOSUR's lists of products classified as capital goods or telecommunications and informatics goods covers more than 1.600 products (at HS 8 digit-level). Each country has its national list of exceptions for these goods, which does not cover the whole set of goods classified as capital or telecommunications and informatics goods. These are temporary exceptions, as those applying to national special import regimes, but they have been extended at different moments and remain in place.
15. 100 goods each for Brazil and Argentina, 225 for Uruguay and 649 for Paraguay.
16. Bouzas, R.; Motta Veiga, P. e Torrent, R. (2002) – In-depth analysis of Mercosur integration, its prospectives and the effects thereof on the market access of EU goods, services and investment, report prepared for the Commission of the European Communities, Observatory of Globalization, University of Barcelona, november.
17. Motta Veiga, P. (2003) - A agenda de institucionalização do Mercosul: os desafios de um projeto em crise, Pedro da Motta Veiga, Interamerican Development Bank.
18. In the WTO, MERCOSUR countries have not acted as a bloc, but individually.

This difficulty can be at least partially attributed to the resistance of vested (industrial) interests in Brazil and Argentina to any agreement that could challenge their dominant position in the domestic and regional markets. As a result, MERCOSUR producers remained relatively isolated from the global trade and the diffusion of international value chains, contributing to a competitiveness gap that affects the local industry vis à vis the rest of the world.

At the convergence of these trends and evolutions, MERCOSUR's performance as a tool for economic integration between member countries and with the rest of the world can be deemed disappointing, when assessed by its own explicit goals and metrics. The project has also fallen short from the objectives of the "deep integration" – EU model or the NAFTA-like multi-thematic FTAs, both fashionable projects in the 90s.

Some data confirm this assessment. Trade in goods between MERCOSUR countries has grown strongly in the early years of the project, leading the share of intra-bloc trade in the total foreign trade of member countries from 13.5%, in 1992, to more than 20%, in the second half of the 90s. Following the crisis of the late 90s and early 00 in Brazil and Argentina, it plummeted to 11%, growing again after 2002, to reach 19% in 2011.

Since then, however, the downward trend has largely prevailed, leading the value of intra-bloc trade to the same level of 1992[19]. As would be expected, the relevance of intra-bloc trade varies greatly among member countries, reaching, in the case of exports, 47.5% for Paraguay, 25% for Uruguay, 19.3% for Argentina and 10% for Brazil, in 2016[20].

MERCOSUR trade has become a very relevant one for Paraguay, but also for some sectors as the automobile sector producing in Brazil and Argentina and for capital goods produced in Brazil. As an example, between 2016 and 2018, the auto sector was responsible for 47% of the total exports from Brazil to Argentina and for 40% of the total exports from Argentina to Brazil, accounting for 44% of the bilateral trade flows[21].

The impacts of MERCOSUR on direct investment seem to have been mainly associated to some specific sectors – food and beverage, chemicals and automobiles – and to inward flows from non-member countries. Intra-bloc flows have been limited. As for 2017, the stock of Brazil's FDI in Argentina represented only 1.3% of the Brazil's total FDI, while the share of Uruguay was almost at the same level (1.2%)[22].

As for trade in services, the available data on Brazil's relations with its MERCOSUR partners also suggests that these countries still occupy a secondary place among Brazil's partners. In fact, as for 2017, the share of MERCOSUR in Brazil's exports and import of services was 2.2% and 2.2%, respectively. Argentina was the largest markets for Brazil' exports among its MERCOSUR partners (56% of the intra-bloc exports) and Uruguay is the main source of Brazil's services imports within the bloc (54%).[23]

19. At least in part, the stagnation of the share of intra-bloc trade reflects the impacts of the emergence of China on the exports and imports of MERCOSUR countries.
20. BID/INTAL, Informe Mercosur, various issues.
21. Trade in the automobile sector between Brazil and Argentina is regulated by a mechanism of trade management, supposedly temporary, but whose enforcement has been extended many times.
22. Banco Central do Brasil (2018) – Estatísticas de capitais brasileiros no exterior.
23. Ministério da Economia, Indústria e Comércio e Serviços do Brasil (2018) - Estatísticas do Comércio Exterior de Serviços 2017.

## 3.2. Making sense of MERCOSUR's trajectory

How to explain the achievements and flaws of MERCOSUR? As argued, the project has been quite successful in setting a free trade zone for goods – despite the persistence of negotiated or unilateral mechanisms of managed trade. But it surely failed to consolidate its explicit goal as a trade integration project: becoming a customs union.

MERCOSUR's main achievements date back to the 90 and can be explained by the fact that the sub-regional integration project was part of a broader economic and political shift in the member countries: political democratization and trade and economic liberalization after decades of protectionism. The integration project was perceived as fully compatible with – and as a component of – the political and economic priorities of the new national agenda of the member countries.

The international environment was also favorable to integration projects and experiments. "Open regionalism" and "deep integration" were the expressions used to refer to the wave of preferential agreements launched during the decade, even if the negotiated arrangements could be quite diverse in their methods and objectives (e.g., NAFTA and the EU 92 Project).

Despite its promising initial years, MERCOSUR was not able, from the end of the 90s on, to advance its customs union agenda. Even the "free trade area agenda" going beyond the suppression of tariffs applied to the intra-bloc trade has been difficult to accomplish.

The "imperfections" of the customs union imposed costs to the free circulation of goods within the bloc and barriers to intra-bloc trade in goods and services resulting from the divergence in regulations and standards remained.

As a result, MERCOSUR appears as an economic integration process that can be classified as "narrow" in scope and "shallow" as far as the level of commitments negotiated and enforced is concerned[24]. How to make sense of this? Which factors can be invoked to explain the evolution of the project and its current shape?

Three kinds of factors seem to have played a relevant role in driving MERCOSUR's evolution:

- **Structural factors (economic and policy-related ones).**

The disparity of economic sizes between countries generates what can be named "asymmetric interdependence" between them. Smaller countries are more dependent on access to larger countries' markets and more affected by economic policy decisions taken by the larger countries than vice versa.

Therefore, in principle, larger countries can have less incentive than smaller ones to negotiate themes perceived as hindering their economic sovereignty in policy areas where they value their

24. The simple fact of being narrow and shallow cannot be deemed a problem or a failure in any integration project. Many preferential trade agreements opt for a shallow and narrow level of commitments, concentrating on tariffs, for instance, and bringing from the WTO agreements a short set of disciplines applicable to trade in goods (tariffs). In the case of MERCOSUR, however, the reference to being "narrow and shallow" points to the fact that the project has not been able to accomplish its own goals and to reach its explicit ambition as a regional integration project.

national autonomy.

In the case of MERCOSUR[25], the largest economy – Brazil, representing 2/3 of the regional GDP - has historically valued national autonomy and sovereignty in the design and enforcement of broad trade and industrial policies area. These policies have been the central piece of the import substitution industrialization strategies.

Despite the trade liberalization episode of the early 90s and the setting of MERCOSUR's CET, Brazil's trade policy concept and instruments still pertain to the import substitution paradigm. Changes in the political economy of trade and industrial policies have been limited and the interests of industrial sectors competing with imports remain the main driver of these policies.

Asymmetric interdependence plus the hegemony of protectionist interests and ideas in the largest country converge to limit drastically Brazil's willingness to negotiate and to commit to disciplines in thematic areas seen as likely to limit "national autonomy" or "national policy space".

From the very beginning of MERCOSUR, Brazil showed a limited flexibility to negotiate issues that could imply economic sovereignty sharing and this trait has strongly marked the economic performance of the bloc as well as its institutional shape. Any intent to develop institutional instances within Mercosur was resisted by Brazil as were the efforts made by its partners to negotiate rules on subsidies to attract FDI, in the 90s.

- **Macroeconomic / Conjunctural factors**

During the whole existence of MERCOSUR, the two larger economies have gone through episodes of macroeconomic crisis, whose unfolding impacted growth rates and led, in many cases, to the devaluation of national currencies. The spill overs of these crises negatively impacted the sub-regional integration project, through two different channels.

First, the reduction of domestic demand in the country undergoing a crisis episode hindered the perspectives of exports – hence of growth – of the other members to that country. Second, a currency devaluation following the irruption of a crisis usually impacted intra-bloc trade flows, fostering exports from the country having devaluated to the other member countries and inhibiting the trade flows in the opposite direction. Currency devaluations in one member countries have often been at the origin of the rising of non-tariff barriers by other members and of trade frictions between them.

Besides these two channels, the impacts of recurrent macroeconomic crises on the integration project also manifested through the loss of priority accorded to the project during the periods of crisis, when the affected country concentrated on its domestic policy priorities and constituencies' interests, leaving aside the integration agenda.

- **The strategic options made alongside the project**

Two strategic options made at the origin of the project seem relevant to understand the difficulties

25. Bouzas, R. and Motta Veiga, P. (2008). La experiencia europea en el tratamiento de las asimetrías estructurales y de política: implicaciones para el Mercosur, in Masi, F. and Terra, M.I. (ed.) Asimetrías en el Mercosur: ¿impedimiento para el crecimiento? Red Mercosur.

faced by MERCOSUR to reach its explicit objectives or, more broadly, to make progress in the direction of a less shallow and narrow integration project.

As stressed, the building of a customs union has been the strategic goal pursued by MERCOSUR since its beginning. The option for the customs union model expresses essentially Brazil's policy preference and its ability to impose it to the other member countries through a CET modeled after Brazil's tariff structure.

As the trajectory of MERCOSUR has evidenced, the customs union model was hardly compatible with the structural characteristics and policy preferences of the other member countries. Many types of exceptions were created or kept in place despite the introduction of the CET and none of them has ever been removed.

It is worth reminding that the customs union model was widely minoritary among the economic integration projects of the 80s and 90s all around the world. Almost always, the free trade area model has been adopted in these negotiations and arrangements.

Maybe the only customs union´s successful case, the European Union is an integration project strongly institutionalized and relying on supra-national governance, two options discarded by MERCOSUR countries – particularly by Brazil – from the beginning. In this sense, it is possible to formulate the hypothesis that the option for a customs union model was incompatible not only with different national policy preferences, but also with the main choices made by the bloc in the institutional and governance sphere.

Independently from the strategic objective of creating a customs union, MERCOSUR has also made limited progress in enforcing the commitments and disciplines negotiated, as well as in widening the scope of the commitments made. Here, the structural factors referred to above accounted a lot, but the institutional model elected by MERCOSUR also played a relevant role.

At the institutional level, MERCOSUR made the option for an evolutionary model of integration, following the EU process in broad terms. In contrast to NAFTA-like agreements, negotiated once and for all for a broad set of themes[26], the evolutionary model adopts a methodology in which successive agreements between the member countries improve, deepen and extend the commitments made.

The problem with MERCOSUR in this case refers to the fact that its founding treaties are ambitious as for their goals but imprecise as far as the means and timetables to achieve them are concerned. Hence, the dynamics of negotiation and enforcement of the agreements additional to the founding treaties – for instance, the trade in services agreement – is driven essentially by the political and economic circumstances in which the integration process evolves. These circumstances include the political and electoral cycles in each country, the shifts and the volatility in national policies potentially affecting the integration commitments, etc.

As a consequence, MERCOSUR has become a project with a limited degree of effectiveness, in the sense that its ability to influence and shape the behavior of public and private players within and outside the bloc is relatively low, with some exceptions. In other words, the existence of MERCOSUR

26. As recently as in 2018, the renegotiation of NAFTA has included in the agreement a review clause, establishing that the agreement will be reviewed for update every six years.

and the commitments it generated play a role less than relevant in the setting and enforcement of public policies and business strategies in the region.

None of the factors listed above can, in isolation, explain MERCOSUR's trajectory. It is the convergence of them that can make sense of the achievements and the resistances faced by the integration project to reach its explicit goals and its ambition.

A favorable political and policy-related context set the conditions for the initial push that distanced MERCOSUR from the limited previous initiatives under ALADI. Structural factors seem to have played a very relevant role in determining MERCOSUR' current shape through the influence it exerted all along the process. Conjunctural circumstances have acted to limit, in different occasions, the priority given by the larger member countries to the project. Strategic options made during the process somehow amplified the influence of the structural factors, specially through the setting of a governance model that do not favored the deepening of the project and the enforcement of rules.

## 4. Lessons from MERCOSUR's experience

MERCOSUR is almost thirty years old and some lessons can be drawn from its experience, although one must recognize that complex social experiences – mixing economic, political and institutional features – cannot be transposed from their original context to other ones.

The first lesson that can be learned from MERCOSUR's experience points to the fact that the integration project must be compatible with the general directives of economic policy - reinforcing these directives – and ideally be part of a broader arrangement between member countries, encompassing political and economic dimensions.

In the case of MERCOSUR, the bloc's larger economies were undergoing a process of unilateral trade liberalization and had recently moved from authoritarian political regimes to democratic ones. These pre-conditions were highly favorable to giving traction to the first steps of the economic integration project.

By contrast, the previous ALALC/ALADI experiences of reciprocal liberalization had rapidly reached their limits, which were defined by the national industrial strategies of import substitution: the concessions exchanged through these agreements did not challenge the dominant position of the domestic producers in their markets and had no relevant economic impact on the participating countries.

The setting of MERCOSUR through an automatic methodology that eliminated in a few years the tariffs between member countries for the whole universe of goods (with some exceptions, it is true) distanced the then new experience from its predecessors and contributed to rapidly create a more open economic environment between member countries.

The relevance of the compatibility between the integration project and the member countries priorities in broader economic policies also appears, although negatively, in the case of MERCOSUR during the period when Brazil and Argentina had post-liberal governments.

In this period, the national economic projects of both countries did not contemplate the liberalization drive and the logic of sovereignty sharing that characterizes ambitious integration processes – as MERCOSUR intended to be. Not by chance, the trade and economic agenda of the bloc stalled during this period.

A second lesson emerging from MERCOSUR's experience refers to the economic integration model to be pursued. As argued, MERCOSUR set the constitution of a common market as its final goal, but was managed as a project whose strategic objective was the establishment of a customs union – clearly Brazil's policy preference accepted by the other member countries.

Since the beginning, the customs union agenda overlapped with the free trade area one and both agendas suffered from this overlapping. As the project evolved, the customs union agenda proved to be excessively demanding for all the member countries – Brazil included.

As a result, the customs union implementation process was not able to go beyond the setting of a common external tariff, with many exceptions, barely contemplating the other dimensions of a common trade policy. At the same time, many themes that make for the free trade agenda (trade in services, investment, non-tariff barriers etc) were given a non-priority treatment.

Therefore, the second lesson is one of realism and pragmatism. There are very few examples of successful customs union all around the world and developing countries face additional challenges in sharing policies with each other. In this sense, the option for the free trade area model seems to be recommended by MERCOSUR's experience.

The third lesson of MERCOSUR' experience refers to the relevance of making sure that the mechanisms for the production and the enforcement of commitments and rules agreed upon provide predictability for the economic players – especially the private ones – and generate incentives to the setting of a "pro-integration" coalition in member countries.

This is particularly relevant when the integration project opts for an "evolutionist" model, where a broad founding text has to be complemented by other agreements addressing specific themes as well as issues relating to enforcement of the commitments. From this point of view, MERCOSUR appears as a dynamic process at is beginning, gradually losing traction under the impact of national and international circumstances.

There is no magic solution for this dilemma. Ideally, "political will" – here identified to convergence between national and sub-regional or regional projects – is the best guarantee for the enforcement and respect of the rules. However, "political will" varies in time and the desirable predictability of the rules can be jeopardized by political and economic circumstances affecting one or more member countries.

The second and third lessons above are related to the weight of the Brazilian economy within MERCOSUR (2/3 of the sub-regional GDP) and the power it derives from its economic weight in the sub-regional negotiations. Brazil imposed the customs union model and the shallow institutional design to its partners, preserving, to its own benefits, the space for adopting industrial policies even when these could negatively affect the other member countries. Hence, the fourth lesson that can be derived from the MERCOSUR experience relates to the problems that as integration project can face when one of its members account for a large share of its economy. In these cases, MERCOSUR's experience suggests that opting for a free trade zone – as an alternative to a customs union – and defining, within the founding treaties, rules for trade in goods and services, investment and public procurement, among other issues (as in NAFTA) could be e first-best option, although it is forceful to acknowledge that this is not a magic solution for the problems that derive of a unbalanced composition if any integration bloc.

The fifth lesson is that, despite the inexistence of magic solution to the dilemmas pointed out in the previous lessons, some methodological options can help mitigating this problem. In the case of MERCOSUR, for instance, the option for an automatic methodology to withdraw in a few years – according to a pre-set timetable– the tariffs hindering the intra-bloc trade was essential to dramatically moving the bloc's agenda.

Larger timetables for less developed countries to comply with negotiated rules can be a better option than the setting of exceptions whose validity tends to be repeatedly kept in force. The setting of exceptions has itself to be carefully assessed: when trade between member countries concentrate in a few goods, exceptions can hamper the expected positive impacts of reciprocal liberalization.

The sixth lesson relates to the need to be selective when electing the issues to be set as priorities in the agenda of the integration project. In the case of MERCOSUR, trade in goods appeared as the main thematic priority and it is possible to argue that trade – together with investment – should be a priority in every economic integration project.

Conceptually, this is what economic integration is about. Beyond trade and investment, other issues can be included, according to the characteristics of the region (or sub-region): infrastructure and logistics, the movement of natural persons as part of trade in services, etc.

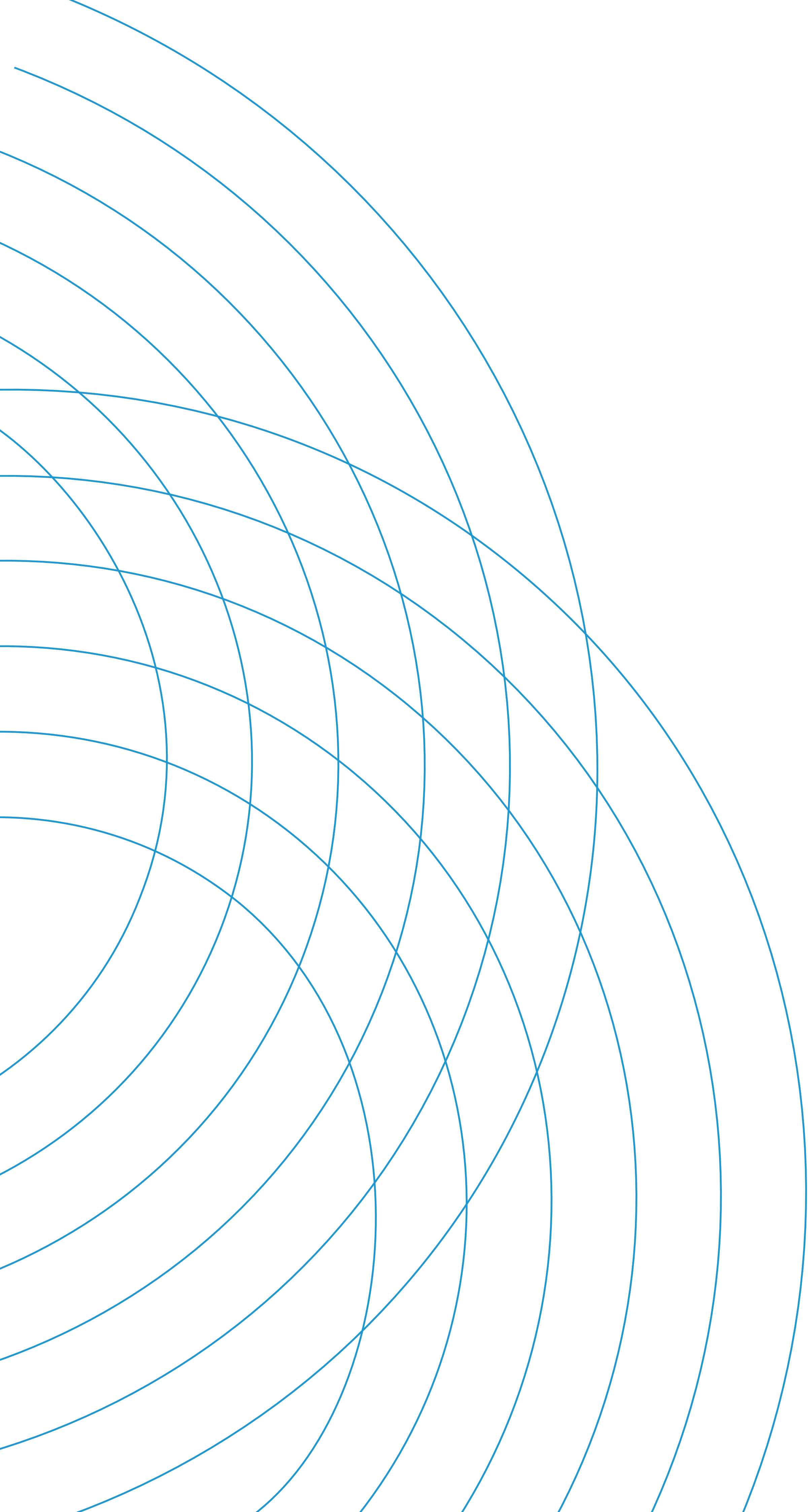
# 5. Conclusions

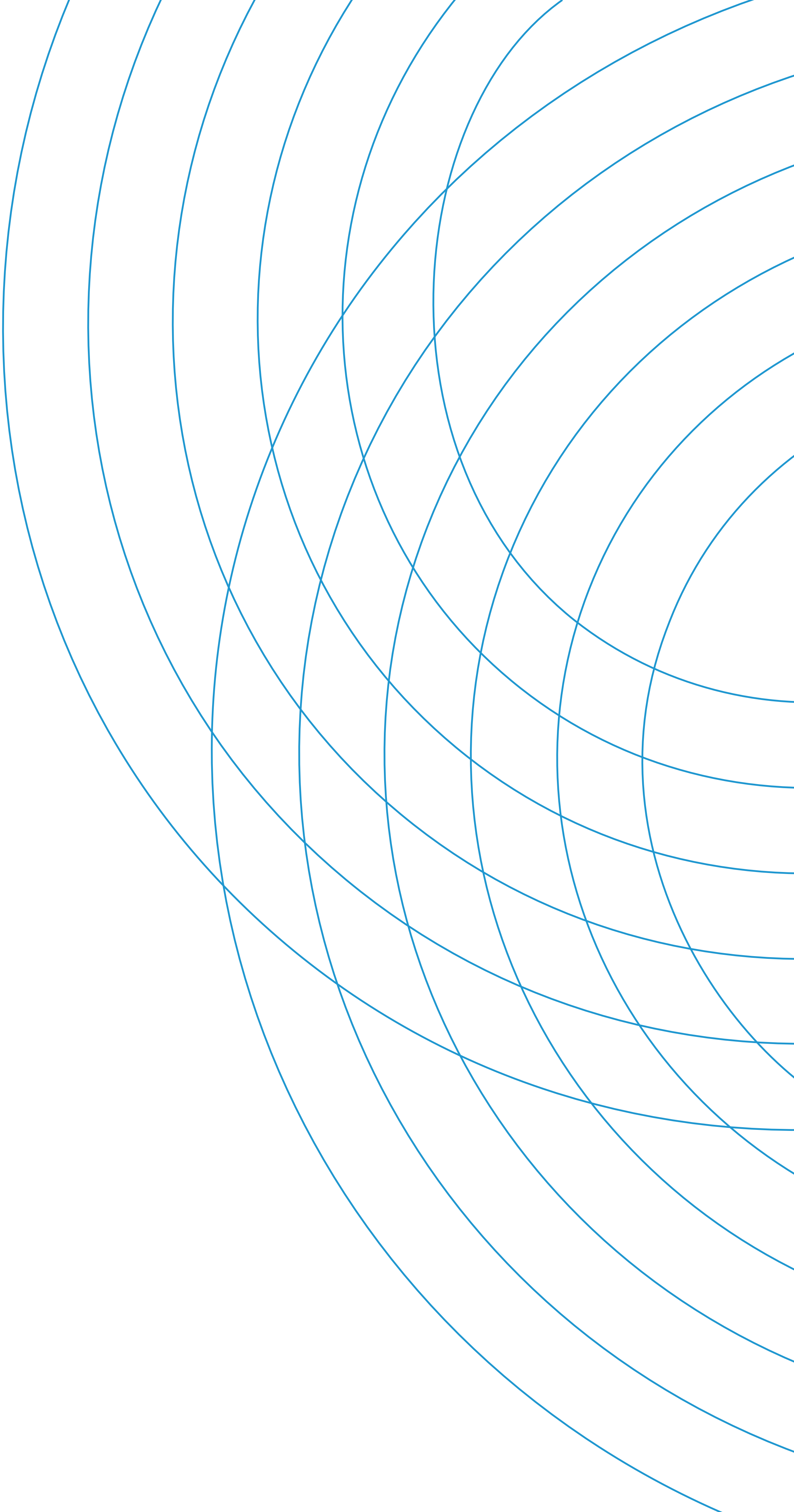
One relevant criterion to evaluate the effectiveness of the integration project is its ability to influence and shape the behavior of public and private players within and outside the bloc. As pointed out, MERCOSUR has become a project with a limited degree of effectiveness, except for a few number of players. In other words, the existence of MERCOSUR and the commitments it generated play a role less than relevant in the setting and enforcement of public policies and business strategies in the region.

This output should be seen as the effect of the convergence of factors that have reduced the predictability of the integration process and the relevance of its rules, especially vis à vis the national rules of the member countries. At the end of the day, together with the sustained growth of trade and investment between member countries and with third countries, effectiveness – as defined above – is the main criteria to evaluate the degree of success of any economic integration project.

As it happened when MERCOSUR was created and its CET defined, the orientation of Brazil's trade policy is the main factor conditioning the future evolution of the integration project. Trade policy reform has come back to the policy agenda in Brazil, pointing to a new episode of trade liberalization – the first once since the early 90s.

Sustained economic growth for MERCOSUR's economies will demand a reform of the bloc's common external policy.The future shape of MERCOSUR is likely to be less protectionist and more open to the rest of the work.





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