P. VAN DIJCK AND M. WIESEBRON *EDS* **Ten Years of Mercosur**

CUADERNOS DEL CEDLA 9

Pitou van Dijck and
Marianne Wiesebron *eds*

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Cuadernos del Cedla

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ECONOMIC ACHIEVEMENTS AND CHALLENGES AHEAD

Pitou van Dijck

1. Mercosur: seven critical steps

When analysing the dynamics in the formation, implementation and expansion of Mercusur, the following critical steps may be distinguished. First, the rapprochement between Argentina and Brazil resulting in the Iguazú Declaration of November 1985 in which the two countries declared they would strive for the intensification of a relationship built on friendship and solidarity.

Second, the initiation of the bilateral Programa de Integração e Cooperação Econômica (PICE) of Brazil and Argentina which started the integration process in the Southern Cone in 1986 and included sectorwise agreements to stimulate trade in a controlled manner. Between July 1986 and April 1988 the two countries agreed upon 24 protocols dealing with investment, production, trade, and import tariffs in the sectors of capital goods, energy, biotechnology, the automobile sector, food industry, and transportation.

Third, the agreement in November 1990 to introduce a scheme of automatic tariff reductions on intra-regional trade between Brazil, Argentina, Uruguay and Paraguay and the Treaty of Asunción signed 26 March, 1991.

Fourth, the Ouro Preto Protocol that rounded off the transition period and heralded the formal start of a customs union (CU) by 1 January, 1995.

Fifth, the initiatives to extend the coverage of the liberalization programme and reduce the extent of exceptions and special arrangements, and measures to deepen integration among Mercosur members including attempts at the coordination and harmonization of macroeconomic policies.

Sixth, the subsequent initiatives undertaken to expand preferential intra-regional trade relations with Chile, Bolivia and the members of the Andean group, and the plan to establish a South American Free Trade Area (SAFTA).

Seventh, the initiatives undertaken to participate in interregional trade preferential systems with the USA, the European Union (EU) and with South Africa.

Section 2 of this chapter reviews briefly the main achievements of Mercosur during the last decade, particularly in the areas of trade liberalization, fostering intra-regional integration through trade, attracting foreign direct investment (FDI), and the establishment of preferential economic relations with third countries. Section 3 studies two major challenges for Mercosur in the years ahead: deepening of regional integration including full implementation of the Treaty of Asunción, and dealing with the potential effects of a Free Trade Area of the Americas (FTAA).

2. Achievements

Liberalization of trade

The Treaty of Asunción set out an extraordinarily ambitious and comprehensive reform programme involving the four countries in the Southern Cone of the Americas. The treaty was ratified by all four members and entered into force on 29 November, 1991. As Article 1 of the treaty puts it:

The States Parties hereby decide to establish a common market, which shall be in place by 31 December, 1994 and shall be called the Common Market of the Southern Cone. This common market shall involve:

The free movement of goods, services and factors of production between countries; through, *inter alia*, the elimination of customs duties and non-tariff restrictions on the movement of goods, and any other equivalent measures;

The establishment of a common external tariff and the adoption of a common trade policy in relation to third States or groups of States, and the coordination of positions in regional and international economic forums;

The coordination of macroeconomic and sectoral 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 and any other areas that may be agreed upon, in order to ensure proper competition between the States Parties;

The commitment of States Parties to harmonize their legislation in the relevant areas in order to strengthen the integration process.'

The common market was to be established by 31 December, 1994 between Brazil and Argentina, while Uruguay and Paraguay were to join one year later. Annex I of the Treaty specifies the programme of linear and automatic tariff reductions to realize free trade. By 1 July 1991, tariffs on trade were to be cut by Argentina and Brazil by 47 per cent and subsequently every six months with another seven percentage points up to 30 June, 1994, to be eliminated ultimately by 31 December, 1994. Moreover, non-tariff barriers (NTBs) to imports had to be abolished by 30 June, 1995.

Mercosur was notified to the General Agreement on Tariffs and Trade (GATT) on 18 February, 1992 under the provisions of the Enabling Clause, not Article XXIV of the GATT. The Enabling Clause, which deals with the specific position of developing countries and includes legal provisions for preferential trade agreements among developing countries, is less specific regarding the acceptable degree of tariff liberalization and the abolishment of NTBs as compared to the specifications of Article XXIV.

When assessing the achievements regarding the liberalization of regional trade and cooperation in the implementation of a regional trade policy, one needs to take into account that the two major partners, Argentina and Brazil, only had very limited economic interaction prior to the formation of Mercusur. Hence, Mercosur is not simply a formal framework to facilitate economic relations among countries that were already highly integrated in terms of trade and investment. Moreover, these two major partners belonged to the group of so-called late-reformers in Latin America, or 'third-wave reformers' as Edwards put it (Edwards, 1995, pp. 2-3, Table 1.1). During the period of implementation of the liberalization measures, these countries still suffered from large macroeconomic imbalances and price instability. The sharp fluctuations in the bilateral exchange rate between the Argentinian and Brazilian currency throughout this period resulted in a substantial variation in the bilateral trade balances and increased pressure on both governments to intervene in trade flows with taxes and other administrative measures. Clearly, the inconsistencies in macroeconomic policies and the high risks involved in this sub-optimal sequence of policy reform – liberalization prior to stabilization – underscore the need of a supportive macroeconomic context for regional integration, both in its early stages and in the subsequent stages of the deepening and widening of the integration process in the region.

The objective of the Treaty of Asunción, namely to establish a common market by 1995, was not realized, but notwithstanding the enormous stabilization problems, the programme of automatic tariff reductions accompanied by the elimination of NTBs to trade among Mercosur members was continued according to the pre-arranged schedule for most product groups included in the scheme. The major exceptions to the intra-regional liberalization programme were products listed as sensitive products, which were of little importance in overall trade, products dealt with in separate regimes such as sugar and most importantly automobiles, and issues not dealt with in the treaty such as services and government procurement.

At the same time, the programme of external trade liberalization progressed successfully and the common external tariff (CET) scheme included 88 per cent of all products by the inauguration of Mercosur as a CU. Most products were included in 11 categories with CET rates ranging between zero and 20 per cent. However, some selected product groups were protected by much higher tariff rates while some other product groups were excluded from the CET such as the products on the country-specific exemption lists of sensitive products.

As shown in Table 1, the average CET rate was planned to be 11.2 per cent, and 11.5 per cent for manufacturing at the end of the transition period, January 2001 for Argentina and Brazil, and January 2006 for Uruguay and Paraguay. However, Mercosur's CET has been distorted by still existing preferential trade agreements (PTAs) and special import arrangements between individual Mercosur countries and other members of the Latin American Integration Association (LAIA). This situation, in itself, is in contradiction with the very concept of a CU or common market, and has resulted in a kind of generalized application of rules of origin to products traded within the CU rather than exclusively to products exempted from the CET. In recent years, the unilateral introductions of temporary changes in the CET for balance-of-payments reasons or to protect sectors deemed to be threatened by a sudden upsurge of imports, have contributed to the complicated character of Mercosur's CET regime. Clearly, this situation has weakened Mercosur's capability to insert itself into international markets

Table 1. Final common external tariff, 2001/06.

	%
Total	11.2
Agriculture, hunting, forestry and fishing	7.0
Mining and quarrying	3.4
Manufacturing	11.5
Food, beverages and tobacco	11.6
Textile, wearing apparel and leather	17.1
Wood and wood products incl. furniture	10.5
Paper, paper products, printing and publishing	10.9
Chemicals	8.1
Non-metallic mineral products	10.9
Basic metal products	9.9
Fabricated metal products, machinery and equipment	13.3
Other manufacturing industries	16.6

Source: WTO Secretariat, as reproduced in: S. Laird, *Mercosur: Objectives and Achievements*, Staff Working Paper TPRD 9702, p.12, Table II, WTO, Geneva, 1997.

and to define common positions and targets in trade negotiations at the regional and multilateral level.

Regulation of the trade in automobiles and components thereof and the location of FDI in this sector has been a source of continuous conflict between Argentina and Brazil. The two countries agreed on a common automotive regime for the period August 2000 to December 2005, according to which bilateral trade in new vehicles is free of import tariffs and NTBs, provided trade is balanced. Provisions are included in case trade imbalances emerge, and high minimum regional content requirements – up to 60 per cent for parts and components, and 50 per cent for new models – limit the trade liberalization potential of the regime. The CET rate for vehicles is as high as 35 per cent but CET rates for agricultural and road machinery, and parts of vehicles are only 14 per cent. Based on the bilateral agreement, a new common automotive regime for Mercosur was agreed in February 2001, which included the 35 per cent tariff rate for imports into Argentina and Brazil from third countries. Notwithstanding these agreements, the automotive regime has remained a source of frictions and conflicts among the Mercosur partners.

Hence, Mercosur was an almost complete CU by 1 January, 1995, with largely liberalized trade among its members, and with CETs, differentiated for product groups, at an average nominal rate of 14 per cent, which is low as compared to average tariff rates at the beginning of the formation of Mercosur, but relatively high as compared to average most-favoured-nation (MFN) tariff rates in Latin America.

It should be noted that applied rates in Mercosur member countries are significantly lower than the levels at which they are bound in the World Trade Organization (WTO), thus allowing for upward adjustments without violating WTO commitments. However, the effective rates of protection in manufacturing may be significantly higher than nominal rates, resulting from wide margins of difference between the nominal tariff rates on unprocessed inputs and processed inputs. The highest effective CET rate in 2006 will be for cars, trucks and buses (Laird, 1997, p. 15).

The liberalization of intra-regional trade contributed to the strong increase in trade among Mercosur members but trade with the rest of the world increased rapidly as well. Table 2 shows the dynamics in intra-regional trade during the 1990s and the sharp increase in its significance for the overall trade performance of the two major trading nations in the Southern Cone, Argentina and Brazil. As shown, the values of intra-Mercosur exports and imports of these countries were rather small at the start of the decade but increased sharply, particularly in the first half of the decade. Remarkably, both in Argentina and Brazil the shifts in export destinations in favour of Mercosur were much more significant than the shifts in the origins of their imports. Argentina in particular became strongly dependent on the Mercosur market, most notably the Brazilian market, for both its exports and imports during the decade. Developments in the second half of the 1990s were significantly less dynamic than in previous years and the shares of intra-Mercosur exports in overall exports of Argentina and Brazil stagnated.

The strong increase in intra-regional trade as such cannot simply be considered a positive outcome of Mercosur's trade regime, for two reasons. First, as gravity models of international trade show, the size of trade flows is mainly determined by two types of factors: the size of markets of trading nations, as reflected by their overall purchasing power, gross national product (GNP), as well as by their per capita income levels; and by barriers to international trade, including several types of transaction costs such as the costs of transport and insurance, import tariffs and the tariff equivalent of NTBs. As the models generally show, import tariffs and NTBs to trade do play a significant role in explaining bilateral trade flows, be it that their impact is less substantial than the impact of income- related variables (Linnemann, 1992, and Frankel, 1997). As Frankel shows in his gravity model analysis, trade among Mercosur countries is intense in view of the limited size of their markets and of the average purchasing power of their population. Hence the so-called bloc effect of Mercosur contributes to an exceptionally high degree of intra-Mercosur trade volumes in his model in 1990 (Frankel, 1997, pp. 93 and 94).

Second, intra-regional trade may reflect trade diversion and, as such, may reduce rather than increase welfare, at least in the importing partner country. Traditionally, the overall export structure of the Southern Cone countries reflects a strong comparative advantage in primary products. The predominant role of capital-intensive products such as cars and trucks and their components in intra Mercosur trade has created a structure of intra-regional trade very different from the structure of Mercosur exports to the rest of the world, which is dominated to a high degree by commodities, particularly coffee, soybean, wheat, fruits, livestock, and iron ore. Trade diversion may explain a substantial part of intra-Mercosur trade in these capital-intensive product groups but also in some other groups, as argued by Yeats (1997) in his controversial World Bank report. However, serious methodological problems limit the reliability of the outcomes of his conclusions. Nagarajan shows that a study of shifts in imports provides less evidence for trade diversion than Yeats' analysis based on export flows (Nagarajan, 1998). Estevadeordal, Goto and Saez (2000) show substantial trade creation effects as an outcome of the liberalization of intra-regional trade in Mercosur, in combination with a comprehensive and relatively low CET. Further lowering of CET rates for automobiles and components thereof in the years ahead will in all likelihood reduce trade diversion effects.

In the area of the liberalization of trade in services, the Protocol of Montevideo of December 1997 lays out a programme to liberalize the service sectors in ten years time, including possibilities to liberalize at a higher pace in the areas of financial services, insurance and professional services, satellite communications and air transportation. So far, not much progress has been made in this area, which is in part due to significant differences between the Merocur member countries in the rates of liberalization. In the WTO, Argentina has committed itself to a higher rate of liberalization than the other Mercosur countries. Also,

Table 2. Intra-Mercosur exports and imports, in millions of US dollar, 1990-2000.

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
Exports of Brazil											
Argentina	645	1,476	3,040	3,661	4,136	4,041	5,202	7,291	6,747	5,364	6,233
Paraguay	380	496	543	961	1,054	1,301	1,325	1,406	1,249	744	832
Uruguay	295	337	514	775	732	812	811	870	881	670	779
Mercosur	1,320	2,309	4,097	5,397	5,922	6,154	7,338	9,567	8,877	6,778	7,844
Percentage of total	4.2	7.3	11.1	13.9	13.6	13.2	15.4	17.7	17.4	14.0	14.0
Total	31,414	31,620	37,046	38,783	43,623	46,605	47,763	53,906	51,156	48,313	56,138
Imports of Brazil											
Argentina	1,514	1,747	1,721	2,809	3,662	5,570	6,775	8,120	8,028	5,812	6,843
Paraguay	335	223	187	275	352	514	551	531	349	260	351
Uruguay	594	446	341	440	569	737	932	980	1,048	647	602
Mercosur	2,443	2,416	2,249	3,524	4,583	6,821	8,258	9,631	9,425	6,719	7,796
Percentage of total	10.8	10.4	10.9	12.5	13.9	13.8	15.4	15.5	16.4	13.5	13.9
Total	22,707	23,210	20,554	28,168	33,079	49,421	53,552	61,938	57,558	49,801	56,250

(continued on next page)

Table 2. Intra-Mercosur exports and imports, in millions of US dollar. *(continued).*

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
Exports of Argentina											
Brazil	1,423	1,489	1,671	2,814	3,655	5,344	6,615	7,752	7,829	5,629	6,843
Paraguay	147	178	272	358	498	575	584	556	604	550	632
Uruguay	263	311	384	512	650	663	726	688	828	800	900
Mercosur	1,833	1,978	2,327	3,684	4,803	6,582	7,925	8,996	9,261	6,979	8,375
Percentage of total	14.8	16.5	19.0	28.1	29.3	32.3	32.7	35.5	35.6	30.5	31.4
Total	12,353	11,975	12,234	13,118	16,403	20,363	24,217	25,371	26,004	22,884	26,663
Imports of Argentina											
Brazil	718	1,532	3,339	3,568	4,286	4,038	5,327	6,824	7,095	5,600	6,856
Paraguay	42	40	65	73	72	98	182	319	350	304	350
Uruguay	116	166	351	571	789	249	119	364	522	396	475
Mercosur	876	1,738	3,755	4,212	5,147	4,385	5,628	7,507	7,967	6,300	7,681
Percentage of total	21.5	21.0	25.3	25.1	23.0	22.8	23.2	24.8	25.1	24.7	30.2
Total	4,078	8,275	14,862	16,773	22,364	19,221	24,235	30,284	31,710	25,518	25,420

Source: IMF, Directory of Trade Statistics Yearbook, Washington, D.C., several volumes.

public procurement policies will have to be integrated in a common framework, and a common anti-dumping legislation must be developed further.

Creating a platform for foreign direct investment

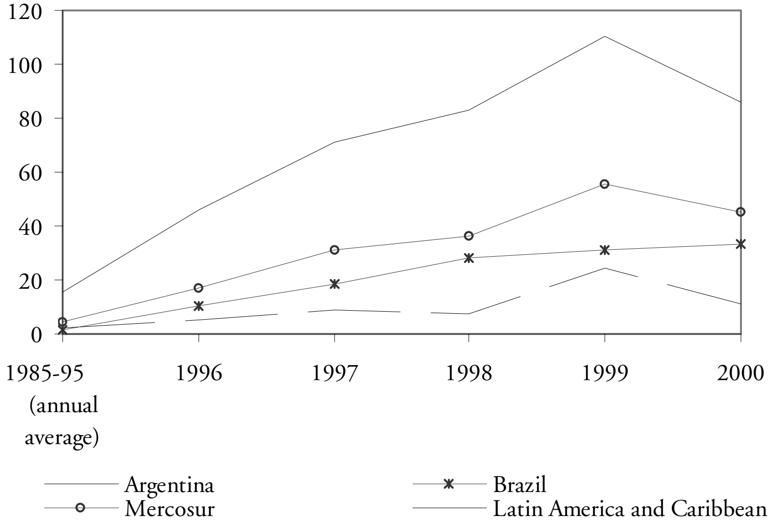
In the area of FDI, two agreements were realized that may be considered the basic elements of an integrated FDI policy for the region. The Protocol of Colonia del Sacramento of December 1993 requires national treatment and prohibits the use of performance requirements regarding foreign investors from the region, and includes provisions for compensation in case of expropriation. The Protocol on Promotion of Investment from States Not Members of Mercosur allows member countries to pursue their own foreign-investment policy towards non-member countries, lays down some principles for fair treatment, and provides a dispute-settlement procedure.

The context of macroeconomic reform and regional liberalization stimulated strongly FDI in the region, particularly so during the second half of the 1990s, as shown in Figure 1. These developments contrast sharply with the pattern in the 1980s and early 1990s in which FDI flows to the region were fairly insignificant. A substantial share of the boom in FDI may be attributed to the process of privatization in telecommunications, and investment in financial services, and it is difficult to indicate what the specific additional role of regional integration has been in the decision-making process of the foreign investors. However, the boom in FDI in the automobile sector is very directly related to the formation of Mercosur. By 1999 Mercosur had become the single largest destination of FDI among newly industrializing countries, larger even than China. However, if we were to combine flows to mainland China and Hong Kong, Mercosur would be reduced to be the second largest destination of FDI in that year. These FDI flows, however, are rather volatile and the combination of a recovery from the Asian crisis in the Pacific Rim countries, with a continuous economic crisis, currency volatility and economic tensions and conflicts among Mercosur member countries, has reduced the attractiveness of investment in Mercosur in recent years, particularly in Argentina.

Mercosur as a hub

Since the mid-1990s, some progress has been made in turning Mercosur into a centre of a cobweb of preferential trade linkages, as visualized in

Figure 1. Foreign direct investment inflows, in billions of US dollar, 1985-2000.

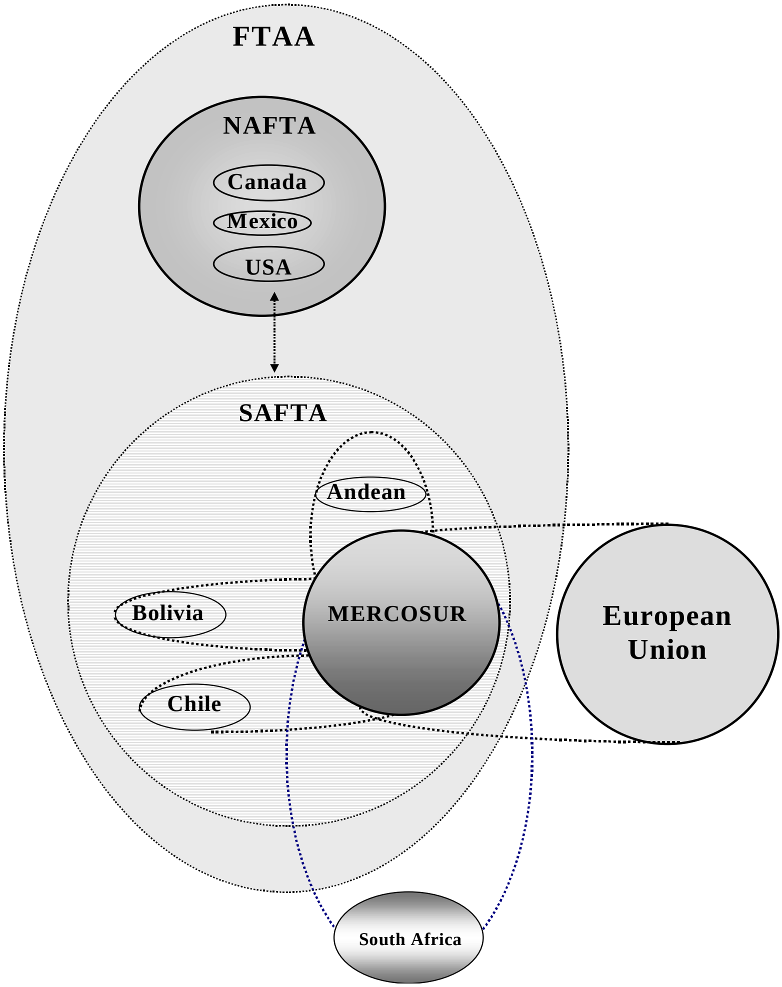


Source: UNCTAD, *World Investment Report 2001: Promoting Linkages,* Geneva, 2001. Data for 1996 taken from UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisions and Development*, Geneva, 2000.

Figure 2. In real terms, the achievements so far are concentrated in the preparation of preferential trade areas (PTA) with the regional neighbours, Chile and Bolivia. Both countries signed an association agreement with Mercosur in 1996 and it is expected that they will have liberalized their trade with Mercosur by 2005 and may even become full member by that time. Negotiations on Chile's full membership of Mercosur started in June 1999 but Chile's membership may be hampered, at least in the short term, by lower Chilean tariff rates and the country's strong preference for an independent stance in creating its own cobweb of preferential trade linkages, with countries in the region as well as with its trade partners in Asia, Europe, and with the USA.

Mercosur and the other major CU in Latin America, the Andean Group, initiated negotiations on the formation of a PTA among themselves in 1995, which resulted in the signing of a framework agreement in April 1998, aiming at the launch of a PTA by January

Figure 2. Clustering around Mercosur



2000. The establishment of a comprehensive PTA between these two CUs could potentially be a major stepping stone for the creation of a SAFTA. Stagnation of groupwise negotiations prompted Brazil to continue negotiations independently, resulting in a partial and temporary trade agreement and a commitment to head for a PTA between the two groups. Argentina followed suit soon, and from July 2001 onwards negotiations between the two groups of countries have been continued, with Mercosur aiming at the establishment of a PTA in ten years of time through automatic tariff reductions and a maximum tariff reduction schedule of 15 years for the most sensitive products. It is difficult to see that this timeframe will contribute to the realization of Brazil's strategic target to establish a SAFTA that could be instrumental in the negotiations with the USA on an FTAA.

Strategic considerations and the actual progress made in the formation of a SAFTA and the FTAA, as well as the transatlantic linkages with the EU and South Africa are analysed in several chapters of this volume.

In retrospect, the period between the signing of the Treaty of Asunción in March 1991 and the Ouro Preto Protocol in December 1994 witnessed rapid integration. Subsequent years revealed many initiatives to deepen and widen integration but in real terms progress has been fairly slow and cooperation has been endangered by macroeconomic disruptions and policy inconsistencies between Argentina and Brazil in particular.

Notwithstanding these slowdowns and setbacks, within a relatively short period of time a CU was established with the size of a 1.4 trillion US dollar economy, a dominant factor in Latin America, certainly a major player in the 12 trillion US dollar economy of the Western Hemisphere but not yet a dominant factor in the 36.6 trillion US dollar world economy, as illustrated in Figure 3.

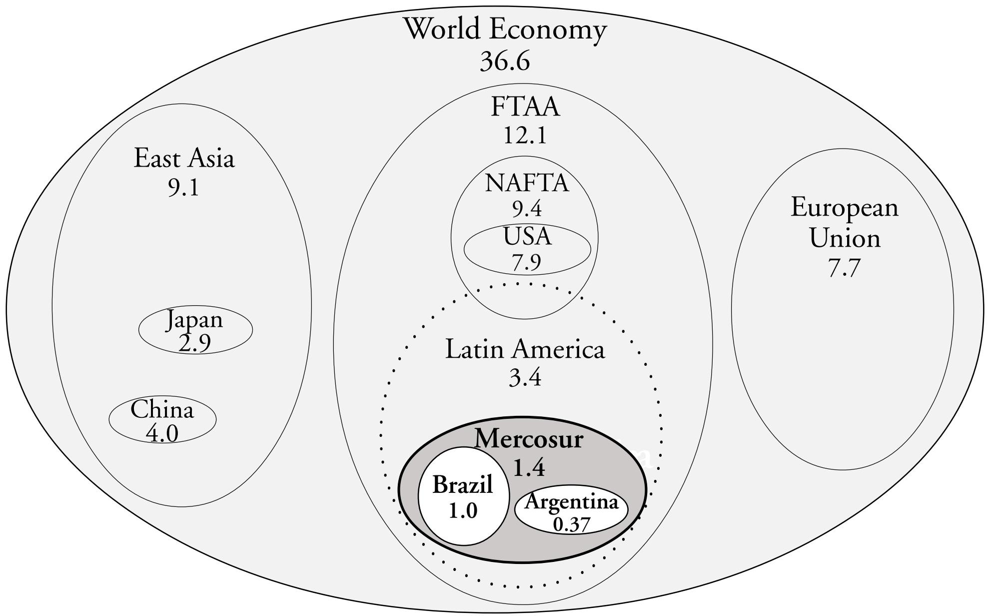
3. Challenges Ahead

Two challenges are distinguished: deepening of integration including full implementation of the Treaty of Asunción, and the integration of Mercosur into the FTAA.

Deepening integration

Full implementation of the Treaty of Asunción involves not only the free movement of goods and services in an integrated market with a CET, but also the free movement of capital and labour, macroeconomic

Figure 3. Mercosur in the world economy. GNPs in trillions of US dollar, 1998.



Source: based on The World Bank, *World Development Report 1999-2000*, pp. 230-31, Table 1, Oxford University Press, Oxford, 2000.

coordination, and harmonization of legislation. Institutional strengthening may be added. In all these areas major challenges lie ahead. As noted earlier, the CET is distorted and incomplete, and consequently rules of origin are applied extensively.

After the period of a relatively stable rate of exchange between the Argentine peso and the Brazilian real from early 1995 to late 1998, followed a period characterized by exchange rate volatility, which contributed to the intensity and frequency of trade-related disputes in a large number of sectors, including the automotive sector, textiles, footwear, rice, poultry, pigs, among others. As a consequence of the lack of adequate intra-Mercosur safeguard measures, Argentina threatened to apply the LAIA safeguard regime. The highly unstable combination of the two exchange-rate regimes has frustrated seriously progress in the integration of the market of the Southern Cone and alternative approaches to exchange-rate management in the region need be introduced, as analysed by Vos in Chapter 2 of this volume.

Pertinently, conflicts between Brazil and Argentina regarding the common trade regime for capital goods are related to different perceptions of strategic industrialization and trade regimes. In line with its long-term development strategy to foster a large and diversified capital goods sector, Brazil has favoured continued protection, whereas Argentina views access to capital goods and technology at international market prices as a crucial factor in supporting the competitiveness of its economy. This is reflected by the special position these sectors have been accorded in the Mercosur trade regime and the exceptionally high but declining rates of protection for the capital goods sectors deemed to be of specific strategic interest.

Mercosur essentially is an intergovernmental arrangement that neither Argentina nor Brazil is keen to abandon. Its structure is small and weak and it has hardly any bureaucracy of its own, with the exception of a small administrative secretariat in Montevideo. Its officials are simultaneously national civil servants. The Presidency rotates every six months among the presidents of the member countries. By implication, conflicts are ultimately dealt with by politicians and the Presidency, not so much by technocrats. The strong reliance on presidential diplomacy and the limited institutional framework of Mercosur may become a major weakness to deal with the complex and overburdened agenda of the future. Institutional strengthening is required to relaunch Mercosur successfully (Van Dijck, 2001).

In this still relatively open regional context, differences in national regulations, standards, and rules may become major factors affecting the competitiveness of industry and the accessibility of the national markets in the region. One can argue about the merits and drawbacks of policy coordination, harmonization and the establishment of a super-governmental decision-making structure. In that context the problems of applying the subsidiarity principle have to be faced, pertaining to the optimal level of decision making: national, regional, or multilateral. Clearly, deeper integration is not necessarily a superior form of integration.

To clarify issues pertaining to the rationale of the use of regional rule systems and standards, a distinction need to be made between different types of standards and different ways of applying such standards at the regional level. Several options are available, ranging from policy dialogue and information exchange, reflecting a low commitment to a regional regime, requirements to abide by national rules, mutual recognition of standards in use in partner countries, the use of common floors and ceilings, and ultimately regional harmonization, reflecting full commitment to regional authority in this matter. However, the more comprehensive approach to the creation of a regional level playing field need not necessarily be the most effective and efficient, particularly not when applied to environmental and social standards. The experiences of the EU and the reorientation in its policy in this regard in the course of time reflects the difficulty in shaping an optimal regional regime.

Hence, different forms of deepening integration at the regional level must be distinguished to assess the potential contribution of welfare when pushing the programme of cooperation beyond the stage of liberalization and border measures to facilitate the exchange of goods and services. By not deepening integration, welfare may be forgone, but deepening in the wrong way may also inflict costs on participants as well as outsiders (Van Dijck, 2000a, pp.110-115).

Transaction costs have potentially been lowered by the Argentine-Brazil understanding on mutual recognition of certificates and technical standards for selected industrial products while preparations are being made of mutual recognition of standards in the area of foodstuffs. April 2000 the Mercosur Standard Association started functioning in order to regulate the use of technical norms.

In spite of the Protocol of Brasilia, Mercosur lacks a well-functioning dispute settlement mechanism (DSM) and a judicial body capable of making verdicts pertaining to the proper meaning and implications of Mercosur treaties and agreements. A trading environment without Court of Justice or Permanent Court of Arbitration at the supranational level leaves room for arbitrary and politically motivated decisions, and is particularly to the disadvantage of the smaller trading nations that have only little leverage in trade disputes. However, strictly speaking this absence need not be per se a major problem for the traders in the Mercosur, provided there is a clear understanding about involving the DSM of the WTO in cases of conflict among the partners. Alternatively, a future DSM of the FTAA may be the preferred mechanism, if at all. The most recent development in this context is the agreement among Mercosur members to create a permanent Mercosur DSM.

FTAA

The second challenge involves the integration of Mercosur in the FTAA. The USA initiated the plan for an FTAA during a hemispheric meeting of Heads of States in Miami in December 1994, aiming at hemispheric free trade by 2005. In this approach, which followed upon the earlier proposal to establish a Western Hemisphere Free Trade Area (WHFTA), all countries in the Southern Hemisphere are participating simultaneously in negotiations on the comprehensive liberalization of trade and trade-related issues. The new approach would deny the USA the potential advantages of the hub-and-spoke approach envisaged at an earlier stage. In the Miami Summit, an ambitious and comprehensive programme for interAmerican cooperation and integration was presented including the defence of democracy, good governance, civil society and women's rights, environmental protection, the fight against corruption and poverty and measures to control money laundering. According to the FTAA Draft Agreement signed in Quebec in May 2001, the negotiations on an FTAA will be terminated by the beginning of 2005 and the FTAA will start functioning by the end of that year.

At the trade ministerial meeting in Belo Horizonte in May 1997 it was decided that the FTAA could coexist with bilateral and sub-regional PTAs to the extent that the rights and obligations under these agreements are not covered by or go beyond the rights and obligations of the FTAA. Undoubtedly, Mercosur will attempt to exercise maximum influence on the shaping of the FTAA, whether or not as key players in a SAFTA, and at this stage it is hard to assess accurately the scope and content of the FTAA agenda. Nevertheless, three implications for Mercosur seem to be clear (Van Dijck, 2000b, pp. 333-345).

First, an FTAA reduces the preferential margins on intra-Mercosur trade and consequently lowers the significance of Mercosur in boosting regional integration. At the same time, it should be noted that reduction of the CET reduces the costs of trade diversion, particularly in the sectors of automobiles and telecommunications.

Second, by regulating government policies in a wide range of areas, an FTAA will limit options for an interventionist and discriminatory industrial policy in Mercosur, thus making a sustainable and supportive exchange-rate policy of even greater strategic significance.

Third, the Quebec decision has constrained the time for creating a SAFTA, which in Brazil's vision, is meant to play a key role in the shaping of continental relations in the Americas. True, there is more time left than might be preferred by the USA, Argentina, and Chile that favoured an FTAA by 2003, but nevertheless time to prepare a SAFTA has been effectively constrained.

Hence, the ultimate challenge that the FTAA poses to Mercosur once it will have been implemented in full is twofold. First, competitiveness must be enhanced in an essentially open American market, which will leave only little room for preferential market access in the Mercosur area itself. Second, Mercosur must develop the capability to design and implement rules and standards to deepen integration in an effective and efficient fashion beyond the agenda of the FTAA.

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2

CURRENCY VOLATILITY AND POLICY COORDINATION

Rob Vos

1. Samba or tango?

We all know that it takes two to tango, but the samba can be danced alone or with many others. Where it comes to trade integration, the Mercosur countries have managed to keep a fairly steady and synchronic samba rhythm. However, where it comes to other areas of regional integration, above all financial integration, the major dancing partners have been more out of step, with Argentina trying a rather ugly tango on its own and Brazil switching from one samba to another. The other two smaller dancers, Uruguay and Paraguay, not to mention wallflowers Bolivia and Chile, are trying to keep the rhythm, but it is unclear to which rhythm they are dancing, or, if anything, they seem to be trying one of their own.

Macroeconomic stability and policy coordination are increasingly recognized as essential ingredients of successful economic integration. The future of Mercosur has been put under increasing pressure in recent years in the wake of macroeconomic instability in essentially all four member states. The stark difference in exchange-rate regimes between the major partners is a focal point of concern. Brazil has switched to a flexible exchange rate following its financial crisis of 1999, which it allows to keep samba-like degrees of freedom in conducting its macroeconomic policies. Since 1991, Argentina has kept a fixed exchange-rate regime run by a currency board, which makes macroeconomic policies as rigid as a tango. In the aftermath of the Brazilian crisis, Argentina's economy has wound up a deflationary spiral as falling export competitiveness and creditworthiness have dried up resources. Argentina's policy regime impedes giving a stimulating response through devaluation or fiscal expansion. Hence, worsening external conditions have to be responded by domestic demand deflation. Ironically, the architect of Argentina's currency board, Domingo Cavallo, is back to clean up the mess and is now subtly trying to redress the regime. The one-to-one fixed peg to the US dollar is to be turned into a peg to a small basket of two currencies, the US dollar and the euro, once the euro is back at par with the US dollar. For the time being, Cavallo has already announced tariff increases on a range of consumer products in order to protect Argentine industries for the steep loss in competitiveness after Brazil's devaluation. Such policy responses are understandable in the light of Argentina's woes, but of course could undermine the trade integration process.

Macroeconomic policy coordination is therefore very much on the Mercosur agenda, as much as it should be on the agenda of other regional integration agreements, including that of the Free Trade Area of the Americas (FTAA). The Mercosur countries acknowledge this and have agreed to come to a gradual harmonization of a number of macroeconomic targets such as inflation rates, fiscal deficits and public indebtedness, in the recent Declaración de Buenos Aires[1]. Yet others have proposed more far-reaching and ambitious solutions such as a full monetary union for Mercosur or even official dollarization. Full dollarization is an option favoured by some policy makers in Argentina but these have recently lost influence. As the FTAA shapes up, the dollarization discussion in Latin America is likely to heat up and Mercosur will have no option but to define its position. The pros and cons of various frameworks for macroeconomic policy coordination will be sketched out and what could work and not work in the short and long run for Mercosur will be identified. The case for coordination is easily made. Finding common ground in objectives and instruments is more complex, not least given structural differences between the member countries.

2. Policy choices and macroeconomic adjustment in Mercosur

Macroeconomic policy coordination is a complex problem. Much of recent debate has been geared towards the choice of exchange-rate regimes, as alongside trade barriers these provide a direct link to the outside world of an economy, but also because these tend to set the degrees of freedom in which national macroeconomic policies can manoeuvre. In Mercosur the sharp decline in intra-regional trade following the Asia crisis and the devaluation of the Brazilian real has raised concern over the existence of very different exchange-rate regimes among the member countries of the group. As long as the economies are all growing, and the principal macroeconomic variables show some sustained convergence, different exchange-rate regimes alone should not slow down intra-regional trade. This is also the thrust of the Declaración de Buenos Aires, which aims to enact joint policies that will guarantee the stability of each economy in order to reduce vulnerability of the bloc to world economic crises. None of the Mercosur countries has a particularly good track record in maintaining macroeconomic stability irrespective of the exchange-rate regime. Economic volatility – as measured by standard deviation of growth rates of gross domestic product (GDP) – has remained high during the 1990s, even though it has not increased with economic liberalization as is sometimes assumed, as shown in Table 1. Greater macroeconomic policy coordination might help to stem economic instability, but this is easier said than done. Policy regimes and objectives differ and the countries also face different degrees and types of external vulnerability.

Standard macroeconomic policy analysis frames the problem of choosing the right exchange-rate regime as a so-called trilemma or, an 'unholy trinity' (Vos, 2000). It says that policy makers have to decide on three things: first, the desired degree of autonomy in monetary policy; second, the degree of capital mobility; and third, the degree of nominal exchange rate flexibility. The trilemma says that there are limited degrees of freedom, implying one cannot simultaneously have a flexible exchange-rate regime, free capital mobility, and an active monetary policy. One of these would have to go. Today's conventional wisdom has it that when accepting openness to capital inflows, only two options remain at each extreme of the spectrum: either you opt for a fixed exchange-rate regime and forego independence in conducting monetary policies or, if you prefer to keep the latter, then you should opt for a flexible exchange-rate regime. Intermediate regimes are also widely applied, but have lost some credibility among the profession in view of the Asian crisis, as many put the blame on the 'soft pegs' which would enhance exchange-rate risk to investors and have triggered the financial crisis (Vos, 2000). Some prefer to 'fix' in view of this evidence, in order to stave off the risk of financial crises. Incomplete financial markets limit investor possibilities to hedge against exchange-rate risks and therefore flexible exchange rates, which create greater uncertainty,

Table 1. Volatility of economic growth in the 1990s.

	GDP growth	*Volatility of growth (standard deviation)*	
	1990-99	*1990s*	*1960-99*
Argentina	4.7	5.5	5.4
Brazil	2.5	3.0	4.3
Paraguay	2.1	1.5	3.7
Uruguay	3.2	2.8	4.2
Chile	2.5	3.5	5.2
Bolivia	3.9	1.0	4.0
Latin America	3.2	3.3	4.5

Source: based on ECLAC data base and The World Bank Development Indicators.

would be less attractive. If you agree to 'fix' is the solution, then – some will argue – why not fix once and for all? Dollarization or a monetary union then comes into the picture.

The Mercosur countries face rather asymmetric situations and this complicates the possibilities for effective macroeconomic policy coordination. Exchange rates among the member states are far from aligned. During the 1990s the Argentine peso appreciated against the US dollar in real terms. In the context of Mercosur, the peso also strongly appreciated against Brazil's currency following maxi-devaluations of the real in the early 1990s and after the Samba Crisis in 1999, as shown in Figure 1. Argentina has lost a good degree of export competitiveness within Mercosur in consequence. Policy regime differences are summarized in Table 2.

Argentina has a fixed exchange rate (a currency board) and free capital mobility, thereby surrendering independent monetary policy, as well as much of the Central Bank's capacity to act as a lender of last resort to the domestic financial system. Given its history of hyperinflation and macroeconomic instability, Argentina has preferred to shut the door on populist inclinations to run to the money printing press in order to secure nominal exchange rate stability, low inflation and free capital flows. This has worked well for a while with growth spurts fed by a rise in capital inflows attracted by the greater monetary stability. The currency board works like the gold standard did in the old days. When capital inflows slow down, domestic demand contrac-

Table 2. Trilemmas in Mercosur countries.

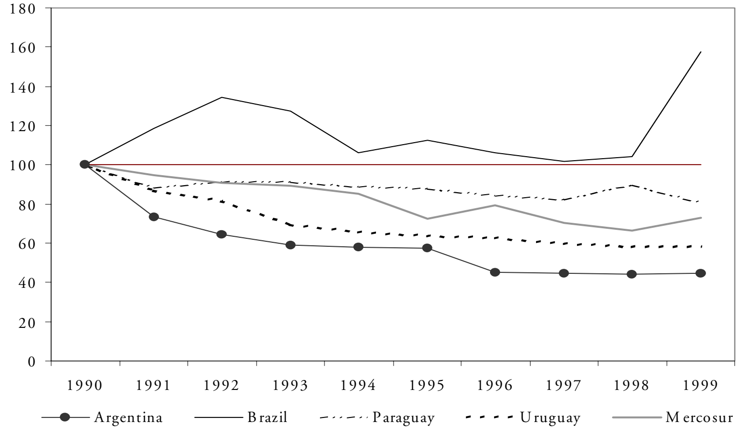
	Argentina	*Brazil*	*Paraguay*	*Uruguay*
Exchange rate regime	Fix	Flex	Crawling peg	NER target
Capital mobility	Free	Free	Free	Free
Monetary policy autonomy	No	Yes	Limited	Not in practice

tion is the only possible macroeconomic adjustment option. This slows down growth, creates higher unemployment and lower real wages, thereby increasing poverty. To this one has to add that trade liberalization has been a cause of structural unemployment growth, particularly in the manufacturing sector in Argentina (Frenkel and Gonzalez, 2001). Argentina now has to fight its way out of the downward spiral. Dollarization has been preferred by some, in the hope this would reduce volatility in capital inflows. Dropping the currency board and move to a more flexible regime could be another, but is likely to be a hard sell politically. The current moves by Cavallo nonetheless move cautiously in the direction of more flexibility, by fixing to a basket of US dollar and euro, but in the short run this is expected to have little effect or may even lead to some further appreciation of the peso, as the euro may appreciate against the US dollar. Using tariff increases as recently proposed, may be seen as an alternative, but could undermine trade agreements. Argentina lacks the degrees of freedom to reactivate its economy.

Brazil used to target a stable nominal exchange rate under the Plano Real, but moved to a flexible exchange rate with free capital mobility in response to the 1999 crisis. This has increased the scope for monetary policy as an instrument to achieve macroeconomic targets. Brazil's official target is inflation, but it trades this off by keeping some scope for macroeconomic stimulus to fight unemployment. Brazil's economy is large and relatively closed despite the trade and financial opening process of the past decade. For Brazilian policy makers it pays off to trade in greater nominal exchange rate volatility for more degrees of freedom to steer the domestic economy.

Uruguay and Paraguay are of course only minor players in this economic game, but as member states do have some political say. Both are very small economies, more open than their large neighbours and

Figure 1. Mercosur, real exchange rates, 1990–99 (rate of the US dollar is CPI corrected, 1990=100).



Source: IDB socio-economic database.

with an important share of their trade dependent on intra-Mercosur channels, as shown in Table 3. Uruguay has a strong preference for keeping a stable nominal exchange rate and unrestricted capital flows as part of its strategy to become a major regional financial centre. It has not fully fixed its exchange rate like Argentina, but allows it to fluctuate within a narrow band. In practice though, its preference for targeting nominal exchange rate stability has put independent monetary policy on the shelf. Paraguay has allowed for regular adjustment in the nominal exchange rate through a crawling peg system, but for most of the 1990s it has used the exchange rate as a nominal anchor to control inflation. The real exchange rate has appreciated over time in consequence, though less so than in Uruguay and Argentina. Paraguay is strongly dependent on agricultural exports and re-exports in a triangular trade between Argentina and Brazil. The real exchange rate is possibly of minor importance in determining this trade, which is most affected by agricultural productivity and border controls. Trade liberalization in Brazil and Argentina has already caused a loss of comparative advantage for Paraguay, which has had no effective control of trade restrictions of its own. Border trade and related domestic commerce dropped significantly at the end of the 1990s when the border controls in Brazil were strengthened. The economy has been in a slump for most of the

Table 3. Optimum currency area indicators for Mercosur countries.

	Argentina	*Brazil*	*Paraguay*	*Uruguay*	*Mexico*
Size relative to USA *(GNP as % of US GNP)*	3.3	8.9	0.1	0.2	5.1
Openness (M+X)/GNP	24	17	50	41	72
Trade concentration *(as % of total trade)*					
USA	15	22	5	9	81
Western Hemisphere	55	48	71	63	86
Rest of Mercosur	30	19	60	46	n.a.
Similar shocks					
Relative to USA	No	No	No	No	?
Relative to Brazil	Partially	--	Partially	Partially	?

Source: World Bank and IDB/INTAL data bases.

second half of the 1990s and there is little macroeconomic scope to redress the situation.

Such asymmetry in policy objectives and policy regimes seems to form a serious obstacle for attempts to achieve greater policy coordination at the level of Mercosur, as well as to the growth of intra-regional trade. Of course, if the current choices for the exchange-rate regime are optimal for each country, they should contribute to ensure macroeconomic stability. This clearly does not seem to be the case. Growth of effective demand appears to be the most critical factor in determining the intra-regional trade of Mercosur, as some econometric studies have shown[2]. Hence, from the perspective of Mercosur, the better regime is that which can ensure steady and rapid economic growth in each of the partner countries. Macroeconomic stability in itself is a factor that may help to achieve this, as it will provide incentives to foreign investors and domestic demand may expand with growing capital inflows. It will also reduce uncertainty among domestic investors. However, targeting for stability may not be enough, particularly not if markets are imperfect. Argentina's dilemmas are a case in point. Its regime forces to keep monetary stability and low inflation, but at the cost of continuous exchange-rate appreciation and domestic demand deflation when external conditions turn unfavourable. It cannot introduce anti-cyclical monetary and fiscal policies to avert recessions. Moreover, Argentina's economy is not much more open than that of

Brazil, as shown in Table 3, and less than a third of its trade is within Mercosur. Hence, growth in Brazil will help to stimulate Argentine exports, but only to a limited degree. Inversely, Brazil's economy is almost three times that of Argentina with less openness and less dependence on Mercosur trade. Income spillover effects are even smaller. So, the business cycles of both countries do not necessarily move in the same direction. This and the other differences in economic structure indicated earlier, likely will induce the countries of Mercosur prefer to stick to their own policy regime.

3. Options for macroeconomic policy coordination

So what are the options in such a diverse setting? And, how fast should a process towards greater financial cooperation go, if desirable at all? The European Union (EU) took the long view whereby monetary integration via the European Monetary Union (EMU) was a sort of crown on a long process of trade integration, convergence among the member states, and joint targeting of exchange rates. Mercosur is not the EU and could consider a more speedy monetary integration to force macroeconomic convergence and promote trade integration, rather than seeing it as a consummation devoutly to be wished.

It seems to make sense to consider the short-term restrictions and accept differences in policy regimes as they currently exist and enter a gradual process of setting common targets for macroeconomic stability. This is what the countries have agreed to do and it seems consistent with the economic and political realities of all member states. As already indicated, Argentina's attempts to deal with its economic crisis could undermine the integration process. So, even if countries agree on specific targets, will they be credibly respected by all member states in times of heavy economic weather and when they would be most in need of being respected? And, will member states steer clear of measures that could be harmful to the integration process, such as reintroducing trade restrictions? None of this will work if the member states do not see enough of an economic interest to make it and do not see enough value added in Mercosur to ensure its sustainability.

As said, more stability may help forge intra-regional trade, but as such may not be enough as income growth should accompany stabilization. Convergence also does not automatically follow growth. The EU has effectively promoted economic convergence among member states through its large compensatory funds, including the common agricultural fund, funds in support of backward regions, and so on. Such a large fiscal transfer system does not fit in with any of the Latin American regional integration schemes and would seem more likely to form another constraint on a relatively smooth adjustment processes to external shocks. So, one could think of a gradual process of convergence of some macroeconomic targets (such as inflation rates, fiscal deficits, and public indebtedness), as currently proposed with some academic support (*e.g.* Fanelli, 2000). However, the policy trade-off between inflation targeting at the level of Mercosur and stimulating domestic growth and employment may be too large for individual countries, such as Brazil, to cope with. Also, the trade-off may be only solvable through demand deflation given the nature of the policy regime – as in Argentina. Under such asymmetries full macroeconomic policy coordination would reinforce the need for compensatory funds and the sharing of fiscal adjustment costs. While desirable, this type of coordinated fiscal policy will face serious economic and political obstacles, as all countries and, not in the least the larger ones, will be confronted with great fiscal fragility. Priorities in both Argentina and Brazil are to strengthen the financial position of the public sector. In the current context, this severely limits the scope for anti-cyclical fiscal policies and the means to attack unemployment problems and regional disparities.

Alternatively, more imposing schemes could be proposed and indeed are under discussion at various levels. None of these seems very viable politically for Mercosur in the short run, but yet it is worthwhile to consider alternatives even though none seems to provide immediate solutions to the policy trade-offs sketched above. For a schematic presentation of several options, see Table 4.

One is dollarization. With the formation of the FTAA and if this is to take off, then the calls for creating a dollar zone from Seattle to Santiago in the Western Hemisphere will probably gain in strength. Some countries in the regions have already taken this step unilaterally for various reasons. Recently, Ecuador and El Salvador have joined Panama as dollarized economies and Guatemala has made a move just as close by accepting the US dollar as official means of payments alongside with its own currency. See Vos (2000) for a more elaborate discussion of the dollarization debate. As indicated, Argentina has flirted with the idea and it is also seriously being discussed in the context of the North-American Free Trade Agreement (NAFTA), though with a 'no' for now from the Mexicans. Dollarization would work the way Argentina's currency board does but make the fix on the exchange rate

Table 4. Options for fixed-rate regimes and implications.

	Currency board	*Dollarization*	*Mercosur Monetary Union*[a]	*Flexible coordination*
Anti-cyclical monetary policy (unemployment target)	No	No	Yes	Diverse
Inflation target	Yes	No	Possible	Diverse
Export competitiveness	No	No	Yes	Yes
Interest premium	High	Low	Low	High
Financial deepening	No	?	?	?
Lender of last resort	No	No	Yes	Diverse
Seignorage	Yes	No	Yes	Yes

Note: [a] assuming the MMU currency follows Brazil's flexible exchange regime *vis-à-vis* other currencies.

more irreversible and, of course, eliminate the relatively small economic gain of printing money (seignorage). If any individual country of Mercosur were to make the move, say Argentina, it would not do much for improved coordination by itself, as asymmetries in policy regimes would remain. Mercosur could decide for dollarization as a bloc and this might serve Argentina and Uruguay, but would probably be much less effective for Brazil and Paraguay. It would serve Uruguay from the perspective of its aim to become a regional financial centre and its focus on exchange rate stability. It could serve Argentina as it implies only a small step from its current regime and it could raise hopes to reduce the country-risk premium for foreign investors, which remains very high despite the fixed exchange-rate regime.

On the other hand, it would also do little to resolve its current policy trade-offs, except that it would now face similar adjustment problems as do its neighbours. A common fiscal stabilization fund might even be a greater necessity. The USA could be asked to step in here, but it is unlikely it would be willing to take on this role, as much as the Federal Reserve Bank is unlikely to take over the role as lender of last resort in the event of severe financial fragility.

The case against dollarization would be most obvious for Brazil. A basic set of criteria to judge whether dollarization or a monetary union makes sense, comes from the literature on optimal currency areas (Mundell, 1961, and McKinnon, 1962). Tables 3 and 4 summarize the traditional criteria for the Mercosur member states, and, by way of comparison, also for Mexico. Brazil is a large and fairly closed economy, has a diversified trade pattern, and is not particularly dependent on trade with the USA. Exports still contain a large proportion of primary products and natural resource-based manufactures, implying that shocks and business cycles between Brazil and the USA would be unlikely to coincide. Brazil has fairly well-developed financial markets, but the situation is still far from satisfactory, and the lender-of-last-resort facility has been used with some frequency in recent years. All these factors would make dollarization fairly non-compelling for Brazil. The single advantage for Brazil to dollarize seems rather theoretical. Theory would predict the closing of interest rate spreads in relation to the USA. However, country risk could remain high in the eyes of foreign investors, as this depends not only on the exchange-rate risk (Vos, 1994) and lower spreads do not preclude more tight rationing and continued volatility in capital inflows.

If Brazil does not dollarize, it seems like a bad policy choice for Argentina as well. Argentina scores almost as poorly as Brazil on the criteria for an optimum currency area. Its economy is fairly closed and trade is diversified. It relies much more on trade with Brazil than with the USA. Its shocks are more similar to those of Brazil – see *e.g.*, the spillover of the samba crisis – than to the USA. From this perspective, Argentina might better consider a monetary union with Brazil. The other countries of Mercosur have even stronger trade links within the region and hence could see even greater benefit in a Mercosur monetary union (MMU). However, given Brazil's flexible exchange-rate regime and assuming it also wants to keep its degrees of freedom in such a monetary union, Uruguay might object, given its prime objective, which is to maintain exchange rate stability.

If a monetary union for Mercosur is an option, given the above, the most logical choice would be to create one on Brazil's terms. That is introducing a common currency, which is flexible against other major currencies. Given the differences in size, this would place most of macroeconomic policy making in hands of Brazil. There will be huge and obvious political obstacles for Argentina to accept this. Pegging the Mercosur currency to a major currency such as the US dollar in a kind of euro/CFA arrangement in francophone Africa, as proposed for Mexico within NAFTA (FitzGerald, 2001), would seem less relevant to trade links so much weaker between the USA and Mercosur.

Further economic and political issues would have to be dealt with as well when considering a monetary union. Two of them will be highlighted. The first has already been emphasized and refers to the desirability of introducing fiscal mechanisms to cope with asymmetric adjustment problems among member states and to deal with regional disparities. At present this seems to encounter a major obstacle in the fiscal problems existing within Mercosur. In the short run, external assistance would be required to overcome this. The second issue is price and wage flexibility. A good working monetary union would require a good deal of this, otherwise macroeconomic convergence will be difficult to achieve and demands for compensatory funding would become vast. Economic liberalization has brought much more flexibility in goods and factor markets, but rigidities remain and are likely to remain given the high degree of structural market imperfections. While, of course, there is some labour mobility within Mercosur, this seems relatively modest in size, as might also be inferred from the marked disparity in regional unemployment rates. Reforming labour legislation has been politically extremely difficult in each of the Mercosur countries during the 1990s. A rapid unification of labour markets within Mercosur therefore will be a very distant point on the agenda indeed. Capital has also shown some mobility within the region, if only because exchange-rate risk and other cost barriers have led some companies to build subsidiary branches on both sides of the Argentinean and Brazilian border and to expand production wherever relative costs make production more profitable. The investment flows involved are small, however, compared to overall capital movements and also in relation to the degree of mobility required to overcome disparities caused by the differences in policy regime and structural market bottlenecks.

With dollarization appearing a poor policy choice and a MMU posing huge obstacles, what options are left? For now, the only politically feasible option would seem to be the gradual and relatively flexible coordination scheme as set in by the Declaración de Buenos Aires. This would permit accommodating the existing disparity in exchange-rate regimes. Yet this will not solve any of the current problems if the framework is not extended to include at least: (a) fiscal transfer mechanisms allowing for some anti-cyclical policy action and (b) openings to greater synchronization of exchange rates. The latter could imply considering a move towards a common intermediate regime with an established band within which bilateral real exchange rates would be allowed to move within and outside Mercosur. This would, of course, imply a major deviation from the current regimes in both Brazil and Argentina, but sustainable harmonization of macroeconomic policies seems difficult without.

4. Conclusion

The tango and the samba are different rhythms and are out of step with each other. Argentina's fixation on the tango ('fix') and Brazil's on the samba ('flex') provide important obstacles in the way of the better macroeconomic policy coordination required to support the integration process with the necessary conditions for growth and stability. Dollarization and a MMU do not seem to provide ready-made and feasible alternative frameworks in the short- to medium-run. Dollarization appears poor policy advice for Mercosur, especially for Brazil. If Mercosur is here to stay, then a monetary union sounds like better advice, but will still have to deal with vast economic and political obstacles. The proposed more flexible and gradual approach to defining common macroeconomic targets appears to be the only real option currently available. However, for the arrangement to become credible, the partners should be open to the idea of widening the coordination from one purely based on targets to one that would also synchronize policy instruments, if integration is to become a core dynamic element in economic development of the region. A Mercosur dance style would need to be created which is less rigid than the tango, but also less flexible than the samba.

Notes

[1] A Macroeconomic Monitoring Group has been working since April 2000 on a methodology to harmonize economic statistics among member states, focusing on core macroeconomic variables (IDB, 2000). At the XIX Meeting of the Mercosur presidents in December, the Central Bank governors and Finance Ministers agreed to establish a mechanism of macroeconomic convergence and to define measures that could be taken if deviations from agreed targets occur. This is to be introduced in two steps. During 2001 the countries will announce targets for inflation, consolidated public debt and growth of net consolidated public debt (net of international reserves). In 2002 the second step has to be taken with the adoption of common targets, including a 5 per cent ceiling for inflation between 2002-2005 and 4 per cent thereafter, as well as common targets for fiscal variables.

[2] See *e.g.* Heyman and Navajas (1998), who have shown that income effects dominate price effects in explaining intra-Mercosur trade flows.

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3

THE INSTITUTIONALIZATION PROCESS

MERCOSUR, *QUO VADIS*?

MARCELO DE A. MEDEIROS

1. Introduction

Regional integration processes evolve differently in the implementation of their institutions. These institutions may involve the simple intergovernmental logic of cooperation or, conversely, complex dynamics of integration anchored in supranational principles (Quermonne, 1999). Here, a conflict between the two main poles of international relations theory comes to light. On the one hand, Realism – and its variants – advocating the construction of flexible free trade areas (FTAs) or, ultimately, the creation of custom unions (CUs), both preserving the sovereignty of nation states. On the other hand, Transnationalism – and its variations – encouraging more advanced modalities of integration such as common markets or, at last, genuine federations which lead to a progressive abandonment of sovereignty (Molle, 1994).

In this context, the configuration of the Common Market of the South – Mercosur – seems to be characterized by an *ad hoc* logic which houses the rudiments of an integrationist approach, although it does not succeed in promoting the development of those rudiments[1]. Notwithstanding a number of attributes which emphasize the creation of institutional difficulties and, consequently, the detection of a tangible and beneficial inertia – *e.g.* the derived community law, the emergence of a Mercosurian incipient civil society and the unambiguous backing of economic agents – the Common Market of the South is not yet skilled enough to break into the monolithic conception of sovereignty embodied by its member states. As a result, the Mercosur institutionalization process has been finding itself in a bit of a dead end, because it cannot summon up the effort needed to cross the fatal threshold leading to supranationality.

After years operating along negative integration dynamics, Argentina, Brazil, Paraguay and Uruguay are experiencing serious difficulties in reaching a positive integration stage in which they could deepen their partnership through the presence of some supranational mechanisms (Scharpf, 1996, pp.15-39). Currently, Mercosur is determined to renounce taking the routes which would lead to the two classic forms of supranationality. The first route is inherent in the idea of representation which could at the start provide the institutionalization process with a community coherence and a redistributive logic – essential to the positive phase, but one which has been lacking since the beginning of the Southern Cone integration movement[2]. The second route is more fundamental and demands a deeper degree of integration maturity, *i.e.*, the supranationality founded on a qualified majority vote. Refusing to embrace either, Mercosur persists in supporting national representation and a unanimous vote. This way of thinking implies, that the implementation of common funds, which could set up new allegiances among the discrete political levels of administration, has to be postponed.

Indubitably, both an array of multiple endogenous asymmetries and the huge influence of exogenous factors coincide to form obstacles to the Mercosur institutionalization process. The preponderance of Brazil, at the internal level, and the possibilities of enlargement and trade negotiations with the USA and the European Union (EU), in the external framework, are just two instances.

2. Asymmetry issues

It is understandable that, since the collapse of the Berlin Wall and the failure of the Soviet Union during the 1980s, nation states have been struggling to overcome the vast entropic situation in international relations. One attempt has been the endeavour to set up regimes and institutions which could act as a catalyst and, consequently, assign some order to the political and economic relationships among international actors.

This is precisely where Mercosur fits in, trying to achieve regional integration and insertion into the global structure by the establishment of a specific system of association between its member states. Despite all efforts, it seems that issues of asymmetry have been working as a significant broke on the development of the institutionalisation process of the Common Market of the South. The crux of the matter is that Brazil represents roughly two-thirds of the gross domestic product (GDP), population and territory of Mercosur. This inmediately places it in the position of a *de facto* hegemon which aspires to *de jure* institutional procedures which would reflect its original power. By contrast, Argentina, Paraguay and Uruguay expect a pattern of integration which might rein in the crucial decision-making process of Brasilia.

Regardless of its relative preponderance, the position of Brazil does not fit into the realist regime understanding of hegemonic stability (Kindleberger, 1973), which relates equilibrium to the existence of a hegemon. Brazil is not strong enough and is heavily dependent on developed countries such as the USA and the members of the EU. Consequently, partners of Brazil can act as free riders and the potential collective aim – stability – remains beyond reach. Taking the realist interpretation of the concept of regimes, the power approach postulated by Krasner is possibly the one which could, in some measure, explain certain features of the evolution of Mercosur (Krasner, 1983). He states that albeit international relations rest essentially on a power game logic, regimes are helpful because nation states have a common aversion to the absence of predictability and, from time to time, prefer to cooperate in order to amplify their relative benefits. Mercosur is, to some extent, a source of this predictability as it reduces the risk of random actions by member states.

Alongside this vision – but favouring both a holistic interpretation and supranational institutions, where nation states are virtually powerless – neo-liberal institutionalists suggest that regimes are an instrument designed to facilitate cooperation, as they can orchestrate the motivations for work as a team (Keohane, 1989). Apart from this, regimes are important for reducing uncertainty as they furnish general information and prepare the way for more readable and transparent negotiations. Despite its rhetorical teleological objective of constructing a political model of integration, the Common Market of the South reveals that functionalism inside its frontiers is underlined by a *pseudo* spillover, which differs from that developed by the EU. Mercosur does not have supranational institutions such as the European Commission which moves the integration process forward and its spillover feedback contamination effect is still fragile and limited. So, it is likely to be the neo-liberal approach which could elucidate, for instance, the Brazilian attitude towards a broad integration process, as it realizes it is not sufficiently powerful to face at the global level strong partners such as the EU or the USA. In such a situation reinforced cooperation or even supranational institutions are required.

If the realist and neo-liberal perspectives may offer some tentative explanations on the question of Brazilian hegemony in Mercosur and its implication for the institutional integration process, the influence of more than a few intra-state discrepancies on the development of Mercosur could scarcely be observed without considering the idea of epistemic communities[3].

According to Ruggie (1998, p.55), this idea refers 'to a dominant way of looking at social reality, a set of shared symbols and references, mutual expectations and a mutual predictability of intention'. The cognitive approach of regimes underlines the importance of ideas, knowledge and expertise in international relations. This theoretical path criticizes the realist and neo-liberal perceptions as for the cognitivists nation states have preferences, interests and identities. Cognitivists opt for an analysis which seeks to study how preferences, interests or identities are forged taking into consideration actors' beliefs and values (Hasenclever, 1997).

Taking this into consideration, two points might emerge: firstly, a quasi-consensus founded on the market-democracy axis has been set up by an epistemic community which has succeeded in disseminating its representation of political and social development worldwide. Elites in developed and also developing countries have commonly accepted the implementation of liberal postulates, even if some of them may have profound consequences for their already divided societies. These postulates should increase disparities and, as a result, disturb the integration process. This is especially the case of Brazil, which matrix of development is essentially centered on the interests of its south and south-east regions, even though some of the population in the north and north-east is still enduring misery. It is sound policy to promote international insertion and for being competitive Brazil needs to use its more efficienct sectors and high value added exports – concentrated in the Rio de Janeiro, São Paulo and Minas Gerais triangle – but this should not exclude public policies of redistribution designed to promote schemes for the economic development of the poorer hinterland regions.

Secondly, the nation state is no longer understood as a black box in which output is the central issue. Henceforth, the internal dynamics of each country are considered as an important variable in the entire system. In the case of Mercosur, this could explain Brazil's reticence to create community funds which might divert investments from disadvantaged regions as the north-east or Amazonia to certain poor regions in Argentina, Paraguay or Uruguay – although national politics have showed this has not been a major priority. As the richest partner Brazil would probably pay the price rather than throw a spanner in the works of this supranational mechanism. It would then be more difficult for federal Brazilian civil servants to legitimate their attitude to the politicians from poverty-stricken regions.

As a result the functioning of Mercosur has been characterized by what one might term a 'framed intergovernmental cooperation' (Medeiros, 2000). This means that the regionalization process of the Common Market of the South is placed somewhere between a simple cooperation strategy and a more complex integration scheme. Even though it is true that Mercosur runs closer to a cooperation than to an integration logic – as it has not adopted supranational principles – some practices have characterized its development and could emphasize the emergence of significant inequalities (Monnet, 1976). These inequalities have been giving rise to a positive inertia from which common political actions may strengthen their momentum. As a matter of fact, a number of economic, institutional and social phenomena could be pointed out as constitutive vectors of the inequality/inertia linkage in the Mercosur arena:

(i) the economic agent's vision of the world at present is founded on a regional basis rather than on a nation state perspective;

(ii) the derived community law, even if it requires national incorporation, represents a vehicle of restraint and solidarity among member states. It follows that decisions, resolutions and directives, as well as the existence of a mechanism for the settlement of disputes – the Brasilia Protocol – reinforce the community frame and the integration strategy. It is important to underline these norms are not limited to economic issues, but extend to other subjects as education (Dec. 07/92) or regional development (Dec. 37/93) among others;

(iii) an incipient civil society is coming into sight. Five elements might stress this trend: (a) the intensification of dialogue between political parties of member states; (b) the emergence – even though restricted to intellectual and/or economic elites – of a public opinion favourable to the Mercosur integration process; (c) the emergence of lobbying activities by trade unions and company confederations of the four partners; (d) the improvement of sub-national movements as Crecenea/ Codesul or Mercocidades networks; (e) the possibility for the armed forces to use the Common Market of the South as a means to rethink their doctrine – the Cruzeiro do Sul manoeuvres is one such instance.

In this light, Mercosur reflects an effort by the goverments and societies of Argentina, Brazil, Paraguay and Uruguay to regulate their relationships and those with other countries. And this albeit various asymmetries can be identified between them and between them and their foreign partners. The evolution of the 'framed intergovernmental cooperation' towards a more consolidated design of integration is likely to pass by the enlargement of Mercosur. On their own, a positive inertia and various asperities are not able either to reduce imbalances, or to introduce supranational mechanisms.

3. Enlargement *versus* deepening

The interaction between enlargement and deepening has imprinted itself on the history of regional integration around the world. Since its foundation in the 1950s, the EU has often been challenged to reconcile the necessity of continental stability – enlargement – and the need for building a coherent political set skilled to face major partners such as the USA or Japan – with deepening.

In the Mercosur arena, however, the situation is to a certain extent different. In fact, the present imbalance, triggered by Brazilian preponderance, could be mitigated if other Latin American countries would agree to join the four founding members. From a strategic point of view, the GDPs, populations and areas of the members countries of the Latin American Integration Association (LAIA) – Mexico excepted – correspond, *grosso modo*, to those of Brazil. The enlargement of the Common Market of the South might not only increase solidarity among partners, it could also facilitate the creation of supranational schemes such as voting procedures on the basis of minorities or majorities. National representation and a unanimous vote might begin to be eroded, and the notion of shared sovereignty could even begin to crystallize. For this reason, enlargement seems to stimulate deepening and does not contradict it.

Unsurprisingly, if the increase in the number of member states offers an array of different arrangements of loyalties, these arrangements of loyalties are sometimes not attained without difficulty and, as a result, engender a lack of effectiveness. This means that enlargement can be a source of difficulties for the elaboration of public policies and also for their implementation, as some member states, particularly those which constitute the minority, may not execute common decisions in their territorial area as early as they might. Yet, enlargement which would encompass less-developed nation states such as Bolivia or Ecuador implies an augmentation of the poor regions within Mercosur, in which internal inequities are extremely pressing already. The administration of a future common funds is likely to be more complex in an enlarged Common Market of the South, where donors are not rich enough to support the financial burden of integration.

Furthermore, the interaction between enlargement *versus* deepening is also essential from the perspective of the foreign relations of Mercosur with its two major partners, i.e. the USA and the EU (Vizentini, 2000). The Common Market of the South enlargement represents a strategic path towards the constitution of a broader diplomatic bastion able to discuss economic issues with third countries (Hillcoat, 1999). The political legitimacy and economic weight of an enlarged Mercosur would increase perceptibly and should provide it with more room to manoeuvre. The process of establishing the Free Trade Area of the Americas (FTAA) and the Mercosur-EU FTA negotiations are both clear cases in point.

The former underlines the inevitability for Latin American nation states of being organized in their dealings with the USA, since they share, broadly speaking, similar problems of development. It is notable that the single undertaking and building blocs strategy of these countries supplanted the United States Trade Representative (USTR) strategy. The previous USTR representative Charlene Barshefsky was a severe detractor of Latin American integration and during her term invariably sought to undermine solidarity between developing partners.

The latter opens up both an opportunity to negotiate better conditions for agricultural exports, as the common agricultural policy (CAP) of the EU is very restrictive to South American products, and a possibility of setting up a counterweight to an enlarged Mercosur-USA relationship. In contrast to the hostile USA perception, the EU has been one of the chief supporters of the integration logic in the Southern Cone. The EU is naturally interested in reproducing its nature of political functioning worldwide, and has motivated regionalism around the five continents. For Mercosur both the 1992 and 1995 Framework Agreements and their vast corollaries have represented concrete instruments for increasing bargaining power *vis-à-vis* the USA (Working Group, 2000).

Following this way of looking at processes, connections with Asian and African partners should become important. Mercosur enlargement in the direction of Andean countries could facilitate exports to Southeast

Asia and Japan through a number of harbours as Arica, Antofagasta, Iquique or Ilo. The idea is to construct what has been called bi-oceanic corridors, which could facilitate trading products from the Mercosur hinterland to such destinations. Simultaneously, Argentinean, Brazilian or Uruguayan ports could facilitate exports from Andean countries to the markets of Southern Africa (Thahane and Van der Merwe, 1999).

4. Mercosur: *Quo vadis*?

As in Alphonse Daudet's *L'Arlésienne* drama[4], Argentineans, Paraguayans, Uruguayans and, particularly, Brazilians have conceived of Mercosur with a major absence, i.e., the institutionalization. This is precisely why the history of the Latin American integration process has been marred by successive fiasco's erupting from an incongruity between form and function (Barbosa, 1994). The former preceding the latter often creates institutions devoid of social, administrative and political practices. The Andean Community is an example of this premature institutional sclerosis and its present apathy reflects a deficiency in the combination between form and function. The current stake for Mercosurian officials is to find an optimal institutionalization *modus operandi* able to crystallize the *acquis communautaire* and to galvanize the interdependences forged among member states. They should be converted into a catalyst of institutional achievement by setting up competent organs which could respond to societal demands and encourage both their perennial character and their efficiency.

In order to breathe fresh life into the Mercosur institutionalization process and haul it out of its lethargic condition, it is essential that member states engage themselves in a real political project. The strategic losses for them in a weak Mercosur would be more substantial than those in a solidly integrated venture. In this project national asymmetries must be considered a vital issue and understood in the broad context of regionalism and globalization. These asymmetries are above all a challenge to domestic politics, but should not be seen in isolation from foreign constraints as the notion of a frontier now goes far beyond the precepts established by the Westphalia Treaties (Putnam, 1993). In a deeply interdependent world, without social capital the citizens' capacity for mobilization appears very limited and as a result political plans prove almost impossible to implement. Yet, the cultural similarities shared by Latin American countries may smooth the progress of enlargement and deepening procedures which are quite complementary.

Finally, to overcome the impasse in institutional building in Mercosur, by reinforcing and institutionalizing 'framed intergovernmental cooperation', more favoured countries – like Brazil – should adopt a magnanimous attitude that would correspond to its standing as a leader. Despite its internal inequalities, the Brazilian government could give preference to its Mercosurian partners in numerous spheres concerning public market, economic, mercantile and political questions. Besides this, LAIA nation states represent an important market for Brazilian industrialized products and a precious alternative source of energy (e.g. Venezuela, Argentina, Bolivia), especially in the present context of the partial collapse in the supply of electricity.

If all this is to be achieved, less favoured countries, such as Argentina, Paraguay and Uruguay, should show more understanding regarding the exercise of Brazilian leadership. Inexorably, economic access to Brazilian market potentialities must have a political price, but it seems that within an institutional structure founded on democratic rules and mirroring the specific weight of each partner, small countries can be better protected – the hegemon becoming, *pari passu*, less vulnerable. An isolated confrontation in the international arena with mighty potentates, which have a very different cultural and historical background, such as the USA, the EU or Japan might be far more dangerous for the survival of Latin American societies (Elias, 1991).

Notes

[1] Two ideal strategies are currently used to scrutinize regional integration processes. Cooperation, founded on intergovernmental institutions and decision making based on consensus; integration, marked by supranational institutions and decision making established by the majority (Quermonne,1998).

[2] For instance, the European Commission and the European Court of Justice. The Common Market Group or the Brasilia Protocol of Mercosur are not supranational representative institutions.

[3] A seminal work on Epistemic Communities was elaborated by Haas (Haas, 1992a and 1992b).

[4] Alphonse Daudet, French author of the drama *L'Arlésienne* (The Girl from Arles), a drama in which the major personage never appears.

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4

BETWEEN EU AND FTAA
WHAT AMERICAN INTEGRATION?

JANETTE HABEL

1. Towards the formation of two interregional trade areas

Since November 1999, the European Union (EU) and Mercosur have entered into negotiations aimed at liberalizing trade between the two regions. The interests at stake in the intensification of transAtlantic integration are considerable but the negotiations are facing numerous obstacles at the present time. These negotiations are the first between two customs unions (CUs), one belonging to the North and the other to the South. Even though the EU and Mercosur share the same concept of regional integration and want to build more than a free trade area (FTA), there are many differences. To start with, there are large differences in levels of development and the degree of regional integration. The existence of other negotiations linked to the geopolitical context add to the difficulties. It seems that after the Nice Summit – even if it does not appear to have been very successful – expansion to the east and the redefinition of preferential relations with countries in the Mediterranean and Middle East have become EU priorities.

For Mercosur, the hemispheric negotiations in the context of the Free Trade Area of the Americas (FTAA) make the negotiations with the EU particularly complex. Since November 1999 several meetings have been held in Brussels and Latin America, organized by the Working group on EU-Mercosur Negotiations, but tensions arising from protectionist practices on both sides have already appeared, and at the present stage agriculture is a particularly sensitive sector.

The real priorities for the different governments are not clear: as the French Presidency of the EU and the Brazilian Presidency of the Mercosur coincided in 2000, some people were hoping that this would stimulate the integration process. However, the French Presidency was busy with European enlargement and solving institutional difficulties, and Latin America was not a priority.

The Bush Presidency reaffirmed just the very opposite at the end of the year 2000. And Chile began to negotiate a bilateral agreement with the USA at the very time when it was supposed to join Mercosur as a full member at the end of December 2000.

For Mercosur, FTAA poses an enormous challenge given the size of the North American market and since the first Summit of the Americas in December 1994 it has been engaged in the negotiation process. Confronted by this dynamic North American bloc, Mercosur has attempted to reinforce itself as a pole of Latin American integration trying to create a South American Free Trade Area (SAFTA) under the Brazilian pressure with the Andean Community, and at the same time to strengthen the links with the EU. Both processes move slowly and are complicated, while meanwhile the negotiations on an FTAA have reached an advanced stage with the first draft of the Treaty presented in April 2001 at the Third Summit of the Americas in Quebec.

Will the EU, Mercosur's main trading partner, be able to offer an alternative enabling Mercosur to survive and to resist in the framework of the FTAA? Is there a Latin American project able to propose a different perspective for sustainable development? The answers to these questions will have important consequences for the future of economic and geopolitical relations.

There is a race against the clock between the FTAA and the negotiations between Mercosur and the EU. First and foremost, future developments depend on the possibility for President Bush to get fast-track authority from a Congress which is split into two almost equal parts, with the Democrats – and trade unions and environmental lobbies – wanting to include labour and environmental standards in the FTAA agreement, and rejected by big firms who want to open markets. The trade unions fear that low wage countries will undercut jobs in the USA, business fears that labour standards will make foreign investments more difficult and the governments of developing countries have rejected them because they see it, not without reason, as hidden protectionism and a tool which can be used to violate their sovereignty.

In fact, even though the US President could not get the fast-track authority – which is now referred to as Trade-Promotion Authority and would make far easier to conclude trade agreements with other countries – the negotiations for the FTAA are far more advanced than the bilateral discussions between Mercosur and the EU, which began only five years after the signing of an agreement between both regions in Madrid in 1995.

The bilateral negotiations between the EU and Mercosur have been slowed down by agriculture and the common agricultural policy (CAP). This is why some experts in Europe thought that it was better to wait for the discussion of a new round of negotiations in the World Trade Organization (WTO). It is essential to take into account the fact that concessions made in a regional agreement will be implemented later in global negotiations. One of the consequences of the failure of Seattle has been to postpone some decisions until after the beginning of a new round.

Once President Bush has got trade-promotion authority, Mercosur will be confronted with the prospect of a new pan-American trade bloc which, with the access to the US market, will also be in its own interest. In contrast, the EU risks being partially ousted from a continental FTA of 800 million consumers. From the perspective of the EU, establishing a comprehensive FTA with Mercosur may substantially reduce the risk of trade and investment diversion, as was the case with the North American Free Trade Agreement (NAFTA), as a consequence of which the commercial exchange between Mexico and the EU decreased.

For Mercosur a bilateral relationship with the USA alone would be very risky unless progress is made towards a substantial political integration. For the moment the FTAA project is progressing faster than the formation of a preferential relationship with the EU. The main difficulties for the two partners are, first, the CAP, which cannot be amended before 2006 as a consequence of decisions already taken regarding the European budget. The core of the matter is that for Mercosur, the weight of agriculture in the trade balance is a central issue.

The other problem is institutional: the European Commission wants to know who is negotiating with whom: with one interlocutor for the regional bloc or with four countries with different opinions?

From the perspective of Mercosur, trade negotiations with the EU could be useful in limiting the risks of a bilateral confrontation with the USA. It could also help to reinforce its integration process. For some experts, the FTA with the EU will be complementary with the FTAA and will benefit Mercosur's industrial sectors, while trade with the EU would be profitable for the agro-business firms if access to the European market were to be opened and European agricultural lobbies weakened, particularly in France. The fly in the ointment is that European competition is opposed by trade unions which fear its negative impact on employment.

In the Mercosur countries, what is at stake is the protection of national productive activities, the defence of employment and the environment, and the EU does not appear to present itself as a credible alternative to FTAA, all the more as the interests of big European corporations appear to be not very different from those of American corporations, with similar economic risks and social consequences.

2. Towards an autonomous Latin American bloc?

As Pereira (2000) puts it: Mercosur can either assert itself or will be eaten up by the FTAA project. In his eyes Mercosur presupposes further political integration, the opportunity for supranational powers to regulate the economy and for the launching of a common currency. Obviously the main challenge that the FTAA process poses for Mercosur is that of the very survival of its regional integration project. Faced with the significance of the North American bloc, Mercosur is trying to strengthen its negotiation capability by presenting itself as a pole of South American integration. To achieve this, it is necessary to improve the CU, to coordinate macro-economic policies and discuss the possibility of a monetary union, but the monetary crisis in Argentina in July 2001 made such a prospected outcome much more difficult.

Seeing how slow the negotiations with EU are, refusing the FTAA does not appear to be a realistic option for Latin American countries which need access to the markets of the main industrialized countries.

There are already strong pressures – in Uruguay, Argentina and Chile – to join the FTAA in one way or another. For Jorge Battle, the President of Uruguay, there is almost nothing to discuss with the EU. There are obvious differences of criteria between Brazil and other governments. As Chile is looking to the North, the Mexican President Vicente Fox made a proposal in August 2000 for Mexico to join Mercosur in ten year of time.

Some of the Latin American political elites are convinced that regional integration based on free trade, in which the USA would be the main partner, is the most realistic alternative. Surprising as this may seem, this attitude can be explained by the difficulties accumulated in the past, including the failure of the previous model of inward-looking development, the debt crisis in the early 1980s with its ensuing ultra-liberal policy of deregulation, privatization and trade liberalization; and the limited economic complementarity of the various countries hindering the strategy of common development. All these liabilities weaken the credibility of a South American integration policy which would form an alternative to the creation of a continental market under the aegis of the USA. This is all the more true since the commercial crisis that occurred between Brazil and Argentina in July 2001. Even if the various economic interests of the different countries are increasingly intertwined, their geopolitical projects often diverge. The Andean Community (CAN) Summit in June 2001 decided to create a regional Common Market and an Andean National Bloc by 2005, by which time the FTAA negotiations should be concluded. But CAN is also engaged in negotiations with Mercosur. When, on September 2000, President Cardoso convened a meeting of South governments in Rio, the Andean countries had agreed to form a Latin American bloc by 2002.

Brazil wants to lead the economic integration process and negotiate with the USA after having consolidated a South American bloc. But this exhibition of ambition by the most powerful country of the subcontinent does not appeal to its smaller partners Uruguay and Paraguay, which complain about Brasilia's hegemony and a bilateral partnership with Argentina, that excludes them from the process.

Turning to Argentina, in the past it has already shown interest in NAFTA and has advocated several times the idea of dollarization to ward off the risks of financial instability. Moreover, Argentina is a privileged member of the North Atlantic Treaty Organisaton (NATO).

Mercosur is the only regional integration project in which the imperialist superpower plays no part. In fact, the issue is whether to choose between a FTAA that would turn Latin America into a huge free trade zone or a more extensive and stronger Mercosur resting on a different type of integration (Sader, 2000). Such a project supposes the existence of a common development strategy ineluctably linked to a social project, determined to resist the North American and European multinationals. The problem is that the political will to unite is often not strong enough to overcome the different economic interests of these countries, hence the risk of demands for reappraisal every time they encounter economic difficulties.

Since the devaluation of the real in Brazil, Mercosur has been experiencing tensions. Relations between Brazil and Argentina are particularly tense. The two countries have no common policy as regards technological development and there is no regional awareness that is sufficiently strong to counter the global strategies of the multinationals.

An assessment of Brazil shows that this country acts mainly in its own interests. Although President Cardoso presented Mercosur as a 'second nature', it is significant that the real was devalued in 1999 without consulting any of Brazil's partners and this, with the financial trouble in Argentina linked to the currency board, lies at the root of the present crisis. Mercosur enables Brazil to have the upper hand in its negotiations with the USA and to gain time. Indeed, it would be too risky for Brazil to rush into the FTAA. Some management sectors think that Brazil is already too open, for joining FTAA would mean more liberalization when, within the WTO and its sub-regions, liberalization has seriously harmed the interests of Mercosur companies. Brazilian economists warn against rushing matters, seeing that American competitiveness far outstrips that of Brazil, not only in industry but also in agriculture. They argue that making a mistake with the USA would be fatal, whereas such a slip-up would be less deleterious with the EU since some Brazilian products are cheaper than European ones. The conflict with Canada makes them even more wary. Because of this commercial conflict, Brazil threatened not to attend the Third Summit of the Americas in Quebec in April 2001 after the ban on imports of Brazilian cows by Ottawa, an excuse for another conflict about aeronautics, in which Canada accuses Brazil of subsidizing their Embraer planes.

The monetary problem lies at the heart of the debate about whether or not to dollarize or create a common currency. But which common currency: the peso or the real? To dollarize would finish off Mercosur and leave the FTAA with a free hand. The Brazilian government does not want any of this but, until recently, has done nothing. Businessmen and the Latin American ruling classes are divided.

In Rio in September 2000, the 12 governmental representatives discussed the future of Mercosur and the monetary issue. The governor of the Brazilian Central Bank has voiced his thoughts about the real taking over as the common currency of Mercosur. This question is discussed in more detail by Vos in Chapter 2 of this Volume.

A real alternative to this project is only feasible if it takes the social aspect into account. A project for social and democratic development would mean radical changes. However, both NAFTA and Mercosur include measures to deregulate foreign investment, which may entail lower wages, poorer working conditions, more unemployment and environmental damage in the region.

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5

FROM MERCOSUR TO SAFTA

A COUNTERWEIGHT TO THE FTAA

PAULO VIZENTINI

1. Introduction

Even while celebrating its tenth anniversary, Mercosur is undergoing a serious crisis and is faced with challenges such as negotiations about the Free Trade Area of the Americas (FTAA) led by the USA. Opinions are split, but the prevailing feeling seems to be an underlying pessimism regarding the future. In this context, this chapter will try to stress that the present crisis is not a crisis of integration itself. Instead, it is a crisis related to the neo-liberal programmes of international projections and the world system. Moreover, it will also argue that in spite of concealing its political-strategic aspects, Mercosur and its potential extension to South America as a whole, is presenting somewhat of a challenge for the projection of the American economy over the region. Finally, the chapter will consider how the establishment of additional external links, mainly with the European Union (EU), could be viewed as a way to solve some of the present predicaments. However, the key to solving today's crisis depends on the domestic politics of Mercosur's member states, especially Brazilian decision making and the political consequences of the Argentinean crisis.

2. Mercosur, NAFTA and the FTAA

In December 1994, at the Miami Summit, President Clinton relaunched the proposal for creating a hemispheric free trade zone that later would be called the Free Trade Area of the Americas (FTAA). In this meeting, Brazil presented itself as the defender of the future convergence and co-operation of the various already existing integration projects, rejecting the possibility of establishing bilateral agreements with the USA. Besides, the Foreign Ministry of Brazil, Itamaraty, worked to secure the guarantee that even with this rapprochement, contacts and agreements with other areas would not be dismissed, such as those with the EU. It is with this strategy in mind that, in response to American strategic advances, Mercosur launched the negotiations with the EU that led to the signing of the first inter-bloc economic agreement, the EU-Mercosur Interregional Framework Agreement on Co-operation, signed in Madrid in December 1995.

As expected, Mercosur's pretty positive results in the economic field and the co-operation with other poles of integration in a context of growing economic and technological competition in the North are leading to some divergences with the USA. The permanent broadening of trade relations inside Mercosur is not the only issue, other elements are emerging as obstacles. It seems to be much clearer now that Mercosur has as an implicit goal: the maintenance of an industrial basis inside its territory, creating conditions to sustain the ongoing presence of transnational corporations.

Beyond these advances, Mercosur's agreements with other areas, such as Europe and East Asia, bother the USA significantly. So, since the beginning of Clinton's second mandate, Washington has been criticizing Brazilian and Mercosur trade practices and their rapprochement with other processes of integration. During this no-gloves debate, Brazil has been arguing that Mercosur, which intends to create a common market, represents a much deeper process of integration than the North American Free Trade Agreement (NAFTA) or the FTAA, that are only free trade areas (FTAs). This fact alone is regarded as reason enough to justify Mercosur's survival as a bargaining partner, instead of individual members making country to country agreements with NAFTA. The response of the White House has been to renew NAFTA's power of attraction with the promise of obtaining fast-track authority, especially in relation to Chile.

In its turn, the USA is harshly attacking the co-operation with EU and Asia. This scenario can be deduced from Clinton's speech to the Senate in 1997, asking for the approval of fast track. '[w]e need to act, to expand our exports to Latin America and Asia since these two regions are growing fast or we will be left behind as these economies strengthen their ties with other countries' (Martins, 1997, p. 66). Charlene

Barchefsky, the former US trade representative, stated before a Senate Commission that 'the growing attention that Mercosur is getting not only in South America and in the Caribbean, but also in Europe, Japan, and China is viewed [by us] as a threat to US trade interests and also to our own leadership in the hemisphere' (Martins, 1997, p. 57).

3. The fall of the real and the Mercosur crisis

The association of Chile and Bolivia to Mercosur, the ongoing negotiations with other South American countries and the announced membership of the former, added to the intensification of trade exchange and other aspects of the integration have unequivocally characterized Mercosur as a success. However, in 1997, the Asian financial crisis affected the region negatively, a situation that was worsened by the stock market collapses in Asia and Russia in 1998. This produced capital flight from the 'emerging markets', especially Brazil, with a loss of 50 per cent of exchange reserves. At the beginning of 1999, Brazil had to devaluate strongly the real. The impact of the devaluation on intra-regional trade hit Argentina badly and was the beginning of the so-called Mercosur crisis that some identified as the end of the regional integration process.

More than a crisis of the integration process itself, this represented the erosion of an economic model and, especially, of the international context in which it was based. The world economic reality at the end of the 1990s is very different indeed from what it was at the beginning of the decade. The global financial instability, the slow down in the economic growth plus the recession in the region, the debacle of social development and the increase in unemployment altered the internal political situation, leading to the erosion of the legitimacy of the governments of the Mercosur countries. Furthermore, Argentina exacerbated the situation because of its presidential elections. Moreover, in the wake of the steady recession in Argentina imports from Brazil had not grown significantly.

Therefore, recovering economic growth in the region is an essential condition for the integration process to be kept going and the governments are aware of this. Moreover, the virtual danger that Mercosur endured, prompted several agents, that usually were inactive and even critical of the integration process, to realize the damage of its possible disappearance. As many entrepreneurs have found out, the liquidation of Mercosur would generate a loss of confidence among foreign investors and trigger off a demoralization that would hurt each country of the region.

In the reality of worsening problems linked to globalization, there is a growing perception that Mercosur is a good instrument by which to articulate a new form of international projection for South American countries. Despite some remaining uncertainties, few agents question the essentially beneficial character of the process. So, at the same time that the decision-making mechanisms and the institutions necessary for an adequate functioning of Mercosur are being re-evaluated, issues such as the deepening and the enlargement of the process emerge as important strategic questions. Lastly, it is necessary to respond to the challenges of the hemispheric integration represented by the FTAA and of Mercosur's place in it.

Turning to the enlargement of the Mercosur, it is essential to remember that the Southern Cone is already a developed area, with moderate prospects of economic and demographic growth. In contrast, the Andean region, especially in its northern part (Colombia and Venezuela) represents a dynamic area with greater opportunities for growth, in spite of the crisis that affects it at the moment. Any rapprochement with them through an association with or adherence to Mercosur, makes the establishment of a South American Free Trade Area (SAFTA) a real proposition although via different paths, creating a concentric circle around the original hard core. On the other hand, the Southern Africa Cupertino, declared in ZoPaCAS (Zone of Peace and Cupertino of South Atlantic) and strengthened by President Mandela's Mercosur meeting in Ushuaia, would represent the second concentric circle. Therefore, an area with considerable productive and technological capability would be forged, rich in natural resources and an attractive market conducive to the expansion of regional activities and appealing to other zones.

The fulfilment of these objectives would help to create a power pole capable of taking part in the multipolar international system that seems to be emerging at the dawn of the 21st century. In order to reach this point, it will be essential to maintain diversified relations with other poles of world power, such as the USA/NAFTA, the EU and East Asia. Here, there is an issue that must be dealt with realistically: the FTAA proposal. It would be suicidal to merge Mercosur into a hemispheric integration led by the first world power, but it is unrealistic to turn its back upon it. With a strengthened Mercosur capable of negotiating as a bloc, it would be viable to search for some kind of hemispheric integration that might even help its international projection. To achieve this, it is of utmost importance to abandon a mere reactive and bargaining position and to invest in Mercosur's set of simultaneous multilateral relations with strategic importance. Therefore, at the turn of the century, Mercosur faces a series of challenges that, if dealt with care, would help to strengthen it, leading to the exploration of the new potentialities of the international scenario.

The so-called Mercosur crisis was provoked by capital flight from Brazil, as well as by the devaluation of the real, the profound imbalance of Brazil's economy, combined with difficulties in expanding its exports outside the bloc, the tensions produced by the displacement of enterprises and workers in a moment of recession and the loss (or the giving up) of the coordinating capacity of states and governments. According to Ambassador Samuel Guimarães of the Ministry of Foreign Relations, an emergency programme to overcome the crisis could be reached by taking certain steps:

a) common policies for the expansion of exports and the control of imports from third countries trying to obtain surplus;

b) a common programme of identification and the elimination of barriers to Mercosur's exports;

c) the creation of a special regime for sensitive products such as sugar;

d) the creation of an industrial restructuring fund and of a fund for technological development financed by the common external tariff (CET) revenues; and

e) the enlargement of timetables in common credit operations, eliminating the need for the use of a strong currency in bilateral transactions and the freeing of transactions with other areas (Guimarães, 1999, p. 25).

Following this minimum programme, integration would be given a new boost, recovering certain strategic objectives of the Brazil-Argentina Cupertino of the 1980s.

4. The Brasilia Summit and South American integration

Facing this growing set of challenges, the reaction of Brazilian diplomacy was to foster South American integration, promoting the Brasilia Summit. This initiative occurred at the same time that the USA was feeling the first signs of a fall in the growth rate and during its presidential elections. Therefore, since July 2000, Washington has launched a package of projects in order to block Brazilian advances and to accelerate the negotiations and the implementation of the FTAA.

The official sanctioning by the White House of Plan Colombia on August 31, 2000, intended to help in the narcotics war, and the simultaneous realization of the Brasilia Summit, a joint meeting of South American governmental officials, made clear that two opposing (but related) trends are developing in South America. These trends represent two different kinds of answers to the end of the politico-economic stability that was reached at the beginning of the decade. Such stability was characterized by the primacy of the market economy, the total openness of domestic markets as a way of taking part in the globalization process, and the adoption of neo-liberal policies of privatization and deregulation in the domestic field. At the same time, the liberal democratic regime was strengthened after the end of the authoritarian rule and the regrouping of the left.

However, this new situation created serious social problems – in spite of the official speeches – that sooner or later began to influence the political and economic realms. This reality, long concealed by the financial stability, erupted into the open when the stock markets started to drop progressively in 1997, reaching its nadir in the beginning of 1999 with the flight of speculative capital and the devaluation of the real. During this period, several political crises erupted in Paraguay, Ecuador, Venezuela and, more recently, in Peru. It goes without saying that in almost every country of the region social clashes were also the order of the day.

As mentioned before, in this context the USA launched Plan Colombia although Colombian problems, such as the left-wing guerrillas, drugs trafficking, and right-wing death squads, were well known before, and there had not been significant changes to justify such policy. Moreover, a prolonged and direct military intervention in the region, or even a closer and clearer support of Colombian security forces would involve very high costs for the White House. Additionally, a discreet, selected and specialized American military presence already existed in the Andean region at the time. So, what was the real meaning of this initiative?

Beyond the display of strength in wars on drugs and towards the left-wing guerrillas that control one third of the country, and the support for President Pastrana's allied government, Washington intended to point out to other countries that it was aware of all the developments in the region, supporting allies and punishing 'strays'. In a similar situation to that in Colombia, in Venezuela President Chavéz not only peacefully dismantled the ongoing political model, shared by all of Latin America, but also designed a new internal regime and an autonomous diplomatic behaviour, recovering the principles of nationalism and third-worldism.

Paraguay has been undergoing a deep-seated political crisis over the last two years. Conversely, Chile and Argentina, and their newly elected governments, betray clear signs of the weakness of their previous political and economic stability. Not so long ago, these countries were being pointed out as 'models'. Finally, Brazil is a double-edged problem for the USA: undoubtedly, the government is debilitated and the opposition is growing; yet, because of this situation and the crisis of the real, this same government is outlining changes of path in the international context.

Brazil's decision to call the South American Summit in Brasilia, that proposed the creation of a SAFTA, at the same time that Mercosur's own survival was being questioned, seemed to surprise some analysts. However, this process is easy to understand and was rationally motivated by the crisis in the country and by the growing international and regional difficulties. In other words, Brazil needed to recover an autonomous – yet, non-confrontational – diplomatic speech, criticizing 'asymmetrical globalization'.

In part, the growing preoccupation of Brazil's business sectors, facing a long-term slow growth and the risks that an adherence to the FTAA would also bring, has motivated the search for international alternatives. In a contradictory stance, the answer to Mercosur's crisis focused on the widening of the integration involving all of South America. Therefore, Brazil's previous 1993 initiative for the creation of the SAFTA seems to be taking shape by circuitous routes. With this in mind, further talks were scheduled in order to establish an FTA that comprises Mercosur and the Andean Pact, to be signed in 2002.

But what steps could be taken to ensure that all these actions, as in other opportunities, end with concrete results? As is widely known, the Brazilian government's possibilities and its ability to resist pressures are limited – not to mention those of other countries such as Argentina – because of its deep integration into the current model. Yet, there are factors that are beyond control. Brazil's economic history shows that when faced with deep crisis in the external sector to prevent it from obtaining convertible currencies, the country was pressed to reconfigure its economic model, its international stance and sometimes even its own political system. Whether or not current predicaments will reach this point is something that we will find out in the future.

5. The FTAA and the future of Mercosur

In the second half of 2000, in the midst of the Mercosur crisis, the American economy started to show signs of a slowdown. At the same time, Brazil was furthering its South American initiative. Coming to terms with their loss in US presidential elections, the democrats tried to create new facts that would lock Bush's presidency into the acceleration of the FTAA negotiations. According to De Paiva Abreu, 'hemispheric integration is, in fact, an extension of NAFTA. Regionalism's role for the USA is a clear sign of the so-called 'crowbar' policy. The expression was mentioned by the American negotiator Carla Hills: to break into closed markets' (Martins, 1997, p. 47).

Among the American actions that were taken to implement this strategy were the co-optation of Chile, renewing the old promise to integrate this country into NAFTA. Chile, with its limited market size, small range of export goods and limited capacity to articulate a national project, has pinned all its hopes in this arrangement. Argentina, in its turn plunging into a deep economic and financial crisis, is also tempted to surrender to the FTAA negotiations, in exchange for bilateral favours in its economic relations with the USA. Therefore, the external context was disadvantageous to Brazil.

The possible creation of the FTAA would mean the end of Mercosur, once it had nullified the advantages that the CET offered the firms of member countries. Since the integration of the Southern Cone is comprised only of developing countries, with limited competitiveness, its absorption in a bloc that included Canada and the USA would mean the collapse of a number of productive chains, for it would grant the more competitive firms of the North the same conditions as local firms. Besides, the end of the CET would annihilate one of the factors that attract investments, the possibility to 'jump' regional barriers, allowing the installation of industries inside somewhat protected countries. Moreover, for Brazilian regional economies, American cattle and agricultural exports would represent a real threat, particularly soybean, rice, manufactured agricultural products, cattle and poultry.

The result of this dispute will depend heavily on Brazilian diplomacy. Several analysts argue that, if Brazil would not take part in the FTAA negotiation, it will be isolated. This is not true, since Latin American countries do not compete with Brazil in either Latin American or North American markets. Most of these countries have already gained commercial privileges in the USA. 'Considering South American countries', recalls ambassador Samuel Pinheiro Guimarães:

'their limited industrial diversity and the size of their economies also restrain their ability to compete with Brazil in the American (and hemispheric) market. Moreover, their exports to the USA are different from Brazil's, focusing on primary products that we do not export, such as the Chilean copper, oil from Venezuela and Equador, Peruvian and Bolivian ores, etc. Argentina's case is more interesting, since it produces and exports the same products that the USA also exports in great quantities, grains and meat, and its priority market is the EU. It is hard to see what Argentina might gain in the trade or in the investments field with its participation in NAFTA or even in a future FTAA' (Interview on www.global21.com.br, 12/29/2000).

From the above, it may be concluded that, despite all its limitations, Mercosur represents not merely a trade initiative, but also a strategic move, which clashes with some North American interests. Inside the FTAA – which is also not merely a trade project –, we would lose our legal capability to make use of mechanisms of industrial, technological and commercial policies to accelerate development, something which would be possible in Mercosur as long as the national rulers freed themselves of their present economic thinking. Brazil, for its turn, needs to avoid the traps created by the difficulties of Argentina – which depends on the Brazilian market – and to start mobilizing its social and business sectors against the risks presented by the FTAA, lifting them out of their lethargic condition and girding them up to confront this critical issue of regional integration. After ten years, it can be seen that Mercosur has been as a proper strategic initiative, which must be developed in geographic, institutional and political terms.

To build a South American economic space is the foremost condition to provide a counterweight to the US integration policy for the Americas, the FTAA. Brazil and South American countries do not need to establish a hemispheric free trade agreement to gain access to the US market. European countries, Japan and China have very important trade links with the USA, without taking part in an FTA. So, why us? At the Buenos Aires and Quebec Summits, April 2001, Brazil delayed the American initiative and posed some conditions for a hemispheric integration, like environmental and social patterns, the abolition of non-tariff barriers (NTB's) and of all agricultural subsidies, which was unacceptable to the USA. So, it is time to propose new ways, as the international scenario is quite different from what it was ten years ago, and the naïve religion of free trade is no longer popular. Finally, the EU must support South American initiatives to build a counterweight to the FTAA, as a way to defend its own interests. It is a time of crisis, but, fortunately, also time for change.

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6

STRATEGIC COOPERATION BETWEEN UNEQUAL PARTNERS

Vivianne Ventura Dias

1. Introduction

The formation of an interregional association between the European Union (EU) and the Mercosur will be a major achievement. Firstly, because instead of a preferential trade area (PTA) that has been traditionally negotiated between individual countries, what is being negotiated is the creation of a unique political, economic, financial, social and cultural partnership between two regions. Secondly, because it will be an interregional association between a highly integrated group of 15 industrial economies and a heterogeneous group of four developing countries that are still coping with the learning process of integrating their economies.

The pace of those negotiations, however, reveals some of the problems confronting in converting rhetoric into action. The Interregional Framework Co-operation Agreement was signed on 15 December, 1995 but it was during the Summit Meeting of Heads of State and Governments of the EU and Latin America held in Rio de Janeiro in June 1999, that the structure of the methodology and the calendar for the negotiations were defined. Those dates also show how much the negotiations have been shaped by factors external to Mercosur-EU relations. Fundamentally, the evolution of negotiations between the two regional groups reflected, on the one hand, the movements towards the launching of a new round of trade negotiations at the World Trade Organization (WTO) and the process of enlargement of the EU, two basic EU priorities, counterbalanced by the progress of negotiations designed to investigate the formation of a Free Trade Area of the Americas (FTAA) led by the USA, and a clear priority for Latin America. It was no coincidence that the Framework was signed one year after the Summit of the Americas and six months after the Denver meeting of trade ministers signalled to the world that the USA, Canada, Latin American and Caribbean countries had serious intentions of negotiating a hemispheric free trade area.

It is necessary to look at the nature of the relations between Mercosur and the EU in order to understand the dynamics of and the constraints to their cooperation. To make this statement more specific two aspects of Mercosur-EU relations will be discussed: (i) its strategic nature and (ii) its unbalanced character. To do so, this will be examined in terms of the volume and content of trade and investment flows. Also the intergovernmental structure of Mercosur and the very incipient level of integration commitment of the South America subregional grouping will be looked at.

2. The strategic nature of Mercosur-EU relations

Strategic is the most common adjective associated with Mercosur-EU relations. Not surprisingly, EU documents have emphasized the strategic importance that EU governments attach to keeping a strong presence in areas of growth potential, such as Latin America, against projections of decreasing shares of today industrialized world in total production over the next 30 years. In addition, some analysts perceive the negotiations for an interregional association agreement between Mercosur and the EU as an instance to diffuse EU's own model of integration to other regional schemes such as Mercosur. Furthermore, some officials envisage that the EU model, leading to the establishment of a single internal market with respect to the diversity of national and local situations and through minimal harmonization of norms and institutions, could itself serve as a model not just for other instances of regional integration, but for the governance of an integrated global economy.

Moreover, as it was mentioned, the negotiations for a free trade area (FTA) between the two regional schemes are strategic in the sense that both for Mercosur and the EU these negotiations can provide a 'credible threat' for Mercosur and the EU to wield in their direct negotiations with the USA. In this sense, the rationale for the creation of an interregional association between Mercosur and the EU cannot be derived from conventional concerns about trade creation and trade diversion, but should be sought in the desire for a defensive strategy aiming at controlling future losses in market shares. In other words, for the EU the establishment of an FTA is conceived as a strategy to reduce potential trade diversion that may result from being excluded from the FTAA. For Mercosur, and in particular for Brazil, parallel negotiations with the USA and with the EU, increase its room for manoeuvering.

It should be recalled that Mercosur-EU cooperation contributes to reinforce the process of integration of Mercosur, whereas FTAA will eventually subsume all subregional free trade schemes. There is an understanding in the FTAA that only regional schemes with higher disciplines than those accepted in the FTAA will survive the free trade area[1]. Mercosur countries do not underestimate the importance of the overall political objective of an association with the EU, which is seen as an essential part of its foreign strategy alongside the process of FTAA negotiations. Many analysts perceive the interregional association with the EU as an instance to help Mercosur to redress the balance between North and South America that has been disrupted with the successful development of NAFTA.

Mercosur also has a strategic role for EU trade and investment relations with Latin America: Mercosur countries account for 50 per cent of total EU exports to Latin America and Mercosur imports explain more than 50 per cent of the increase in EU exports to Latin America between 1995 and 1998[2].

3. The unbalanced nature of Mercosur-EU relations

Mercosur and the EU are highly unequal partners, not just in terms of their economic size and development, but in the relative importance of each one in the other markets. Mercosur imports from the EU account for just 1.2 per cent of total EU exports and 3.1 per cent of extra-regional EU exports whereas EU imports account for more than 25 per cent of total Mercosur exports (European Commission, 1998)[3]. Along the same lines, in 1998-2000, the EU became the largest investor in Mercosur accounting for 50 per cent of the total of foreign direct investment (FDI) of 83 billion US dollars – whereas the USA accounted for 32 per cent (55 billion US dollars). Those figures compare with a ratio of 1:50 of Mercosur FDI inflow in the EU over the period 1992-95.

The relative market shares play an important role since they set the priorities for negotiations of the participants. It is unlikely that the EU will make concessions to Mercosur, a minor partner, in issues such as export subsidies in agriculture to generalize them subsequently to the rest of the world. Conversely, it is more conceivable that crucial negotiations on market access in agriculture will evolve in the multilateral forum, the WTO, with the EU major partners and later the concessions will be extended to Mercosur countries.

Other data reinforce the notion of unbalanced relations: between 1990 and 1998, Mercosur imports from the EU increased from 7.1 to 26.7 billion US dollars; but Mercosur exports to that region increased from almost 18 billion US dollars to almost 21 billion US dollars. In the same period, overall Mercosur exports (including intra-Mercosur trade) increased from 46 to 81 billion US dollars. Thus, Mercosur exports, as a whole, almost doubled in the 1990s, and Mercosur exports to the EU increased by less than 17 per cent.

Table 1 summarizes some of the points mentioned above. Although the two sources of data – Eurostat and United Nations/Comtrade – are not comparable, the data point in the same direction. In 1990, Mercosur exports to the EU accounted for 39 per cent of its total exports. In 1998, the same direction accounted for just 25 per cent, although the results are biased by the diversification of Brazilian exports.

Economic relations between the two regional groups are also unbalanced in terms of their structure of protection. The structure of protection of Mercosur differs from that of the EU since the highest average tariff rates are levied upon manufactures and, in particular, upon machinery and transport equipment. Also, the EU average weighted tariff levied upon imports from Argentina and Brazil is only 5 per cent and 3.3 per cent, respectively. In addition, less than 15 per cent of those countries' exports to the EU are levied duties over 10 per cent. Nevertheless, it should not be forgotten that the existence of tariff rate quotas with prohibitive tariffs for volumes exceeding the quota render low tariff rates a misleading indicator of market access conditions. In contrast, the average weighted tariff rate levied on the EU exports to Argentina and Brazil is 14.8 per cent and 21 per cent, respectively. Over a quarter of Argentina and Brazilian exports to the EU are levied with duties above 20 per cent and nearly three quarters of exports pay tariff rates over 10 per cent (Bouzas and Svarzman, 2000, pp. 19-23). Furthermore, 61 per cent of EU imports from Mercosur (59 per cent for industrial goods and 63 per cent for agricultural goods) already enter without customs protection, which means that structural adjustment will have a limited effect on the EU output (European Commission, 1998). However, it also means that additional gains in terms of market access for Mercosur countries in the EU markets could be small. Consequently, Mercosur countries may face the dilemma of having to provide a larger market access by reducing their high tariffs in exchange for a smaller supplementary access to European markets.

It is important to mention that the other side of the accumulation of trade deficits in Mercosur-EU trade is the composition of Mercosur exports to the EU. In spite of export diversification in Mercosur countries over the past 15 years, very few new products were added to Mercosur exports to the EU. In other words, exports from Mercosur countries to the EU are highly concentrated in a few products.

For instance, in 1985, oilcake, bovine meat and unmilled maize accounted for 33 per cent of Argentine exports to the EU and in 1999 the same products accounted for 38 per cent. In 1985, the first ten products accounted for 63 per cent of total Argentine exports to the EU and in 1999 for 60.

Brazilian exports have diversified over the past decades but its exports to the EU are nevertheless more concentrated as compared to those shipped to the USA. In 1985, coffee green/roasted, soya beans and oilcake accounted for 40 per cent of Brazilian exports to the EU but in 1999 the same products accounted for a little less than 25 per cent. The first ten products added up to 63 per cent in 1985, but to only 53 per cent in 1999. Again, in 1985 Brazilian exports to the EU included only four manufactured items (besides processed food items) in the top 20 items, whereas in 1999, five new manufactured items were added to the list.

Finally, the unbalanced character of the two integration schemes will be reviewed. Although the Mercosur model draws largely on the European model, the Protocol of Ouro Preto that was signed in December 1994 did not provide the organs of the Mercosur with supranational competence, even after the period of transition. The norms of the Mercosur form part of the respective national legal orders after they have been transformed and national judges apply these norms when resolving disputes between individuals. The majority of agreements constitute specific international treaties that need to be ratified by member states before they can come into force, although other acts of the community are mandatory. Moreover, significant differences can be observed between the four Mercosur countries. In Argentina and in Paraguay, the supremacy of the community law with respect to the simple internal law, excluding the constitutional law,

Table 1. Mercosur exports to the EU, and total exports, in millions of US dollar, 1990 and 1998.

	1990		*1998*	
	Exports to EU	*Total exports*	*Exports to EU*	*Total exports*
Mercosur	17,970	46,404	20,427	80,908
Argentina	4,545	12,352	5,193	26,414
Brazil	12,342	31,397	14,533	50,732
Paraguay	564	959	209	1,014
Uruguay	519	1,696	491	2,748

Source: ECLAC/COMTRADE.

results directly from the respective constitutions of the countries. This is not the case of Brazil and Uruguay in which the constitutions do not make explicit reference to the hierarchy of international norms. In those countries, the formal prevalence of international obligations is not clear, but their factual predominance is recognized (Kleinheisterkamp, 2000, pp. 5-34).

Although, as has been recalled by several authors, in negotiating the interregional association Mercosur does not deal with a single actor on the EU side, the 16 actors – the European Community and the 15 member states – make up a more homogeneous and convergent 'states' than the four member states of Mercosur. Mercosur still lacks legal certainty and credible institutions to provide support to the process of integration. Moreover, the last monetary and financial crises have shown that in the absence of solid institutions, individual countries resort to individual solutions to domestic problems with little concern about the effects of such actions on the construction of the integrated space.

4. Concluding remarks

The conditions under which South American countries pursue the integration of their economies are radically different from those under which European countries have been able to build up their integration process. Mercosur countries have been required to spread their limited resources in parallel negotiations at the bilateral, regional, plurilateral, multilateral and interregional levels. In 1994, the implementation of the NAFTA and the Summit of the Americas made clear the intention of the USA to accept the establishment of preferential areas as a means to open up markets for its exports and investments. Since then, paradoxically, the steps towards the creation of an FTAA have introduced new challenges but brought also impetus to the process of deepening and widening subregional economic integrated spaces. Within the group of Latin American countries, Mercosur, and particularly Brazil, has been the most vocal opponent of the speeding up of FTAA negotiations and the most vocal advocate of providing more guarantees to the survival of subregional integration schemes after the conclusion of the FTAA negotiations.

In order to assure that Mercosur will survive after the establishment of the FTAA, liberalization inside the integration area will have to move further in the direction of capital and labour movements, trade in services and other disciplines, as has been argued by Van Dijck in Chapter 1 of this volume. The interregional association between Mercosur and the EU can be a useful tool in the development of Mercosur if its aims are not limited to reaching a free trade agreement between two heterogeneous groups of countries.

However, many doubts remain as to the capability of the Mercosur-EU interregional association to differentiate itself from the FTAA, since basically the same topics are discussed in the two cases. Therefore, a recurrent question that is posed by the defensive attitude of both partners refers to the real possibilities of Mercosur and the EU defining a project of their own, and escaping from the dominant shadow of FTAA.

Mercosur countries want to deepen their integration process in order to blend their economies into the dynamic flows of world trade and investment. Similarly, negotiations for further integration with industrial countries should also aim at the diversification of trade towards segments with higher innovation content. The examination of Argentine and Brazilian trade flows to the EU raises several questions on the determinants of highly concentrated export lists. There are demand components of export rigidity for which negotiated market access can be a useful tool, since many products exported by those countries to the EU are subjected to tariff-rate quotas. However, the difficulties experienced by Argentina and Brazil in increasing and diversifying their trade volumes are mostly explained by supply factors that have to be overcome through domestic policies, access to credit and technology. What the role of the interregional association will be in promoting this diversification is an open question, of which the answer will have to be made more explicit.

It is likely that a basic hypothesis used for analysis of the negotiations for an FTAA, also may be applied to Mercosur-EU negotiations. Countries with a relatively high tariff structure and a weak regulatory system will have to bear higher costs of adjustments when negotiating with countries with low tariffs and strong norms and institutions. Firstly, as mentioned before, the additional market access in industrial countries derived from the reduction of tariffs will be limited, whereas the domestic manufacturing sector in Mercosur countries will have to adjust to free trade and competition in their markets. On the other hand, new institutions will have to be established in order for those countries to benefit from the harmonization of norms and the liberalization of services, for instance. This is not to say that Mercosur countries should not move in the direction of further liberalization of goods and services, but to recall that a process of negotiating a preferential trade area includes costs and benefits and that they should be more evenly distributed among partners. However, there are few hopes that the EU would be willing to finance the adjustment costs of Mercosur countries to an FTA when the governments of member states are also facing the costs of adjustment of Central and Eastern European countries to the process of enlargement.

A final remark refers to the relationship between unilateral, preferential and multilateral liberalization. The EU and the USA amount to more than 53 per cent of total Brazilian imports and 48 per cent of Argentine imports. The liberalization of those trade linkages, in combination with liberalized trade wirhin Mercosur, as well as the bilateral PTAs, will raise the share of free trade to over 80 per cent of Mercosur imports. A question that remains is whether the dispersion of scarce resources in those different negotiations is worth the while, or conversely whether it would not be better to concentrate diplomatic, legal and economic expertise on multilateral negotiations.

Notes

[1] 'The FTAA can co-exist with bilateral and sub-regional agreements, to the extent that the rights and obligations under these agreements are not covered or go beyond the rights and obligations of the FTAA.' (item 8 of the Fourth Trade Ministerial, San Jose, Costa Rica, 19 March, 1998).

[2] If the period before 1995 is selected, the importance of Mercosur to explain growth inEU exports to Latin America is even sharper, due to import restrictions in Brazil at the beginning of the decade, that were later reverted. According to EUROSTAT data from 1990 to 1996, exports from the EU to Mercosur increased 250 per cent.

[3] For Argentina's exports, the EU accounts for 54 per cent of exports of bovine meat, 51 per cent of fresh fish, 34 per cent of processed fish, 60 per cent of fresh fruits, and 27 per cent of wines.

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7

ACROSS THE ATLANTIC

THE MERCOSUR-SOUTHERN AFRICA LINKAGE

Kurt Morais

1. Introduction

Since the early 1990s developing countries have been, individually and collectively, repositioning themselves to maximize the advantages and minimize the inherent costs of economic globalization. The end of the Cold War brought with it a new and positive attitude toward international cooperation, especially for the countries of the global South. One of the trends that flowed from this reordering of the international system has been regional economic cooperation, which was made difficult if not impossible by the Cold War. What followed was not only a renewed interest in intra-regional cooperation but also encouraging prospects for interregional cooperation, most notably between countries of the South, at the close of the 20th century. This chapter aims at providing insight into the interregional relationship between Mercosur and South Africa in view of a future preferential trade agreement (PTA), and the possibility that the Southern African Development Community (SADC) will join at a later stage. Some background information on regional integration in southern Africa is presented in Box 1.

2. Mercosur and SADC: why performances differ

Even though Mercosur has been experiencing problems, as discussed in most chapters of this volume, it has been much more successful

Box 1. Regional integration in southern Africa

Southern Africa has two regional integration bodies – SADC and the Common Market for Eastern and Southern Africa (COMESA), with overlapping memberships. In 1994, when South Africa held its first democratic elections, it decided to join only one of these organizations, SADC. SADC emerged in 1992 out of a politically motivated organization, the Southern African Development Coordination Co nference (SADCC), which had been created to counter the economic might of Apartheid South Africa.

As a regional institution, the Southern African Development Coordination Conference (SADCC) was based on political and bureaucratic decisions, in accordance with what was perceived to be national interest; it therefore operated separately from market demands. Its core function was not to achieve greater economic integration– the absence of southern Africa from the arrangement, given its infrastructural strength and more industrialized economy would have mitigated against it anyway[1].

In August 1992 the SADCC was transformed into a development community, known as SADC. The newly formed body was given the task of positioning itself to take advantage of globalization and reorganize itself collectively to address structural weaknesses that the region faced. After its democratic elections in 1994, southern Africa became a member of the community[2]. The new body retained many of the SADCC characteristics, such as the decentralized system of administration, project coordination and dependence on foreign aid.

The intention of SADC is to achieve the following aims:

- the adoption of common economic, political and social values and systems, democracy and good governance, respect for the rule of law, and the alleviation of poverty;
- deepening of economic and political cooperation for mutual benefit in cross border trade and investment as well as the free movement of goods and services;
- strengthening of regional solidarity, peace and security.

The overall aim is to maximize the involvement of all stakeholders in the conceptualization, development and implementation of projects and programmes, indicating a departure from its original 1980 vision.

(continued on next page)

than SADC in making progress towards the establishment of a regional integrated area, as a customs union (CU) is. Indeed, the achievements go beyond significantly stimulating intra-regional trade. The following reasons for these wide differences in observed performance may be discerned (Cleary, 2001, pp. 92-3).

Size: Mercosur has four members and two associates, while SADC has 14 members. SADC's large membership makes it difficult to reach unanimous decisions on key issues, for example, security and defence.

Box 1. *(continued)*

With its headquarters in Gabarone, Botswana, the body is headed by an Executive Secretary, directly responsible to the SADC Summit, made up of the Heads of State of the member countries. The Council of Ministers, responsible for directing the functioning and development of SADC, advises the Summit on policy matters. One of the main tasks that was undertaken by the Council of Ministers until recently was deciding upon sectoral areas of cooperation and the allocation of responsibility for carrying out these sectoral activities[3]. However, in March 2001 at a SADC Extraordinary Summit in Windhoek, a new managerial structure was adopted. It was decided that the 19 sectors run by individual member countries would merge into four broad directorates:

- trade, industry, finance and investment;
- infrastructure and services;
- food, agriculture and natural resources; and
- social and human development.

Given the criticism levelled at SADC of being over bureau-cratized and lacking in dynamism, it is hoped that this new multilateral commission management system will bring a higher level of efficiency. The old sectoral cooperation approach was problematic because it exposed the weaknesses in capacity of many of these states. For example, sectors were run by the national departments of the respective countries and received uneven investment of money and human resources.

On the trade front, the SADC Free Trade Protocol was signed on 1 September, 2000, four years after negotiations had started[4].

[1] South Africa could not join SADCC because of its domestic policy of apartheid. Furthermore, it sided with the North Atlantic Treaty Organisation (NATO) and saw countries like Angola as a communist threat to southern Africa.

[2] In 1995 Mauritius gained SADC membership with the DRC and Seychelles following in 1997.

[3] Each member country was responsible for co-ordinating its own sector, for example South Africa would co-ordinate finance and investment; Zambia, mining; Mozambique, transport and telecommunications; and so on.

[4] Eleven countries signed the agreement, only ten ratified it, with Zambia outstanding, and Angola, Seychelles and the DRC did not sign.

Failure to achieve unanimity can hold the region hostage, stifling progress.

Congruency: Mercosur members have very similar political and social values, a shared culture, and a common commitment to democracy with a united stance against kleptocracy. SADC members, on the other hand, have differing political and social values, as well as cultures and traditions. Moreover, there is no common commitment to democracy, transparency and accountability, even though these have been encompassed in the community's aims since its inception.

Good interpersonal and political relations: The Mercosur heads of state are said to have good communication links, making frequent contact with each other. In fact this is recognized as one of the critical aspects of Mercosur's success – and perhaps also a weakness – in that it is driven from the top, rather than through institutional structures, which have been created. Relations in SADC are very fragile. Although heads of states do have frequent contact with each other, some leaders have 'unsoothing egos and bombastic personalities' (The Citizen, 29 August, 2000).

Common economic interests and perspectives: Mercosur has a common view regarding the risks and opportunities the global economy poses. SADC members often have opposing views as to how the global economy should be engaged. Most members are attached to two regional bodies with similar and often overlapping aims and targets. Of the 14 SADC members, for example, 10 belong to the COMESA. Nonetheless, SADC countries are aware that they need to engage with the world economy. However, each country is looking out for its own interest, hence the reason why they try different approaches, leading to fragmentation.

Symmetry: Regional asymmetry did not create many problems for Mercosur even though Brazil accounts for 70 per cent of the region's gross domestic product (GDP) and Argentina makes up the bulk of the remainder. Their trade relationship is based on a degree of parity. On the other hand South Africa makes up over three-quarters of SADC's GDP but is unable to secure a relationship with its neighbours such as the one that exists between Buenos Aires and Brasilia. This reinforces the fact that while the relationship between Brazil and Argentina is generally complementary, South Africa has no real complementary partner in southern Africa.

Capacity to manage complex and technical issues: Mercosur has at its disposal a large number of well-trained and skilled technocrats, while SADC has a human resource deficit.

3. The Mercosur linkage with South Africa and SADC

SADC has a total population of 190 million people and a shared GDP of around 170 billion US dollar in 1999. By comparison Mercosur has a population of 230 million people and a GDP of 1.2 trillion US dollar. Both regions display significant opportunities for intra- and interregional trade and investment. However, trade between SADC and Mercosur has been described as 'inconsequential' and investment links as 'negligible'.

Relations between the two regions started in 1996 with a visit by the former SADC Secretary-General, Kaire Mbuende, who called at the Mercosur secretariat in Buenos Aires. The formation of a free trade area (FTA) between Mercosur and SADC was proposed, be it that such an initiative would only be realized after the establishment of an FTA between Mercosur and South Africa. The meeting of the Brazilian Foreign Minister, Luiz Felipe Lampreira, with the South African Minister of Trade and Industry, Alec Erwin, in March 2000 prepared further negotiations on trade cooperation that might lead to the formation of an FTA between Mercosur and South Africa.

The restructuring of South Africa's global economic strategy has resulted in South Africa's FTA negotiations with transatlantic partners being spurred on by four factors:

- the consolidation of South-South relations;
- the need for wider market access for the products in which South Africa has a competitive advantage;
- the need to form strategic partnerships with like minded countries – the 'butterfly' strategy; and
- pursuing common agendas in the multilateral arena.

The process of negotiating an FTA between Mercosur and South Africa is taking place in three phases. Phase One was the signing of a framework agreement for the creation of a FTA between the Southern Cone and South Africa, in Florianôpolis, Brazil, on 15 December, 2000. The signing of this agreement coincided with President Thabo Mbeki's visit to Brazil, to review bilateral relations between South Africa and Brazil and to form a joint binational commission. In so doing Mbeki and his counterpart, President Fernando Cardoso, specifically concentrated on areas of trade, investment, human resource development and health cooperation. The Mbeki delegation included the South African Department of Trade and Industry (DTI) to investigate and study possible sectors of cooperation. The DTI identified the following areas: the automotive sector; agriculture; chemicals and plastics; metals; clothing and textiles; and capital equipment for railways and mining. Phase Two is likely to take place in May 2001, with the visit of a Brazilian/Mercosur delegation to South Africa to identify key areas of cooperation in the proposed FTA. The actual negotiations on an FTA will constitute Phase Three.

The bilateral relations between Brazil and South Africa – the powerhouses and self-declared leaders in their respective regions – serve as a foundation for closer interregional ties between Mercosur and SADC. Brasilia and Pretoria share a number of policy objectives: both encourage South-South cooperation for the enhancement of economic interaction among developing countries at a bilateral, regional and global level. Their main aim is collective self-reliance through economic and technical cooperation, which includes the expansion of trade and more interaction within and between regions in the sectors of finance and industry, science and technology, food and agriculture.

The rationale of this cooperation, therefore, is to encourage mutually beneficial advantages of enlarged markets, economies of scale and the reduction of dependence on countries of the North. This requires the removal of trade barriers.

The reinforcement of relations between Latin America and South Africa is based on Alec Erwin's trade butterfly analogy – the body being Africa and Europe, southern Africa's traditional trading partner, one wing extending to South America in the west and the other to Australasia in the east. Within this paradigm key countries have been identified, that have influence, in their respective regions: Brazil and Argentina in Latin America, Nigeria and Egypt in Africa and India, Malaysia and Australia in Asia and Oceania. Although South Africa regards multilateral institutions as important, its foreign policy dictates that it establish strong bilateral ties with key developing countries. The rationale is that this increases unity and ensures that countries, which carry substantial weight within their respective regions, pursue common goals within multilateral forums.

Moreover, the vision for a strategic partnership between Brazil and South Africa is rooted in the realization that they both share similar internal and external challenges. Internally both countries are grappling with the crisis of poverty stemming from differentiating structural circumstances. South Africa is trying to manage the economy from its apartheid past, while Brazil is confronted by the uneven levels of geographical development. Externally, the two countries are trying to assert the importance of their respective regions in the global economy, while trying to create a common front in global forums for the developing world.

The identification of common challenges brought on by the varying degrees of unity within the developing world, has pushed Brazil and

South Africa closer together, more so since the Seattle Ministerial Meeting of the World Trade Organization (WTO) in November 1999. The increased cooperation between the two countries has resulted in a number of positive agreements and arrangements. Of particular priority is the expressed consensus that multilateral institutions and organizations, like the United Nations Security Council, the International Monetary Fund (IMF), the World Bank and the WTO need to be reformed. This agreement is of particular importance since both countries understand the importance of levelling the global economic playing fields for the global South to participate equitably.

The high level meeting between Brazil and South Africa in Brazil in December 2000 certainly put the two countries on the right footing for dealing with their internal and external obstacles on a consultative basis. Future relations between Mercosur and SADC are expected to develop into tangible benefits for both regions. Although South Africa and Brazil have developed a constructive relationship, South Africa must widen its strategic 'friendship circle' in Latin America, to include countries like Argentina and Chile, since it can gain both directly, through the expansion of trade, and indirectly, through cooperation at the multilateral level.

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8

DEPENDENT AND DISCIPLINARY REGIONALISM

PAUL CAMMACK

1. Introduction

The tenth anniversary of the founding of Mercosur, in March 2001, did not take place in happy circumstances. Argentina was immersed in a political and economic crisis which saw three Ministers of the Economy in the same month, as Ricardo Lopez Murphy took over from the departing José Luis Machinea on 2 March, and made way for Domingo Cavallo just over two weeks later. The return of Cavallo signalled to the international community that Argentina would maintain the convertibility scheme, which kept the peso at parity with the US dollar, and continue its drive to a zero deficit. Brazil, deep in political crisis as corruption scandals threatened President Cardoso's already fragile capacity to manage Congress, meanwhile continued with its contrasting policy of steady devaluation of the real, bringing overwhelming pressure to bear upon its Mercosur partners, and on the projected move to a zero internal tariff by 1 January, 2006. Within weeks Paraguay, registering zero economic growth over the period from 1998 to 2001, would introduce a temporary 10 per cent tariff on goods from its Mercosur partners, and raise the possibility of withdrawing from the association. Uruguay, whose economy had contracted over the last two years, would raise import duties across the board in order to address its trade and fiscal deficits. After Argentina too imposed temporarily increased import duties as part of its emergency programme, Brazil was the only member of Mercosur still applying the 'common' external tariff (CET). These difficulties reflected a fundamental structural imbalance that made Mercosur, effectively a lopsided bilateral arrangement between Argentina and Brazil, weak in global terms and ineffective at a regional level. The domestic projects of economic integration and transformation in the two major partners were at odds on key aspects of economic and financial policy, and the minor partners were caught in the crossfire, seemingly leaving Mercosur no way forward.

However, as Mercosur's progress towards its stated goals of a zero internal tariff and a low CET faltered, other aspects of its subregional role were reinforced. It is of interest to return here to the Latin American 'dependency perspective' developed by current Brazilian president, Fernando Henrique Cardoso, in his earlier incarnation as the region's leading radical sociologist, to suggest that Mercosur today is principally a means to promote 'associated-dependent' development, and in particular to commit its member countries to the disciplines required by global neo-liberalism. In the wake of the institutional crisis prompted by Brazil's sharp devaluation of the real in early 1999, Mercosur has become primarily a local agent for the enforcement of International Monetary Fund (IMF)-World Bank discipline.

2. Dependency and the problem of hegemony

Some 40 years ago, Cardoso identified the problematic nature of dominant class hegemony in Brazil: the industrial bourgeoisie in the country was 'fearful and incapable of breaking its links with traditionally constituted interests, the foreign groups, the great landowners, and the merchants and bankers linked to them', and prevented from leading and consolidating a class project of their own, by fear of losing control of it to new allies in the urban popular forces.

> 'In order to affirm itself as a politically dominant class and to expand economically, the industrial bourgeoisie is forced to support reforms and measures which go against the traditionally dominant groups, but immediately in this very movement of modernization, it sees itself entangled with the only allies with which it can count in the final analysis: the urban popular forces. In order to assure its economic expansion and seek political control at this moment, it risks the loss of hegemony in the future. For this reason after each step forward it turns back against its own interests, retreating a little in the present in order to avoid losing everything in the future' (Cardoso, 1964, pp. 184 and 186).

The starting point of the 'dependency perspective' which Cardoso pioneered with Chilean historian Faletto was the fact of dynamic development, notably in Brazil, as a result of the rapid 'internationalization of capital' after the Second World War, and its principal concern was with the international and internal class politics of capitalist development in the periphery. It addressed the potential for the creation of class alliances, which might underpin stable capitalist development in the future. Before the coup of 1964 Cardoso had dismissed the possibility that the Brazilian bourgeoisie could lead a progressive developmental alliance. With the military regime at its height, he concluded that the 'bureaucratic-authoritarian' state too was incapable of constructing a genuinely hegemonic project to sustain capitalist development:

> 'it is true that the regime has been able to generate effective policies and to keep order. It has not, however, solved its fundamental problems, particularly those of a distinctly political nature. It has not devised means to broaden and firmly establish its legitimacy in the society at large' (Cardoso, 1973, p. 171).

On the other hand, he argued that a reformulated alliance between the state, domestic capital and foreign capital might be able to incorporate elements of the working class, and promote growth in a context of political democracy. His project for 'social-democratic associated-dependent development' grew out of these assumptions. It intended to exploit a limited space for democratic politics within the confines of a project in which domestic and foreign capital would be the principal partners of the state. The project retained the principal argument of the 'dependency perspective': that dependent states in the global system were obliged to follow a developmental path subordinate to and in association with the dominant states and foreign industrial and financial capital.

As progressive intellectuals with a positive outlook on life are inclined to do, Cardoso seriously overestimated the space for social democratic politics in Brazil[1]. And he left unresolved his own question regarding hegemony: how could a class alliance based upon domestic and foreign capital and willing to observe the limits of 'associated-dependent development' secure sufficient acquiescence from the majority of the population, and in particular the working class, to manage and control the process of capitalist development in its own interest? My argument is that Cardoso the president has found an answer that relies more upon discipline than upon the distribution of benefits, and that Mercosur is a key part of it.

Mercosur is a means of promoting and consolidating 'associated-dependent development', and of securing capitalist hegemony at a domestic level. Its significance is as much disciplinary as developmental – it 'locks in' the disciplines of market-oriented or neo-liberal development (Cammack, 1999, pp. 95-115). This intention was there from the start, but has become central since the crisis sparked off by Brazil's 1999 devaluation. There was a significant convergence in that year between the orientation of the association and the global disciplinary framework put in place from the early 1990s by the IMF and the World Bank, and encapsulated in the Comprehensive Development Framework announced by World Bank President, James D. Wolfensohn, in February 1999 (Wolfensohn, 1999). Adherence to the Comprehensive Development Framework – in fact a Comprehensive Dependency Framework – has given Mercosur a new role as a subregional agent of the Joint IMF-World Bank Development Committee.

3. Mercosur: a vehicle for associated-dependent development

Mercosur was always more than a subregional association aimed at removing internal barriers to trade and promoting a steadily diminishing CET. The goals of internal integration and external opening were part of larger projects of political, social and economic transformation aimed at establishing or consolidating democracy, and fixing in place the social and institutional disciplines associated with neo-liberalism (Payne, 1996, pp. 93-129). The signatories to the Treaty of Asunción in March 1991 declared that in view of 'the evolution of international developments, especially the consolidation of large economic spaces and the importance of achieving an appropriate insertion into the international economy for their countries', they considered 'expansion of the current dimensions of their national markets, through integration' an 'essential condition for accelerating their processes of economic development with social justice'. They proposed to achieve this objective 'by means of the most efficient exploitation of available resources, the preservation of the environment, the improvement of physical connections, the coordination of macroeconomic policies and the increased complementarity of the different sectors of the economy, based on the principles of gradualism, flexibility and balance', and they declared themselves 'convinced of the need to promote the scientific and technological development of the subscribing states and to modernize their economies in order to expand the supply and the quality of the goods and services available in order to improve the conditions of life for their inhabitants' (Treaty for the Constitution of a Common Market, 26 March 1991, author's translation).

The programme recalled the 1990 World Development Report on poverty, which had asked developing countries to 'invest in people', improve the climate for enterprise, open their economies to trade and investment, and 'get macroeconomic policy right'. The Bank, too, called for 'common action to preserve the world's environment', the theme of the 1992 Report, and new investment in physical infrastructure, the theme of the 1994 Report. It urged developing countries to 'spend more, and more efficiently, on primary education, basic health care, nutrition and family planning', to intervene less in industrial and agricultural pricing, deregulate restrictions to entry and exit, and focus instead on ensuring adequate infrastructure and institutions, to remove non-tariff restrictions on trade and investments, reduce tariffs, and move away from discretionary forms of trade control, and to introduce market-based incentives for savings and investment to release domestic resources to finance development. The creation of Mercosur sent the message that this group of Latin American states was committed to liberal economic development, political democracy, and the rule of law. And it tied its member states, through formal international commitments, to a long-term process of economic opening to the rest of the world.

Viewed narrowly, the Mercosur project is precarious, and its progress has been limited. Movement towards internal and external tariff reform has been slow and uneven, and the imbalances between the partners have hindered the emergence of common positions on issues of subregional interest. But a broader perspective is needed on the projects of integration and transformation, which Mercosur supports. With the creation of the World Trade Organization (WTO) and the development of a strategic partnership between the World Bank and the IMF, the framework for the global enforcement of projects of neo-liberal transformation is much stronger. Over the last decade the World Bank and IMF have constructed the mechanisms to impose their preferred policy options around the developing world. One consequence is that the integrationist project represented by Mercosur has been largely overtaken – the tightening grip of the Bretton Woods institutions on domestic social and economic policy in all four member states means that the broader role of Mercosur risks becoming redundant. Its commitment to the creation of an internal market and to lower levels of protection has become subsidiary to the constant pressure exerted by the international economic institutions, and to IMF surveillance of all aspects of policy. In mid-2001, all four core-member countries were firmly in the hands of the IMF, which was promoting policies of financial, social security, and labour market reform across the region (IMF, March 2001, June 2001, and 3 May, 2001). Mercosur has responded by re-inventing itself as local agent of the IMF and World Bank, internalizing within the region the crucial role of surveillance, and enforcement of orthodox policy.

4. Mercosur as an agent of discipline

The goals of the 'new Bretton Woods' institutions are ambitious. The WTO seeks to create a comprehensive global free trade regime across goods and services, the IMF aspires to construct a global 'financial architecture' that will guarantee orthodoxy, and the World Bank – the most ambitious of all – proposes to abolish poverty. The centrepiece of the new global architecture of governance, the Comprehensive Development Framework (CDF), was launched by the World Bank in 1999. According to its President Wolfensohn, the IMF would have 'the responsibility for macroeconomic stabilization for our client countries and for surveillance', while the World Bank would have 'the responsibility for the structural and social aspects of development' (Wolfensohn, 1999, p. 3).

It was supplemented by a range of new disciplinary institutions such as the Financial Stability Forum and the Global Corporate Governance Forum, and by new mechanisms designed to control policies down to the smallest detail such as Sectoral Strategy Papers, the City Development Strategy, and a revised framework for Economic and Sectoral Work (ESW). The principal instruments of the CDF were the 'Matrix', a management tool which allowed the Bank to track the adoption and implementation of policy in real time, and the 'Poverty Reduction Strategy Paper' (PRSP), a 'tripartite document endorsed by the government, the Bank and the Fund' (IMF-World Bank, 1999, p. 30, para 74). This was intended to tie social and structural policies directly to IMF-approved macroeconomic frameworks and it was to be 'owned' by the government, but on the basis of content agreed and where necessary provided by the Bank and the Fund. Moreover, it was to be monitored and updated annually, and reworked completely at three-year intervals. PRSPs were to be the basis for agreed Country Assistance Strategies (CASs) presented by the International Development Association (IDA) to the Boards of the IMF and the

World Bank, and in April 2001 it was announced that the whole CAS-CDF-PSRP framework was to be extended beyond the small group of low-income countries covered by the Highly Indebted Poor Countries (HIPC) initiative to the much larger group of World-Bank-classified middle-income countries – such as Argentina and Brazil. These countries would present a 'Letter of Development Strategy', and their Country Assistance Strategies would identify a programme of ESW, so that the Bank could be sure that proposed reform programmes reflected an appropriate public expenditures management capacity.

The framework was intended to allow strengthened collaboration with the IMF, and a clear division of labour between the World Bank, the IMF, and the regional development banks (IMF-World Bank, 10 April, 2001). The CDF, initially created for the poorest of the clients of the IMF and the World Bank, was quickly extended to the full range of low and middle-income countries, with CASs playing a key role in its implementation. Central to it was the desire to arrive at a situation where international institutions had access in real time to reliable comparative data on country performance, and were able to satisfy themselves that appropriate fiscal and economic policies were being pursued.

Against this background, it is possible to identify the common programme pursued through Mercosur by Argentina and Brazil in recent years, despite the differences that brought the association to a point of crisis in the first half of 1999. Since then the two leading partners have cooperated on a 'relaunch' of the association, which took shape between late 1999 and mid-2000. The key theme of the relaunch, dubbed the 'little Maastricht', was macroeconomic coordination – with a common currency a distant goal -, but immediate attention focused on common standards for fiscal responsibility, the harmonization of national statistics, the obligation to report on progress towards economic stability, and a range of measures to improve and enforce competition policy. Banega, *et al.*, (2001, pp. 234-249) note that

'[i]t was stated [at the Mercosur Summit of December 1999] that a set of common economic targets, such as those in Maastricht, would emerge naturally from this mini-Maastricht, which in turn would help each country to push through domestic reforms'[2].

The relaunch of Mercosur reflected the adoption and internalization by the association of the global goals championed by the IMF and the World Bank, and its conversion into a disciplinary agent at a subregional level. First, it was a response to the desire of the World Bank to see competition policy given greater prominence, and dissatisfaction at the limited degree of progress in the area (Rowat, *et al.*, 1997). Second, it signalled the commitment of Argentina and Brazil to public release of key statistics to IMF-defined international standards, reflected in their entry in 2001 to the IMF's Special Data Dissemination Standard (SDDS) launched in 1996. Third, it proposed to strengthen Mercosur's procedures and institutions precisely in relation to the disciplines of global neo-liberalism, rather than in accordance with a separate regional agenda. The commitment made to macroeconomic coordination was not to a general framework for coordination of an open but unspecified kind, but coordination in the specific sense of a common commitment to place formal limits on public spending. Fourth, and most significantly in terms of placing the relaunch of Mercosur in relation to the much greater disciplinary framework imposed directly by the IMF and the World Bank, it represented, for both Argentina and Brazil, a complement to the negotiation of CASs and new loans from the IMF and the World Bank.

The CASs agreed by the World Bank with Argentina and Brazil in 2000 show just how Mercosur fits within a broader neo-liberal disciplinary framework. The CAS prepared for Argentina in May 2000 reports as follows on the programme adopted by the De La Rua government:

> 'The Administration of President de la Rua, which took office in December 1999, is firmly committed to improving fiscal and social performance within the framework of the Convertibility Plan. . This is an ambitious agenda and the first steps have focused on the fiscal front. Faced with a prolonged recession, high unemployment and high levels of poverty, plus a fiscal deficit of more than two percent in 1999, the new administration has moved quickly to cut expenditures, raise taxes, and negotiate a new IMF program. It reached an agreement with the provinces on stabilizing provincial transfers for the next two years. All of these measures served to restore confidence and resulted in a sharp reduction in country risk as compared to mid-1999. It has been quick to reaffirm the importance of Mercosur. Importantly, the Government has proposed a major piece of legislation on labor reform.. On (sic) the long run, it means integrating economic management and making Mercosur an effective tool to enhance growth and to be competitive in global markets' (World Bank, 8 September 2000, pp. 24-25, paras 67-68 and 72).

Within this context, the World Bank affirmed its continuing commitment to a three-point programme of enhancing social development, including poverty alleviation and human resource development, improving the public sector's performance and institutional capacity, particularly at subnational levels, and consolidating structural reforms, including public finance, labour markets, and the financial sector (World Bank, 8 September 2000, p. 34). As this summary and the extended discussion in the text revealed, key priorities were the extension of fiscal discipline to the provinces, and reform of labour markets to induce greater flexibility. These remained central to the Letter of Intent agreed with the IMF a year later. Parallel developments in Brazil are reported in the May 2001 progress report on the Country Assistance Strategy published a year earlier. The Bank highlights the Lei da Responsabilidade Fiscal, passed in March 2000, with its commitment to establish and attain fiscal targets, place ceilings on expenditures, prohibit intergovernmental lending, and oblige the government to disclose and disseminate fiscal laws, accounts and reports (World Bank, 1 May 2001, p. 2, para 6). As in the case of Argentina, the Bank endorses tax, regulatory and financial reforms, and places particular stress on the need to bring states (the Brazilian equivalent of Argentina's provinces) into the disciplinary framework in place at federal level. It states that 'increasingly, economic reports are prepared as joint tasks with Government agencies and/or policy institutes', and lists eight structural fiscal reforms which will enhance public sector management along approved lines (World Bank, 1 May 2001, p. 21, para 46, and p. 24, Table 3). Again, the subsequent Letter of Intent to the IMF confirmed the priority accorded to these policies.

What is described above is not the imposition of neo-liberal policies by the IMF and the World Bank upon helpless governments, but a long-running strategic alliance between the IMF and the World Bank on the one hand, and governments committed to neo-liberalism but lacking domestic authority and hegemony on the other. The establishment of capitalist hegemony is as much about eliminating the space for alternatives as it is about winning positive and enthusiastic allegiance from the proletariat and the poor. In its 'new and improved' form, associated-dependent development in the 21st century reflects an alliance between states and international institutions, aimed at creating the conditions for capitalist reproduction and accumulation in national economic spaces open to competition on a global scale. The relaunch of Mercosur prescribes for it a subsidiary but still significant role in the process, as a subregional disciplinary institution and a local agent of the institutions which police the global capitalist system.

Notes.

[1] For a fuller critique of the origins, nature and limits of the project, see Cammack, 1997, pp. 223-243.

[2] Phillips too notes that 'the process is seen to have particular utility as a strategy of domestic (and subregional) political management', but talks of a heterodox process of 'autonomous economic development' (Phillips, 2001, p. 580). This is wishful thinking. Banega *et al.* are more realistic: 'The Latin American regionalist schemes seem to be a preparation for [the Enterprise for the Americas Initiative], a continental opting out of the Third World, a move from an intermediate to a core position in the world order of regions' (Banega, *et al.*, 2001, p. 249).

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9

THE ROLE OF CIVIL SOCIETY

Marianne Wiesebron

1. Introduction

When considering civil society and integration, a couple of elements should be taken into consideration. Civil society is not homogeneous and consists of many different groups with different objectives and roles at various levels within society. The economic elite is, of course, in a comfortable position, with an enormous influence, while poor women working for a better position are quite a different proposition. While integration can only become a sustainable process if civil society is involved, civil society will never be involved as a whole, and in each process of integration there are losers and winners. The closer a group is to a centre of power, or part of the centre of power, the more likely it is that this group belongs to the winners, and will belong to those wanting to stimulate integration, as in their eyes, such a process will have a positive effect. On the other hand, the further away a group is to the centre of power, the more likely, the same process might have a negative impact, if it is not offset by some actions of their government. Government actions may, however, be limited by dictates of the International Monetary Fund (IMF) or the World Bank, as is the case of Mercosur countries, or of Mexico in the North American Free Trade Agreement (NAFTA). Moreover, civil society is involved in different ways in processes of integration because, as these processes are first and foremost economic, the groups directly affected by economic development, such as industries and companies, will be more involved in such processes than groups that are more distant. Another group that might be closely involved is trade unions. Non-governmental organizations (NGOs) may not be directly concerned, although they might be affected by the results of integration. Furthermore, in most processes of integration, and Mercosur is no different, civil society is only marginally considered during negotiations and, again, afterwards when the process starts to work. This is reinforced by the democratic deficit that exists in these processes. This is still true for the European Union (EU), although a number of control mechanisms have been introduced over the years. It is also valid for NAFTA where complaints, brought to trial within the agreement, are dealt with behind closed doors. In Mercosur specifically, there is a democratic deficit to overcome.

An analysis of the Treaty of Asunción and of the Protocol of Ouro Preto shows that both devote little attention to society as such. In the organizational structure of Mercosur, civil society has been given scant space, even if in some speeches officials have promised otherwise.

This chapter proposes first to have a look at how society has been considered in these treaties, the role civil society is allowed to play in its official structure. Afterwards, some aspects of civil society within Mercosur will be analysed, in particular the roles of the associations of employers, the trade unions, Mercocidades, universities, and the special role of women, and their position as winner or loser will be assessed. This list is, of course, far from exhaustive, as there are many NGOs and other associations participating in this process, with more or less success, depending on how close they are to the centre of power, and consequently, how much influence they can wield.

2. Civil society in Treaty and Protocol

The eighth and last paragraph of the preamble of the 1991 Asunción Treaty states: '*…deixar estabelecidas as bases para uma união cada vez mais estreita entre seus povos*'. The Treaty is very short, with a preamble and 24 articles. The Treaty, with the exception of two more phrases in its preamble which show some concern with people, is focused entirely on economic aspects. In the second paragraph of the preamble, it is stated: '*…acelerar seus processos de desenvolvimento econômico com justiça social*'. In the seventh paragraph, an economic imperative should help improve the quality of life of the inhabitants of Mercosur '*de modernizar suas economias para ampliar a oferta e a qualidade dos bens de serviço disponíveis, a fim de melhorar a condições de vida de seus habitantes*'. None of these phrases are clearly defined, nor are any criteria or time frame established. What does social justice mean? Moreover, in no other part of the Treaty it is made clear how these objectives will be achieved and who will be instrumental in furthering these goals. (Mercosul, 1996, pp.5-26) It is presumed that welfare will increase if the economy is doing better, even though this assumption has been proven incorrect time and again. Is some action therefore required and by whom, and when?

At the end of the Treaty, in Annex V, there is a declaration that sub-working groups will be established on specific topics, to help coordinate macroeconomic and sector policies for the Grupo Mercado Comun, the Common Market Group (CMG), which runs the day-to-day business. In first instance, ten subgroups figured on the list, dealing with areas such as communication, trade, transport, industry, taxes, energy, agriculture, environment and the like. In December of that same year, as a result of the great insistence of the respective Ministers of Labour, who, in turn, had been approached by trade unions, an 11th subgroup was added: on labour matters, which was transformed the next year into labour relations, employment, and social security. In the Internal Regulation of the CMG, it is foreseen that the private sector will have a role in the preparatory phase of the subgroups. Three persons for each member-state from the relevant sectors are allowed to participate in this phase. Once the subgroups reach the phase of decision making, only official representatives of each state are allowed to continue in the subgroups (Mercosul, 1996, pp.155-156). In the case of subgroup 11, which has since become number 10 since, its constitution has been tripartite from the start: government representatives, employers and trade unions delegates. This way, different non-governmental sectors are represented in these negotiations. The topics discussed are technical and eight committees work on certain themes such as employment, social security and labour relations. Very recently, a new subgroup number 11 has been established on health. These committees have to study the specific legislation of the member countries and identify the asymmetries and having done so, suggest proposals to the CMG. So far, however, not many concrete results seem to have been achieved.

In the 1994 Ouro Preto Protocol, the whole structure of Mercosur is defined: i.e., its different institutions, the members of these institutions, what their attributions are and how the different institutions operate. One of these is of special interest, namely, the Economic-Social Consultative Forum (ESCF), as Article 28 of the Protocol determines:

'*[o] Foro Consultativo Econômico-Social é o orgão de representação dos setores econômicos e sociais e será integrado por igual número de representantes de cada Estado-Parte*' (Mercosul, 1996, p. 173).

The drawback is first that this institution is purely consultative and can only present recommendations. Second, the economic and social groups represented here are, first and foremost, employers, trade unions and consumer organizations. It seems that, more recently, some other institutions have also been allowed a say in this forum, such as those which deal with social security and academics. On the other hand, it is understandable that institutions linked, one way or another, to an economic aspects life, are those favoured here, as the purpose of the Asuncion Treaty is principally economic.

3. A historical perspective

This brings us to the importance of the participation of citizens, of civil society at a national level and in the process of integration. Citizens should be convinced of the positive effect of integration. In Latin America, in general, and in Mercosur, in particular, there were not many contacts between the different countries. Most people did not take much interest in one another, and would feel more affinity with Europe for obvious historical reasons as well as for cultural reasons. The USA, with whom many Latin Americans have a love-hate relationship, might also feel closer, amongst other reasons, as a result of the influence of the American entertainment industry and the media, in more general terms. At an intellectual and cultural level, contacts between the countries of the Southern Cone stretch back mostly to the 1970s, when there was a joint solidarity against the different military dictatorships which also worked together in their pursuit of alleged 'subversive' elements. Another element, which had a great effect, was the irruption on the Latin American and European scene of the *música popular brasileira*, Brazilian popular music. It was also the period of the *cinema novo*, with Brazilian movies receiving awards at a number of important film festivals. With such a florescence Argentineans suddenly discovered their neighbour.

From discovery to cooperation, there is some way to go. At the academic level, a positive factor was, beyond doubt, the ALFA programme on Latin America academic formation, launched by the European Commission, specifically by the Directorate General 1 for international relations, not that of exchange programmes. ALFA has intended to stimulate closer cooperation between universities of the EU and Latin America, and to promote cooperation among Latin American universities. Launching an ALFA programme required the establishment of networks between institutions of higher education in several countries in both continents. Projects of integration were among the priority topics and Mercosur was a recurring theme in very different contexts. Many a network that was established in the mid-1990s, when ALFA was started, is still active today. As ALFA has just launched its second programme, these networks may expand in the future.

Maybe as a result of ALFA, or as a consequence of the growing rapprochement between academics from these countries, activities in many areas have developed between universities and institutes of higher education in Mercosur over the last few years.

Moreover, cultural studies on Mercosur relations, which did exist on a modest scale, have started to multiply. More is happening at the cultural level, such as the first art Biennial in Porto Alegre in 1997. It is no coincidence that such an event takes place in the capital of Rio Grande do Sul, at the frontier with Uruguay and Argentina. Besides, in the context of Mercocidades, culture has been allocated, amongst other cities, to Porto Alegre.

4. Mercocidades

Mercocidades is an endeavour by municipal governments to help foster integration and needs to be mentioned here for several reasons. This initiative started in 1995 and the growing numbers of participants and activities are all directed towards improving the situation at the local level. According to data on early 2001, 79 towns were already full member, and others had applied for membership. The cities involved were not only from the four full member states, but also from Chile and Bolivia. Interestingly, and probably not merely by coincidence, in quite a number of the municipalities which have joined, a system of participative democracy, in which civil society is accorded a clear and direct role, has been introduced. This started in Porto Alegre in 1989 and has since been introduced in other cities, metropoles such as Belém and Belo Horizonte, and also in many smaller towns. The capitals of the different countries and the major cities, such as São Paulo and Rio de Janeiro are all full members. Among the major issues these towns are dealing with are citizen participation and democracy, and social development. Other topics on the agenda of Mercocidades are culture, education, the environment, and issues pertinent to urban and local economic development. Schemes of cooperation between these cities involve the agreement to limit policy competition to attract investment and industry, of major concern to employers and workers, who are directly affected by the economic consequences of integration. Olívio Dutra, who was instrumental in starting the participative budget in Porto Alegre in 1989 and is now governor of Rio Grande do Sul, has started an initiative at the state level. The governor of Buenos Aires responded positively and the first meeting was held in 2001.

5. Employers

There are widely different categories of employers and their support for Mercosur depends on a number of factors. Those belonging to the economic elite are sure to protect their interests as they are in direct contact with the highest levels of government. In fact, decisions are taken in common accord. They mostly get what they want, although there can be conflicts of interests between the different captains of industry. Transnational corporations are also in the position to set the rules of the game. They represent major investments, which most governments want to attract by offering facilities. This is where Mercocidades try to play a role. Whatever the future holds, undoubtedly these two groups have done very well with the creation of Mercosur. Increasing the size of the market has shown to be quite an attractive proposition to them.

In this context, what also should be taken into account is the virtually simultaneous opening of markets, the privatization of state enterprises and the reduction of the role of the state. The flexibilization of the work force, the privatization of social security in the areas of health and pensions, are all tendencies which can do less damage to employers at the top.

For micro-, small- and medium-sized enterprises – a large group creating most of the jobs – the parameters were not automatically so favourable and the reactions have been quite varied. It depends, for instance, on the sector affected by the integration and on its level of development and the place of the enterprise in the sector. One way of overcoming some of these problems is the creation of specific organizations at the level of Mercosur per branch of industry. This is already happening in some areas such as industry and agriculture, and specifically for small- and medium-sized enterprises. An International

Chamber of Commerce for the Southern Cone has been established. Cogently, businesses are also trying to foster cooperation in Mercosur, which can cover anything from candle factories to services. There have been other initiatives as well such as the Brazilian undertaking to create a forum for business leaders, dating from 1998.

6. Trade unions

The Coordinadora de Centrais Sindicais do Cono Sul (CCSCS) was established in 1986. Chile and Bolivia are also members. A large number of trade unions participate in this association. In Mercosur, 90 per cent of the unionized workers are affiliated to the CCSCS through their trade unions. If Chile and Bolivia are also included, the share is 85 per cent. Those outside the CCSCS, have created an alternative organization, the Conselho dos Sindicatos do Cono Sul, which is much less representative. But the Treaty of Asunción put a different perspective on its activities and on trade unions generally. In the beginning, trade unions had a negative attitude to the process of integration, and were afraid of the negative impact close cooperation between the member states would engender for the work force in these countries, social dumping being just one instance. This was counteracted by the fact that workers were confronted by the negative impact of the neo-liberal policies, which were introduced at almost the same time, if not earlier, as the Mercosur Treaty was being implemented. Most probably, therefore, later on, trade unions decided to take a more positive position and to discuss problems such as unemployment, legal protection of workers, and other relevant issues together. One issue which really need to be addressed is the circulation of workers, not mentioned at all in the Treaty. Trade unions need to play a prominent role here, even though they represent, primarily, their members, not the workers in the informal sector, rural workers and the unemployed.

7. Women

Women form a very heterogeneous group, economically and socially, and can be part of or close to the centres of power, or far away. Hence, women are also affected in very different ways, and can be winners or losers. Nonetheless, special attention must still be paid to the position of women, as women continue to occupy the most vulnerable position in societies: the large majority of the poor are women, women are still less well educated, have less access to loans, are less well organized in the work force, and are therefore easier to dismiss. They earn lower salaries and have less chance of promotion. In general, they hold more informal jobs, and are thus excluded from the social security system. Pertinently, in Mercosur a substantial number of households are female-headed, making these women more vulnerable in the workplace. On the other hand, women in Mercosur have achieved satisfactory progress in many areas: getting higher degrees in education, increasing their participation in the labour force and improving the quality of their jobs, and, more igenerally, becoming more important actors in all aspects of life: political, economic and social. Even so, this should not induce complacency and they still warrant special attention.

Organizations involved in questions of gender have started meeting on a regular basis to debate a number of topics, such as making comparative studies on the relevant legislation. Seminars on *Mujer y Mercosur* are being organized. There are other meetings organized by different groups interested in specific aspects concerning the position of women within Mercosur. Another sign of growing awareness is that the recommendations from the International Women's Conference in Beijing and its follow up Beijing+5 have been studied in the Mercosur context, especially in order to develop strategies on how to further social inclusion with a special focus on women. One topic considered of special relevance is finding an institutional way to implement equal opportunities.

Organizations that are especially preoccupied with the position of women are more interested in an agreement with the EU than in the formation of a Free Trade Area of the Americas (FTAA), because of the more democratic nature of the former. In the EU, harmonization of legislation has had a positive effect on the position of women, and women in Mercosur aspire to learn from this experience and if possible follow this example. This is in sharp contrast to the aspect of labour in the NAFTA Treaty, which does not bode well for the FTAA.

8. Conclusion

First, at the institutional level of Mercosur, not much has happened so far, although some progress has been made and some marginal influences are creeping in. It should be added that the institutional debate is developing slowly and most subgroups are advancing only little. Nevertheless, the number of subgroups is increasing, up to 14 now and not dedicated exclusively to matters related to trade or economic topics. Quite recently, a number of committees have also been established: one on women, another on science and technology, for instance. At the 13th Mercosur Summit Meeting in June 2000, a Social Charter was signed by the four member states as well as by Chile and Bolivia. All in all, institutional integration is increasing, albeit at a snail pace. This can partly be considered the result of actions by civil society, such as trade unions, women and others.

Secondly, what is impressive when one looks at the role of civil society in Mercosur is the enormous number of initiatives that have been developed over a short period of time, and by so many different organizations, at all levels and with different objectives and perspectives. It is all the more impressive, as the contacts between the populations of these countries were rather sparse until very recently, and existed only in very limited areas, as they were acting as if they scarcely paid any heed to each other. A number of these initiatives are limited to the four member states, others also involve the two associated members, and some even more countries. Clearly, civil society is active in the countries of Mercosur and the associated countries, and has had a positive effect on integration.

Thirdly, it is important that governments and elites look more closely at civil society, improve the social conditions in the societies involved in the processes of integration, especially those that do no benefit directly from integration. Otherwise, civil society will make itself heard in other ways. This has become quite clear since the end of 1999, at several multilateral meetings: in Seattle, Prague, Nice, Buenos Aires and Quebec. Although the media depict those voicing their opposition simply as anti-capitalist or anti-globalization, in reality those involved belong to many different groups, with as many objectives. In January 2000, the First World Social Forum, organized in Porto Alegre, a counterweight to the 33rd Economic Forum at Davos, also voiced a number of preoccupations about civil society. Although these movements and programmes are not limited to Mercosur, quite a number of Mercosur citizens have voiced their concerns at these meetings and have joined forces to increase their strength and the potential of their demands. Civil society in Mercosur is becoming a force to be reckoned with. However, governments should pay special attention to those who risk being excluded from these processes. The social and democratic deficit in Mercosur must be resolved if there is to be real social justice.

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