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# THE FUTURE OF MERCOSUR

COMMITTEE FOR THE STUDY  
OF LATIN AMERICAN AFFAIRS

Félix Peña / Martín Piñeiro / Pablo Bertin  
Carolina Zaccato / José María Arbilla

CARI /

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Committee for the Study of Latin American Affairs

## **Authors**

Félix Peña / Martín Piñeiro / Pablo Bertin / Carolina Zaccato /  
José María Arbilla

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CARI Consejo Argentino para las Relaciones Internacionales  
Uruguay 1037, piso 1º, C1016ACA Buenos Aires,  
República Argentina  
Teléfono: (+5411) 4811-0071 al 74 / Fax: (+5411) 4815-4742  
Correo electrónico: [cari@cari.org.ar](mailto:cari@cari.org.ar) / Sitio web:  
[www.cari.org.ar](http://www.cari.org.ar)

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# Prologue

The following working paper brings together the contributions of different members of the Committee for the Study of Latin American Affairs of the Argentine Council of International Relations (CARI) with the objective of reflecting on the present and the future of the Southern Common Market (Mercosur).

Thirty years after the signing of the Treaty of Asunción in 1991, with the current discussion on the common external tariff, the external agenda of the bloc, and the debate on the possibility that individual member countries could initiate and conclude trade negotiations with third countries, it is necessary to discuss the future of Mercosur with a global perspective, integrating economic analysis with political and institutional analyses.

Thus, we have attempted to gather diverse perspectives, aimed at addressing the current challenges of the bloc and focused on presenting recommendations for its treatment. Félix Peña begins by pointing out the need to introduce improvements on three levels: the conciliation of national interests, the full use of sectoral agreements, a tool provided for in the Treaty of Asunción and, finally, the incorporation of new issues for joint work, including climate change, digital trade, and artificial intelligence. According to Peña, these should be addressed with an active strategy of trade negotiations with both developed and developing countries.

Next, Martín Piñeiro suggests that a long-term solution to Mercosur's difficulties requires the adoption of a development strategy that includes a clear definition of the bloc's role as a central tool for international inclusion and that benefits from the competitive advantages of agribusiness. At the same time, he warns of the high concentrations of exports in this sector in a few markets, mainly Asia.

Pablo Bertin focuses on Mercosur's trade patterns, both among member countries and with its trading partners, and the bloc's tariff structure, from its creation to the present. Based on this analysis, he presents a few reflections to understand the challenges the bloc faces with respect to its trade policy and economic integration.

Carolina Zaccato assesses achievements and pending debts, not only in economic and trade matters but also in political, social, and identity issues. She addresses in depth the discussion on the flexibility of the bloc, the possibility of its integration at different speeds, and the process of symbolic-discursive re-definition that the transition from a customs union to a common market would entail. In conclusion, she presents recommendations for public policies –both regional and national– that would allow for coordination of the transition towards a more dynamic Mercosur while at the same time preserving its regionalist identity and essence.

Finally, José María Arbilla points out that the bloc faces problems of implementation of an agenda with crossed interests, a growing divergence of interests among the members, and a lack of coordination between the internal and external agenda. The author highlights the loss of a common economic development model and focuses on two alternatives: the consolidation of a true customs union or a redefinition of the bloc towards a free trade zone.

With the aim of contributing to the academic and political debate on the future of Mercosur, CARI's Committee for the Study of Latin American Affairs presents this paper, prepared in commemoration of the signing of the Treaty of Asunción and the 30 years of collaboration with our partners from Brazil, Paraguay, and Uruguay.

Buenos Aires, April 2022.

*Carola Ramón, Director of the Committee for the Study of Latin American Affairs*  
*Facundo Gonzalez Sembla and Martina Guarnaschelli, Coordinators*

# A few suggestions for a reflection on the future development of Mercosur

Félix Peña

## I. An overview on experience gained

Thirty years after its creation, Mercosur needs to adapt some of its tools and working methods to new global realities and those of its member countries, in line with its founding objectives.

At times, Mercosur's credibility is affected by the positions of its member countries on issues relevant to its functioning, such as the effectiveness of its common external tariff, and the possibility that individual member countries may conclude bilateral preferential agreements with third countries. Depending on how it is conceived, it is a possibility that could require substantial modifications to the Treaty of Asunción, especially in central concepts of the founding pact, such as "common external tariff", "customs union" and "common market".

Mercosur is built around two complementary ideas. One is the creation of a regional space that, due to its exclusivity resulting from the "customs union" formula used, facilitates joint work when negotiating trade preferences with other countries. The other is a participation in the international trade system that encourages productive investment and economic and social development in its member countries.

In at least three areas, improvements could be made to Mercosur's objectives and functioning. One is in the methods of coordination of national interests for the adoption of effective and efficient joint decisions. Another is to make full use of the sectoral agreements tool provided for in the Treaty of Asunción and in Decision no. 3, adopted in 1991 by the Council of Ministers. The third is the incorporation of new joint work issues, among others, those related to climate change, digital trade, and artificial intelligence.

These are plans that must be addressed with an active strategy of simultaneous trade negotiations with both developed and developing countries. This should include the negotiation of trade and investment agreements with the world's main markets (China and the USA), which should be added to the completed agreement with the EU. Perhaps the moment has arrived for Mercosur to concretize the objective of developing the negotiation of preferential trade or free trade agreements with each of the three major players in world trade, without predisposition to doing so with other countries that have large markets, such as Japan, Great Britain, India, Canada, South Korea, Australia, and Russia, among others.

Market expansions resulting from taking advantage of ALADI's (The Latin American Integration Association) underutilized potential, as well as those that should result from preferential or free trade agreements to be promoted and concluded with the ASEAN countries and the African Union, among others, should be added to these plans.

It should be reiterated that when the Treaty of Asunción, which created Mercosur, was signed, it explicitly opted for a customs union with a common external tariff and joint negotiations with third countries, and not for a free trade zone. Articles 1 and 5 of the Treaty contain the main elements of the scope of the pact signed. And the central idea of the pact is reflected in Article 2, which establishes reciprocity of rights and obligations among the member countries as the main commitment.

To facilitate a rational debate among the partners and to have a broad and diverse citizen participation, some of the following elements should be considered in order to understand the necessary dialogue on Mercosur and its future:

Although the Treaty of Asunción includes a system of reciprocal trade preferences as a central element, it has other political and economic dimensions that are as profound as trade preferences. They penetrate deep into the history of relations between a group of countries, often marked more by tendencies towards conflict than cooperation. And above all, the system implied affirmation of the idea of working together to promote an intelligent, effective, and efficient international integration of each of the Mercosur member countries.



1. More than thirty years after the signing of the Treaty of Asunción, the elements that make up the essential aspects of Mercosur are still valid. In other words, the reason for working together. The commitment of contiguous nations that share their belonging to a region of strong potential and rich diversities to work together to enhance their economic and social development, strengthen their political systems, and achieve a competitive position in the international system, which effectively serves their interests and possibilities, is preserved.

2. The most notable differences can be observed with respect to the methodological dimension, i.e., how to work together. Incidentally, these are usually natural differences in any voluntary integration process between sovereign nations that do not intend to cease to be sovereign. On the contrary, the objective is to share the exercise of their respective sovereignty without losing their individuality as nations.

3. When common institutions and rules are created, they require collective disciplines that allow for the construction of valued integration.

4. This approach may take time, even more than imagined. Hence, it may be necessary to adapt the steps of approximation to the agreed objectives. And the path to the goals pursued may require frequent adaptations.

5. Problems do not stem from the need for continuous adaptation of an integration process between nations and the narrative of the changing realities in the participating countries and in the regional and global environment in which they are inserted. On the contrary, the real problems usually result from the deficiencies of the methods used to eventually reorient the path traced or to revise it when necessary due to the weight of realities.

6. Such problems often reveal shortcomings in the methods used to reach joint decisions or to ensure their implementation. Or they may reflect shortcomings in the development of national positions with respect to the challenges arising from changing realities. They may also result, among other factors, from shortcomings in the analysis of

such realities, which may come from governmental actors or from the business sector itself, or from the multiple and diverse social sectors.

7. Methodological deficiencies can be solved with modifications to the agreed common rules and disciplines, including those in the constitutive articles.

8. If a country perceives difficulties in introducing modifications in the methodological dimension and considers that this may affect its national interests, it always has the existential option of withdrawing from the integration process.

9. In the perspective outlined, it is very important for an integration process such as Mercosur to make a good analysis of its practical difficulties in navigating a world in a continuous process of change. It requires consideration of the national perspective of the partner countries.

10. Assuming that the analysis is correct would not be enough. What is required to address methodological crises, especially if they have the potential to become existential crises, are effective and efficient mechanisms for coordinating national interests in terms of those perceived as common. This priority entails other factors, such as political leadership at the highest level of the member countries, the capacity for concerted action within the common bodies and, in particular, the leading role of the multiple economic and social sectors.

11. The critical moments of integration processes, such as the cases of the very different experiences of the EU and Mercosur, among others, show that it is in the capacity of the main common body to reach agreement and in the quality of the political leadership existing in the member countries that lie the main factors of an effective methodology, which will make it possible to achieve the objectives sought and avoid the deepening of eventual existential crises.

There are certainly other relevant issues to be addressed. But those mentioned are the ones that, after almost thirty years of Mercosur's development, it would seem advisable to keep in mind, especially in conversations at the highest political level.

## II. A vision for the future of Mercosur

Considering Mercosur's current problems and acquired experience, at least three scenarios can be visualized as possible with respect to its future development. Of course, they are not the only ones, nor are they all desirable:

1. A first possible scenario would be the reaffirmation of the main commitments undertaken when the Treaty of Asunción was signed, i.e., understanding the customs union as the necessary basis for the gradual construction of a common market. It would certainly imply adjusting many of the steps that would need to be taken in the future to achieve that objective, which might even require agreeing on modifications or additions to the Treaty of Asunción while preserving the fundamental features of a customs union and a common market. Because of the flexibility resulting from the commitments made, this opens options as to how to achieve the full development of Mercosur's fundamental objectives and with respect to the deadlines for achieving them. This does not exclude the possibility of differential treatment, using one of the instruments of the Treaty of Asunción, sectoral agreements, or that the specific situation of smaller countries and countries with a lower degree of relative economic development be considered. But it does exclude the possibility of a member country seeking to negotiate bilateral preferential trade agreements with third countries, in contradiction with what has been agreed on in Mercosur.

2. A second scenario would be that a situation has been reached that can be identified as "the beginning of the end of Mercosur", at least in the perspective of what was understood to be being promoted when the Treaty of Asunción was negotiated and signed in 1990-1991. Specifically, at the founding moment it was understood that it was feasible and convenient to begin a path that implied the creation and gradual development of a common market. To this end, the four countries explicitly undertook the necessary steps to make the elements of a customs union a reality, as a basis for the construction of this common market. Thirty years later, these steps have still not been fully developed. The customs union formally exists, even if it is far from being perfected. But the commitment that has been made is still valid.

However, what can be observed at present are signs that fuel doubts as to whether the ability or the willingness to comply with the commitments really exists, at least in all member countries. For the moment, there do not seem to be any clear signs in any of the partners that they might eventually prefer to formally set aside the commitments made in the Treaty of Asunción. But neither could we rule out behaviors that, at least in fact, lead in practice to “dissolving” what has been agreed. That is, to introduce and legitimize elements that mean, in practice, to set aside the firm commitments established in the Treaty, without formally modifying them. An example of this could come from the approaches aimed at “adapting” the objective of a “customs union”, in such a way that, in practice, it is transformed into a “free trade zone”. In such a case, each of the member countries could eventually consider formally concluding bilateral preferential trade agreements with third countries, especially those with large markets, such as, the United States, China, or Japan, among others. This is instead of proposing the initiative of preferential trade negotiations that formally establish Mercosur within the world’s major economies, including China and the USA, as was done when negotiating the not yet concluded agreement with the EU.

3. A third scenario would be that a country chooses to withdraw from Mercosur, as explicitly provided for in the Treaty of Asuncion.

The uncertainties with respect to Mercosur as an attractive area for new productive investments are many and varied. This should not be surprising, since the new international environment –not only because of the impact of the current pandemic– has increased the degree of uncertainty with respect to many economies, especially developing ones and not only those of Mercosur or Latin America. Nor should it be surprising that these uncertainties are varied. Sometimes they have political roots, sometimes economic, and often both at the same time.

But the flexibility for member countries to enter into different modalities of preferential trade agreements with other countries would be only one of the aspects of Mercosur’s functioning that requires priority attention.

The methodological deficiencies can be solved with modifications to the agreed common rules and disciplines, including, if necessary, those of the constitutive pact itself.

From the perspective above, it is very important for an integration process such as Mercosur to make a good analysis of its practical difficulties in navigating a world in a continuous process of change. It is an analysis that requires considering both the national perspective of each of the countries participating in the process and the common perspective understood from the integration process itself, in this case, from Mercosur.

Assuming that the analysis is correct would not be enough. What is required to address methodological crises, especially if they have the potential to become existential crises, are effective and efficient mechanisms for coordinating national interests in terms of those perceived as common.

It is therefore appropriate to highlight three issues that may be relevant to modernize Mercosur and restore it to an acceptable degree of credibility and efficiency. In reality, these issues are directly dependent on human factors.

The first issue refers to the methodologies for opening up the respective markets and their impact on international trade negotiations. The second is the institutional methodology –including the capacity to exercise the necessary function of coordination of national interests– applied for the adoption of joint decisions, which also have an impact on the development of the agenda of trade negotiations with other countries. And the third is the methodology used to ensure that the integration process is based on and, therefore, guided by common rules of the game.

Of course, there are other relevant issues to be addressed. But the three mentioned are the ones that, after almost thirty years of Mercosur's development, it would seem advisable to keep in mind, especially in conversations at the highest political level.

But above all, Mercosur requires social willingness and the capacity to generate “de facto solidarity”. Social willingness of the different sectors of a society, especially the majority ones. Whether this is due to conviction or lack of reasonable options. And “de facto solidarities” in the sense proposed at the time by Jean Monnet –one of the founding fathers of the European integration process–, referring to the creation of factors that make it

costly to try to untie links generated by the reality of joint work between a group of countries.

### III. Relevant questions for a reflection on the future of Mercosur

In conclusion, it is worth asking some questions that need to be answered in order to reflect on the future of Mercosur.

Among others, they could be:

1) Working together is a challenge for countries in the Latin American region that has been heightened by the experience of the COVID-19 pandemic. In a more populated and connected world, Argentina and the countries of the region would be in a position to develop, based on their accumulated experience and competitive advantages, strategies of multiple alliances with all the countries of the world, especially with those with which they share concrete interests. Is this so? And, if so, what would be the steps to take that would allow a more active and effective participation in the development of a world trade that is functional to their needs and interests? What contributions could we make to increase solidarity and efficiency in the functioning of global trade agreements, especially the WTO? The WTO is in crisis, among other factors, due to the situation of its dispute settlement mechanism. In what way and with what proposals could the WTO member countries of the region contribute to increase the effectiveness and efficiency of the multilateral world trade system?

2) In terms of trade and economic development, regionalism is seen as a complement to global trade multilateralism, and also as the result of efforts between countries in a region to advance processes that are convergent with the global phenomenon. Is this a realistic vision of regional integration? If so, how to make it effective? How to achieve an effective articulation of the different Latin American integration processes, with a strategy of “convergence in diversity” that considers the different realities, visions and interests observed among the countries of the region? What role can the existing regional organizations, such as ALADI, SELA and CELAC, among others, play in this regard?

3) Both from the point of view of the organization of production and trade (regional value chains and also global ones), and from that of strengthening institutional spaces for trade negotiations, there is a certain consensus that in the post-COVID-19 scenario, the “regional” will tend to deepen. Is this a realistic vision? If so, what steps should be taken to strengthen, both from an existential (why work together) and methodological (how to work together) point of view, the regional integration processes in Latin America, in a manner compatible with the rules of the multilateral global trade system, especially Article XXIV of the GATT WTO and the WTO Enabling Clause?

4) How should the necessary efforts for the development of physical connectivity between the countries of the region and each of its sub-regions be emphasized, especially in terms of the strategies for connecting the different national markets and their respective productive systems? What role can the international financing organizations in which Latin American countries participate continue to play?

5) A strategy of active integration in the international trading system requires a permanently updated analysis of factors that allow for the anticipation of changes that may be significant, both at the global level and at the multiple and diverse regional levels. How could a more efficient cooperation be developed among the institutions in the region that are able to offer such analyses? What role can be played by the different spaces of action-oriented thinking?





# The future of Mercosur: an instrument for international integration

Martín Piñeiro

## 1. Introduction

Mercosur is going through a time of great difficulties. Discrepancies among the four founding countries, especially in relation to the level of the Common External Tariff (CET) and the bloc's degree of trade openness, have recently worsened and have endangered the very survival of the Agreement in its current structure. This is a wake-up call because, from a broader and historical point of view, the preservation, and even more so the strengthening of Mercosur, should be a strategic objective of the utmost importance. The future of Mercosur must be its strengthening as a mechanism for dialogue and the construction of cultural, economic, and political ties between four countries that are indissolubly linked by their geography and history.

Although these divergences have been present for some time, they are now exacerbated by the structural changes taking place in the economies of each of the four countries, in which the agro-industrial sector is establishing new economic and political importance.

In this context, it is important to remember that during the first years of Mercosur, the four countries, with the partial exception of Paraguay, had a development strategy that favored the substitution of imports of industrial origin. Therefore, the creation of Mercosur was, especially for Argentina and Brazil, an opportunity to take advantage of the tariff protection provided by a high CET and to increase bilateral trade for industrial products that were not very competitive in the international market. The result was a significant increase in trade within Mercosur, especially between Brazil and Argentina.

This situation has been changing over the years. For one, the possibilities of increasing the exchange of industrial products became exhausted, especially in the absence

of a more intense productive integration and the construction of regional value chains. Furthermore, in the last two decades the four countries underwent an extraordinary modernization and productive expansion of the agro-industrial sector, which is the most competitive sector in the four economies and, consequently, the main component of the region's international trade. This growing productive specialization in the agro-industrial sector has been similar in all the four countries, especially in terms of the main export products, and therefore has not generated greater economic complementarity as a basis for expanding intra-regional food trade.

This process of economic transformation has been accompanied by changes in the social and political structure. The agrarian sectors have acquired greater economic importance and significance and, therefore, greater organizational capacity and political power.

This new situation has begun to manifest itself in the political economy and consequently in the development strategies proposed and defended by the most representative sectors of society. In Uruguay, Paraguay and Brazil, these positions are being adopted by the governments of each of the three countries. In these new strategic visions, the need and opportunity for greater trade openness and a more aggressive and deeper international integration are evident. The first as a means of increasing the systemic competitiveness of the economy. The second, to increase exports, taking advantage of the competitiveness of the agro-industrial sector and other economic sectors linked to it. Argentina is an exception in relation to this new vision of development strategies because the new economic reality does not yet have a political correlate like that of the other three countries.

These economic and structural transformations have deepened the differences that exist among the four countries regarding their vision of the most desirable development strategy and, within it, the pre-eminence that agro-industrial exports should have. These structural differences have been expressed through the two specific issues under discussion within Mercosur: the level of the CET and the degree of trade openness. However, it is

important that the differences arise from more structural divergences that are linked to the visions and development strategies that these countries are trying to implement.

The most effective and natural way to resolve these disagreements and maintain Mercosur's cohesion would be to move forward with a broad and aggressive program of trade negotiations and agreements that is consistent with the global and long-term interests of the four member countries. Progress on trade agreements would result in a selective reduction of the CET, and in new trade advantages related to the offensive interests of the four countries. The latter should result in increased opportunities for the region's exports. Thus, it would indirectly resolve the two issues that are at the core of the current dissent of the four countries (Piñeiro, 2021).

However, in our opinion, the future of Mercosur, in the long-term, requires that the governments of the four countries agree on two main issues: a) the definition and adoption of a long-term development strategy, including a clear definition of the objectives and scope of the desired international integration, and b) a clear definition of Mercosur's role as the central means for the implementation of the region's international integration.

## **2. Mercosur in the world: opportunities and strengths for its international integration**

An aggressive and long-term program to promote Mercosur's trade negotiations and agreements with third countries would be consistent with the objectives and intentions that motivated its creation: Mercosur as a central instrument for the region's trade projection to the world. One of the central objectives of Mercosur's creation was that it should be a platform to facilitate and promote exports from the four countries.

It is important to emphasize that, as Schenoni and Malamud point out, the region, and even more so, each of the countries taken individually, is insignificant at the global level and therefore weak in terms of its capacity to negotiate international trade agreements (Schenoni and Malamud, 2021).

While this is true generally, it is possible to argue that the region has two important strengths that can serve as the basis for building a new global relevance:

a) Being the custodian of a globally significant endowment of natural resources and therefore an important region for global environmental sustainability. This importance is based on having a natural resource endowment that includes 31 % of the world's freshwater, 50 % of the world's biodiversity and 57 % of the world's primary forests.

b) Being the main net exporter of food to the world, contributing significantly to global food security. As Figure 1 shows, around half of the world's net food exports come from Latin America and the Caribbean, with Mercosur being the main source of these exports.

Figure 1



If exports from North America are added, the two regions together account for nearly 90 % of all global net exports.

In the future, the region's role will be increasingly important because of the technological adoption processes and organizational reforms that give it a very significant international competitiveness. For instance, agro-industrial production in the four countries has expanded and become significantly more complex during the last two decades, achieving high growth rates during the 2000-2020 period.

The most important economic facts that explain this growth in production are rapid adoption of technology, the consequent productive transformation, and the construction of a vast network of productive sectors linked to agro-industrial production. This includes the

transformation industries, which include the food system (oil extraction, sugar, dairy, biofuels, processed foods, etc.), the input-producing industries (agricultural machinery, specialized automobiles, fertilizers, inoculants, veterinary products, etc.) and, more recently, services and industries that create intangibles such as genetics, information, and digitalization. This complex network of interconnected productions is highly efficient and competitive and represents a significant percentage of GDP and exports in all four countries (Bisang et al, 2009 and Elizondo, 2021).

This export preeminence, which could be strengthened and expanded by promoting greater exports from all the sectors associated with agro-industry, could be not only a central axis of the development strategies of the four countries, but also the central element of an export and international integration policy. The strategy would be based on the region's two great strengths, which could be the potential source of a certain international preeminence based on the region's contributions to the world. The international community needs the region to care for and preserve its natural resources, which are also a heritage of humanity, and it also needs Mercosur to maximize its capacity to produce the food needed to contribute to global food security (Piñeiro, 2021).

### 3. Some elements to consider in the construction of an international integration strategy

If the founding countries of Mercosur were to agree on an international integration strategy based on the extensive network of productive sectors led by agri-business and its enormous competitive advantages, it would be necessary to evaluate what would be the most appropriate way to achieve a successful trade negotiation program in the long term. In other words, a path that considers the real opportunities, commercial interests and geopolitical realities arising from the rapid and complex global transformations.

#### 3.1. Commercial interests

Throughout their history, the four countries have had trade strategies dominated by two central concerns. One, to promote their offensive interests linked mainly to the agro-

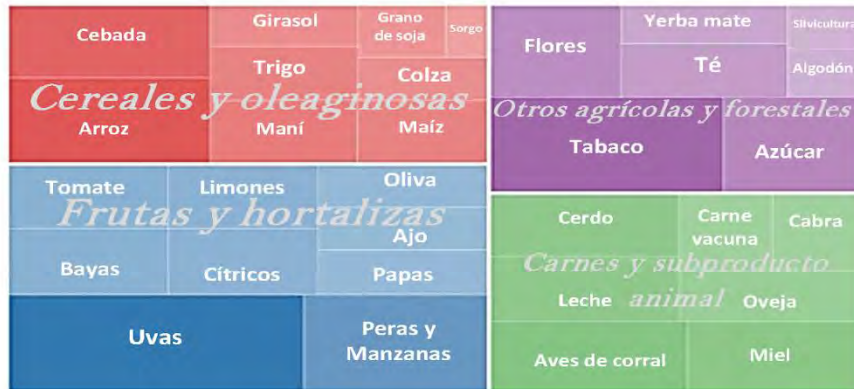
industrial sector, which has built significant international competitive advantages, and two, to protect their defensive interests linked to the industrial sectors that grew under the protection of policies associated with import substitution of industrial origin. However, in this intersectoral balance, the region and especially Argentina and Brazil have privileged defensive interests linked to the manufacturing industry. This stance towards international negotiations allowed for certain basic coincidences between the four countries, especially Argentina and Brazil, which, supported by their greater economic dimension, have guided Mercosur's positions in relation to trade negotiations. Although difficult, this coexistence was sustainable for many years.

As argued in the previous section, the progressive changes in the productive structures and the relative power of the different economic sectors in the four countries, but especially in Brazil, are resulting in substantive modifications in the negotiating positions of all Mercosur member countries except for Argentina. Thus, the offensive interests linked to the expectations of increasing exports originating in a broad network led by agro-industrial production have a higher priority in the positions of Uruguay, Paraguay and more recently in Brazil.

It is possible that the macroeconomic difficulties experienced by Argentina and the enormous potential of its agro-industrial sector, probably the most competitive in the region, will result in changes in trade and production policies like those that have occurred in the other three countries. If this trend were to materialize, Mercosur would be able to define and implement a program of trade negotiations that privileges the offensive interests of the four countries. These negotiations are especially important to achieve better access to markets for agri-food products that generally have high levels of tariff protection (see figure 2).

Figure 2

**Productos agroalimentarios afectados por aranceles altos para las exportaciones de los países de ALC**



Fuente: Piñeiro, Campos y Piñeiro 2001

On the other hand, new concerns related to the environment, food safety, and nutritional aspects linked to human health will progressively lead to the establishment of international standards that will impose new restrictions on trade. These issues will have to be incorporated into trade agreements.

An evolution of Mercosur towards progressing in trade agreements oriented by its offensive interests would also give a clear and powerful guideline in two directions:

First, it would provide clear and convincing criteria in the selection of trading partners, giving clear priority to countries that are major net food importers and therefore markets of great importance for the region's exports. Asia and especially China, the Middle East and North Africa emerge as natural candidates.

Second, I would argue that it is important to seek greater coordination with other countries with similar interests (think alike) to act in a coordinated manner in international organizations, especially in the WTO. Two examples emerge clearly: a) the former experience of the Cairns Group is an example of a strategic alliance with countries that have similar interests. The purification and reorganization of the group could be an objective to be considered, and b) in the area of agri-food production and exports, Mercosur has

common interests with the US and Canada. An expression of this was the joint positioning of the American hemisphere at the Pre-Summit in Rome and the Summit in New York on Food Systems organized by the United Nations (IICA, 2021).

### 3.2. The geopolitics of food

While trade interests are a fundamental criterion for defining Mercosur's trade negotiating agenda, geopolitical considerations are increasingly an element to be carefully considered.

The dominance that the US, and more generally the Atlantic Alliance, has had in the international arena since the end of World War II has begun to weaken. This is particularly evident in the face of the new economic and commercial power of China and, progressively, of Asia as a whole. A power built based on population growth, economic expansion, and the growing participation of Asian countries, and on communications technologies and digitalization, among other strengths, with China and India leading the process.

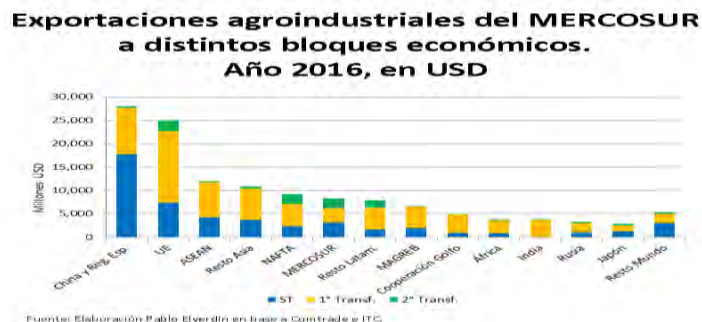
The emergence of a multipolar world with two dominant poles, the U.S. and China, with strong trade ties but with growing competition in the technological and, more recently, military spheres, generates spheres of influence that could restrict the independence and freedom of movement of peripheral countries.

However, in the more limited scope of food, it is possible to define a more limited scope or context of food geopolitics (Piñeiro and Valles, 2021). This geopolitics of food is framed by two fundamental pillars. One, the growing geographical relocation of both food exports and imports, and on two, the institutional framework governing international food trade, represented both by the legal framework of the WTO and by the multitude of trade agreements in force in the world today.

To analyze these issues, it is important to observe how the main trade flows linked to agro-industrial exports have been ordered. Figure 3 presents the main destinations of Mercosur's agro-industrial exports according to the degree of transformation of such exports.



Figure 3



An analysis of Graph 3 suggests some important observations: a) Asia in general, and China in particular, have become the main destinations for Mercosur’s agro-industrial exports, a situation that, according to existing projections, will increase in the future; b) the EU is the second most important destination and exports have the highest degree of transformation. This illustrates the importance of the EU/Mercosur Agreement, the signing of which is currently undergoing a complex institutional process; c) Asia represents almost 40 % of Mercosur’s total net exports and almost half if the EU is not considered; and d) Mercosur is the main net food exporting region.

Mercosur’s trade relationship with Asia, especially with China, generates a mutual dependence. For Mercosur, agro-industrial exports are an important component of total exports and GDP and, therefore, exporting at reasonable prices and under adequate trade conditions is an important element for its macroeconomic stability and its possibilities for economic growth. On the other hand, for net importers, access to food through imports is an important component of national security. This situation creates both a reciprocal interest in these mutual needs and an economic dependence between the two regions through the agricultural trade that has been established between them.

From Mercosur’s perspective, this growing concentration of exports in a few destinations creates a trade dependence and economic vulnerability that cannot be ignored.

Even more so in the face of the growing diplomatic tensions that are being generated between China and Western countries.

An important question that needs to be analyzed refers to the potential conditions that the current food geopolitics may impose on an international integration program and trade agreements that privilege offensive interests linked to the agro-industrial sector. Thus, can Mercosur move forward in a trade relationship that privileges trade relations with a few Asian countries in general and with China in particular?

Australia's recent experience must be considered. The trade and economic retaliation that China applied to Australia in response to political differences arising from an investigation into the origin of COVID-19 was unusual, disproportionate, and sobering. In turn, it generated reactions from Australia and its traditional allies that were also surprising and unexpected, such as the creation of AUKUS. In this framework of tensions and political alliances, it is reasonable to ask what room for maneuver the peripheral countries have in relation to trade agreements and alliances and what is the appropriate response for Mercosur in particular.

This situation strengthens the importance of Mercosur as an instrument of international projection and as an instrument to exercise the bargaining power given by the magnitude of its food exports. Mercosur, acting in a unified manner, is an indispensable food supplier for large net importers such as China. This bargaining power is not available to each of the individual countries, not even to Brazil.

#### **4. A few final thoughts**

In the last 30 years, Mercosur has been a successful initiative. It was useful in terms of its initial political objectives linked to military and nuclear issues, it contributed to increase a first stage of intra-regional trade and facilitated the coexistence of four countries that are neighbors and share a common history. However, the profound economic changes at both the regional and global level, including changes in the productive structure and the increase in the importance of services and intangibles in trade, along with the emergence of

new geopolitical conditions, make a profound revision of Mercosur's objectives and functioning necessary (Elizondo, 2021).

Its existence is necessary, even more so now, in a more convulsed and perhaps more conflictive world. A strengthened Mercosur, adapted to the new regional and international conditions, is a central instrument that facilitates and empowers the region to achieve a profitable international integration. To progress in this direction, a fundamental first step is to achieve greater productive and business integration among the four countries. This requires regulatory convergence, trade facilitation, integration of research activities, harmonized development of legal systems related to intellectual property and regional transnational investments are areas in which it is necessary to work intensively together.

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# Mercosur's economic integration process: guidelines and prospects in international trade

Pablo Bertin

The Southern Common Market was one of the most ambitious economic integration processes in the Latin American region in the 1990s. The establishment of an integration bloc that would demonstrate the intention to liberalize goods and services among its economies, build a common external trade policy, liberalize the circulation of productive factors, and coordinate its macroeconomic policies, required a long-term strategy of harmonization of production and trade among the countries. Although Argentina, Brazil, Paraguay, and Uruguay deepened their economic and trade ties in the early years, regional and global transformations caused the incentives of the countries of the bloc to mutate. In this sense, this paper shows Mercosur's trade patterns (among member countries and with its trading partners) and tariff structure from its creation to the present. From this analysis, some reflections emerge regarding the challenges faced by the bloc to enhance its trade policy and economic integration.

## Mercosur, trade patterns and its common tariff structure

The Treaty of Asuncion signed in 1991 by Argentina, Brazil, Uruguay, and Paraguay created Mercosur<sup>1</sup>. This treaty was the starting point for the creation of a common market among these countries as of 1994. In the period between the Treaty of Asunción and the date for the creation of a single common market (known as the transition period), the member countries of the bloc had to agree not only the tariff reductions among themselves but also negotiate joint tariffs to be imposed on third countries, thus creating a customs

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<sup>1</sup> It is worth mentioning that the rapprochement between the governments of Argentina and Brazil prior to the Mercosur agreement to coordinate and strengthen national security policies between the countries was extremely important to advance in the deepening of economic and commercial ties between them.

union. If we take the classic integration taxonomy or follow the “European-style” economic integration process, these countries proposed a common market in which macroeconomic, trade and sectoral policies were to be coordinated, as well as the liberalization of productive factors (labor and capital) among the members. As of December 31, 1994, 85 % of the universal tariff among the members had been dismantled and an imperfect customs union had been formed, as all the countries presented a list of exceptions to be able to import products from third countries with a differentiated tariff, due to the relevance of these products within their productive structure. In this sense, what remained uncoordinated among the members of the bloc was mainly the macroeconomic policy and the liberalization of productive factors to create the common market proposed in the Treaty of Asunción.

Today, Mercosur has the same economic integration structure, with a free trade area among its members and a common external tariff for the entry of goods and/or services with third countries with which it has not reached a free trade agreement or some type of preferential agreement. In this sense, the purpose of this paper is to analyze what has happened to the trade flows of the member countries since the creation and implementation of the customs union up to the present. To be able to observe their behavior in general and not in particular, the analysis is not only determined among the trade between these countries, but also with their main trading partners. Based on this development, an attempt is made to analyze what type of international integration in international trade these countries had and/or maintain in sectoral terms and with the countries of the rest of the world. At the same time, given that there is an imperfect customs union among the members, the tariff structure and the use of exceptions presented by the countries to temporarily modify its structure in recent years are analyzed.

### **Trade Patterns in Mercosur**

Mercosur is one of the regions characterized by changes in intra-regional trade throughout its history. If we consider the Protocol of Ouro Preto as a starting point, other integration blocs such as ASEAN, NAFTA and the European Union maintained intra-

regional flows at around 21 %, 42 % and 62 % respectively of total trade, while Mercosur's intra-regional trade decreased in almost all years, averaging 17 % for the same period. As can be seen in Figure 1, intra-regional trade was at its peak in the mid-1990s, at the beginning of its creation<sup>2</sup>. Intra-regional trade peaked at 23 % of total trade in 1996. From that year on, the trend of intra-regional trade is decreasing until 2020, reaching a little over 11 % in the latter year. Within the period considered, it is necessary to highlight the drop in intra-regional trade from the late 1990s and early 2000s, a period in which Brazil suffered an economic crisis and devalued its currency, dragged down by the depreciation of the currencies of Asian countries due to the economic crisis of the Asian tigers<sup>3</sup>. Although the crisis in East and Southeast Asia is not directly related to the fall in intra-regional flows, the movement of capital flows and the new measures adopted at that time had a negative impact on the Latin American region (ECLAC, 1998). In turn, Argentina and Uruguay suffered deep recessions in the early 2000s. From this period on, intra-regional trade did not return to the levels of the first years of Mercosur's creation and its share oscillated between 16 % (maximum reached in 2011) and 11 % (minimum value in 2020<sup>4</sup>).

On the other hand, extra-regional trade shows what happened to Mercosur's trade flows. The share of exports and imports with partners from the rest of the world grew throughout the period considered. Looking at both graphs, the trend in extra-regional trade was in the opposite direction to intra-regional trade, which shows that Mercosur countries increased their trade with the rest of the world.

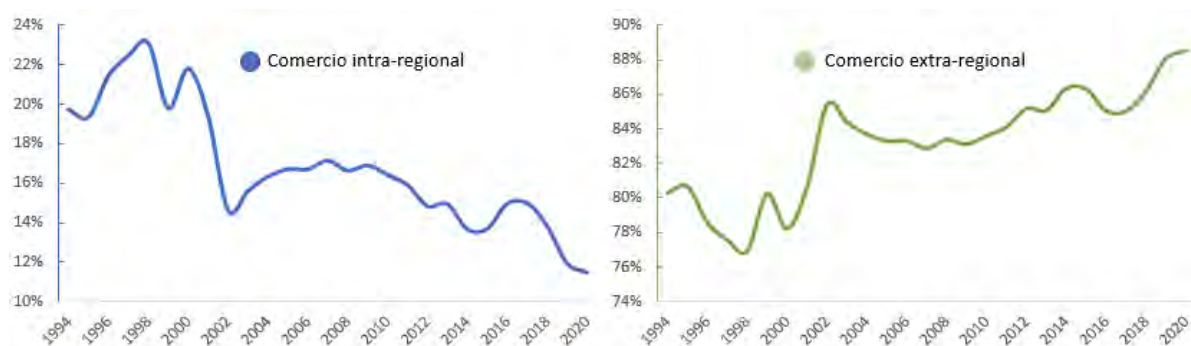
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<sup>2</sup> Intra-regional trade is measured based on the share of exports and imports that member countries send within the bloc.

<sup>3</sup> The Asian tiger crisis began with the devaluation of the Thai baht to maintain its value against the US dollar. In this sense, Southeast Asian countries such as Malaysia, Indonesia and the Philippines modified their exchange rates because of Thailand's decision not to lose competitiveness in their currencies with respect to the US dollar. This led to the valuations of their foreign debts in dollars being directly affected, altering, and causing a collapse in private debt and a fall in the region's assets and stock markets. South Korea, Taiwan and Hong Kong were also seriously affected by the increase in external debt in terms of gross domestic product.

<sup>4</sup> 2020 is a unique year for international trade due to the pandemic crisis caused by COVID-19. Trade flows at the international level fell by 9.2 % and economic activity at the global level suffered a huge recession of 5.2 % compared to 2019.

Figure 1: Mercosur’s interregional and extraregional trade in the period 1994–2020.



Source: Prepared by the authors based on data from WITS-COMTRADE.

The increase in exports and imports with Asian countries, mainly China and India, is highly significant in explaining in part where the increases in extraregional trade of member countries were directed<sup>5</sup>. The expansion of globalization resulting from changes in the way of producing on a global scale made it possible to increase not only trade in goods but also trade in services, expanding the possibilities of trading and defragmenting tasks within the same productive process between different countries (Kolodko, 2020).

To analyze the increase in extra-regional trade, Figure 2 shows the evolution of trade flows since 2000 with the main trading partners<sup>6</sup>. Due to the magnitude of trade with China, the United States and Germany, being the main trading partners of the bloc, the evolution of total trade with these countries is shown in the graph on the left, while the graph on the right shows the rest of the countries that make up the ranking of the 10 countries with the highest trade flows. With respect to trade with China, the evolution is significant in comparison with the other partners at the block level. The growth in the first years of the 2000s is exponential, going from 4,832 million dollars to 36,980 million dollars in 2007. After this year there was a drop in trade flows, not only with China but also at a general level, due to the international financial crisis that began in 2008, depressing the levels of

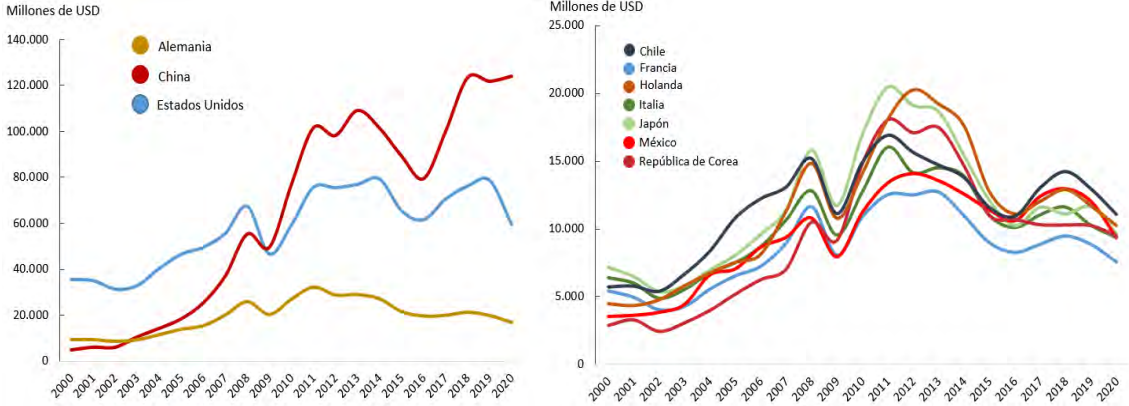
<sup>5</sup> Trade with China and India grew by more than 2,400 % and 970 % from 2000 to 2020.

<sup>6</sup> Trade flows consist of exports and imports with each of the countries.



economic activity worldwide and therefore international trade flows. After the global recession, trade with China grows exponentially again until 2013, having a decline from 2014 to 2017, then recovering and peaking in 2020.

Figure 2: Mercosur’s main partners in the last 20 years



Source: Prepared by the authors based on WITS-COMTRADE data.

Regarding the United States, the evolution of Mercosur’s trade shows a growing trend but less striking than that of China. In the early 2000s, the United States had an extremely relevant importance in trade flows for the bloc, occupying first place as a trading partner and surpassing trade with China by far. The superiority of the values traded between Mercosur and the United States lasted until the year of the international financial crisis. Then, the evolution of trade with the United States was surpassed by trade with the Asian giant, and 2018 shows a decrease in trade flows of 78 %, which deepens in 2020, the year in which the COVID-19 pandemic begins. In the case of Germany, trade flows show growth until 2011, then trends change. For the rest of the partners that make up the top 10 rankings, the trend is similar. There is an increase in trade flows until the international financial crisis where they fall and then recover until 2012 and 2013. Then, the values begin to decrease until an upturn in 2016, which contracts again from 2018 onwards (except for Korea which remains stable). Trade with Japan and the Netherlands suffered the most in recent years due to a decrease in trade by more than 10.8 billion USD and 7.8 billion USD from 2011 to 2020 (a contraction of 47 % and 56 % respectively). Although Chile shows the

same fluctuations as the rest of the partners, trade with the trans-Andean country grew in recent years in relative terms, alongside trade with Mexico.

China played a relevant role in the comparison with other partners within extra-regional trade due to the magnitude of the values observed, even though the United States and countries of the European Union had an enormous influence. With respect to Latin American countries, Chile and Mexico show a greater participation among Mercosur's main partners since 1994.

Figure 3 shows the composition of intra-regional exports and imports for each of the Mercosur member countries<sup>7</sup>. In Argentina, the main economic activities are related to vehicles and chemicals, along with crops and refined petroleum products. The automotive sector, both vehicles and auto parts, is relevant in imports, mainly from Brazil due to the sectoral agreement that these countries have that promotes the production and integration of this sector<sup>8</sup>. The chemical sector is another one that stands out because *chemical products and chemical substances* are among the main sectors. Brazil presents the *automotive vehicles* sector as the main sector within its imports, as does Argentina. The second most important sector is *crops*, which has a greater relative weight than the auto parts import sector for Argentina. The automotive and chemical sectors are also relevant within Brazil's intra-regional export structure and, unlike Argentina, *autoparts* are positioned among the main export sectors.

In Uruguay and Paraguay, the values of exports and imports are lower due to the size of their productive and commercial structure, unlike Argentina and Brazil. In the case of Paraguay, exports of *electric energy* were relevant to the other members of the bloc, as well as *crops*. On the import side, there is a similar structure with respect to the 5 main sectors. Uruguay presents a more homogeneous structure in terms of values within the main export sectors, which are the *food, dairy, milling products and chemical sectors* (unlike Argentina and Brazil, where the automotive sector presents greater relative differences in terms of

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<sup>7</sup> To have a wider scope in the analysis, the total trade between these countries from 1994 to 2020 was taken. The classification used is the International Standard Industrial Classifier for international trade with a 3-digit level of disaggregation.

<sup>8</sup> In 2020, the common automotive policy between Argentina and Brazil was updated, establishing new integration terms until 2029 in terms of quotas and quotas for trade in this sector between the two countries.

values with respect to the other sectors of exports). Within imports, *chemicals and motor vehicles* are the main sectors involved.

Figure 3: Main sectors in intra-regional trade by member country for the period 1994–2020



Source: Prepared by the authors based on WITS-COMTRADE data.

The comparison of export sectors with the rest of the world is substantially modified if we use the first sectors, with the cumulative values from 1994 to 2020, according to data processed by the World Integrated Trade Solution (WITS). The four member countries have the *food production and processing* sector and the *crop* sector in first and second place. In third place, Argentina has the *crude oil and natural gas extraction* sector and Brazil the *iron ore extraction* sector. In the smaller economies, Paraguay has the *leather products* sector and Uruguay the *dairy products* sector. This shows that intra-regional trade has made it possible to diversify exports of some sectors that are not represented as important in extra-regional sectoral exports.

Trade within the Mercosur bloc shows fairly clear patterns. The automotive sector and the chemical sector are relevant for Argentina and Brazil within intra-regional trade, with large differences in the values traded with respect to the other sectors. For Uruguay, food and dairy products are the main sectors, but there are no major differences with the rest of the sectors in terms of values, while Paraguay's exports of electric energy are relevant in terms of accumulated exports from 1994 to 2020.

### The Common External Tariff of Mercosur

In the Protocol Ouro Preto, the Common External Tariff (CET) agreed among the member countries includes 8,500 out of 10,275 tariff positions based on the Mercosur Common Nomenclature (NCM). The customs union formed by this common tariff is imperfect due to the lists of exceptions presented by the countries: Argentina and Brazil presented 232 exceptions, while Uruguay and Paraguay presented 212 and 253 respectively. The exceptions were expanded in mid-1995 with 300 items for Argentina, Brazil, and Uruguay, while 399 items were granted to Paraguay. The adjustment in the Treaty of Asunción allowed countries to submit these lists to have a longer period for sectoral adjustment and to organize a progressive, linear, and automatic phase-out schedule for the products submitted towards the stipulated common external tariff. Capital goods, IT and telecommunications goods, and the chemical-petrochemical sector were the main sectors addressed within the lists implemented.

The common tariff structure of the Mercosur customs union shows differences among productive sectors. The average applied tariff structure of the member countries, based on the data available in Market Access Map<sup>9</sup>, are around 10.6 %. The footwear, clothing and textile sectors have the highest applied tariffs with 29.1 %, 27.3 % and 23.2 %. Other sectors whose incidence lies in inputs necessary not only for production but also for consumption have external tariffs below the world average<sup>10</sup>, such as *animal husbandry* (5.3 %),

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<sup>9</sup> The tariffs analyzed are **most-favored-nation** applied tariffs. In this sense, they are the tariffs charged to third countries with which there is no agreement to grant any type of trade preference.

<sup>10</sup> According to the World Bank, the average tariff rate for most favored nation, is at 8.9 % for 2017.

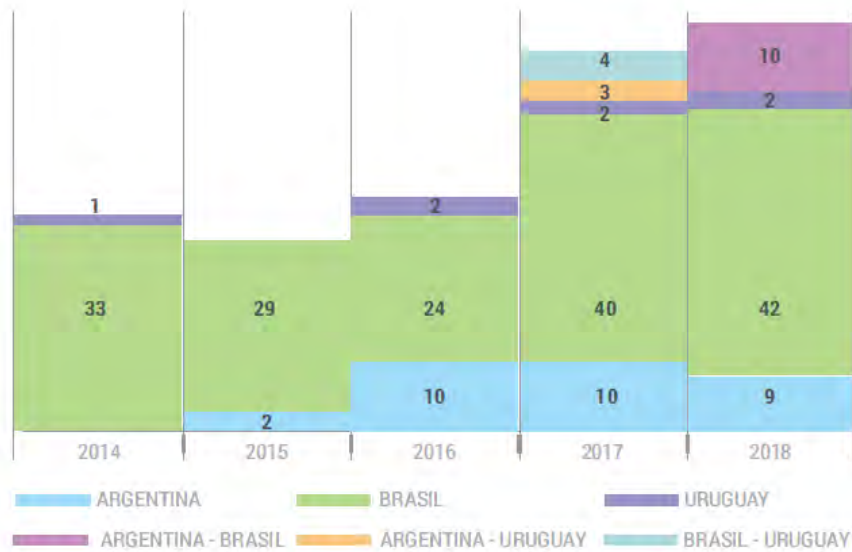
*manufacture of basic chemicals* (6.0 %) and *forestry and timber extraction* (5.3 %). On the other hand, sectors such as the *manufacture of plastic products* (14.5 %), the *manufacture of motor vehicles* (18.5 %) and the *manufacture of beverages* have tariffs above the general average structure of the CET<sup>11</sup>. Sectors such as *architecture, engineering, and other technical activities* (4.0 %), *iron ore extraction* (2.0 %) and *generation, collection, and distribution of electricity* (1.0 %) have below-average tariffs.

Lists with the number of exceptions that each of the countries have decreased but have not yet reached a full conversion to the unification of a perfect customs union. There are several arguments for why the dates agreed for the total coordination of the CET were postponed, from economic crises faced by member countries to unilateral requests of specific urgency for a particular productive sector of the member country requesting it (Ortiz, 2014). To present some mechanisms by which countries can separate themselves from the full coordination of the CET, Figure 4 presents the Specific Actions in the Tariff Field for Supply Reasons (GMC Res. 08/08) to process transitory exceptions to the CET. Brazil is the country that has made most use of this type of action in recent years.

**Figure 4: Number of measures related to transitional exceptions to tariff impositions below the CET from 2014 to 2018.**

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<sup>11</sup> As with trade flows, the information is presented under the International Standard Industrial Classification (ISIC) to homogenize data processing and analysis.



Source: Mercosur Report. Inter-American Development Bank (2018)

In the lists of exceptions and tariff differences for third countries, the main distinguishing features are that Argentina and Brazil have higher tariffs than Uruguay and Paraguay, mainly in textiles, furniture, and automobiles. Tariff peaks on certain products, restrictions such as antidumping tariffs, the system of preferences and other trade mechanisms may affect the flexibility that exists in the CET of this customs union. In this regard, not only the lists of exceptions but also the special trade regimes, preferential agreements and/or economic complementation agreements within LAIA, specific duty regimes, trade defense practices, among others, become relevant. These instruments give rise to deviations at the national level from the CET and Mercosur's common trade policy. In fact, the level of application of the CET, if the bloc as a whole is considered, does not reach 70 % being that 32 % of the tariff positions of the Mercosur common nomenclator are exempted from the CET (IDB, 2018). This shows that the perforation of the CET, whether transitory or permanent, generates heterogeneities in the common foreign trade policy of the bloc (Berlinsky, J. et al. 2005).

The imposition of common tariffs on third countries (albeit imperfectly) provides a greater degree of trade policy coordination than the mere fact of a free trade zone. In this

sense, and in view of the harmonization of the tariff structures of Mercosur countries with a strong influence of the Brazilian tariff structure in its origins (Berlinski, J. et al, 2005), the effects of this customs union can be analyzed and evaluated from different perspectives. On the production side, the sectors that had a higher tariff imposed on products entering from third countries enjoy greater protection than the rest (for example, the textile and automotive sectors), while consumers pay a higher price for these goods, which may or may not be produced within the bloc. In this sense, and given that the evolution of trade has been changing over the years within the bloc, the member countries have different incentives in terms of the magnitude of the reduction of these types of tariffs at the sectoral level according to their productivity and competitiveness to insert themselves virtuously in other markets, as well as the need and/or incentive to acquire these goods at a lower price from third countries, diversifying the variety of products within their economy. In this sense, promoting the redistribution of manufacturing activities within the bloc could bring the members closer together. On the other hand, the common tariff structure has a component of protection for sectors with a higher relative employment intensity in the countries that produce this type of goods, with an orientation towards the domestic market, as is the clear example of the textile sector. When it comes to analyzing and taking positions on the dynamics and changes in tariffs, the member countries present positions that reflect different syntonies according to their commercial and productive incentives. Based on these premises and other heterogeneities and asymmetries within the bloc (Terra et. al., 2008), trade policy coordination at Mercosur level has become increasingly complex. In this sense, the degree of action of Mercosur's supranational institutions is an asset to be strengthened for the development and harmonization of the economic and trade policies of the countries in the region (Doctor, 2013).

## Reflections

Although Mercosur member countries were unable to establish a single common market and the coordination of macroeconomic policies to homogenize the economic situation of the bloc, the evolution of trade within the bloc and the common external tariff

from the imperfect customs union show interesting features from its creation to the present day. The auspicious beginning of the bloc was overshadowed by the deterioration of intra-regional trade since the 2000s, which continues to this day. In this sense, this deterioration could be an opportunity to recover and increase trade between member countries, promoting changes in the productive structures of these countries. The challenges of the 21st century in terms of climate change and the new technologies promoted by the industrial revolution 4.0 show mutations that have a direct impact on the types of goods and services that are promoted and encouraged for the coming decades at the global level. Intraregional trade had a clear sign to expand and diversify the export basket of member countries, mainly Argentina and Brazil. In this sense, this type of trade could drive the new productive and commercial dynamics that arise at the international level in the countries of the bloc, taking advantage of the scales for smaller countries and to diversify products in the export basket of larger countries. In turn, intra-Mercosur trade should be seen as a platform for improving productivity and competitiveness not only at the regional level, but also for increasing and inserting new products in extra-regional markets.

The common external tariff of the imperfect customs union and the bloc's external trade policy is another of the great challenges ahead. The tariff structure has been maintained over the years and that the most protected sectors are in sectors with a higher relative employment intensity. At the same time, the CET has flexibilities that allow countries to have "escape valves" to overcome specific problems. A deeper analysis of the CET to improve the integration of the economies of the bloc into international trade is something to be considered, without losing sight of the enormous challenges faced by the economies of the bloc to generate employment at present and improve the quality of employment in the coming years. In this sense, the instrument of a regional trade policy should be oriented towards this objective.



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# Quo vadis, Mercosur?: The challenge of flexibilization and the future of South American regional integration.

Carolina Zaccato

## Summary

This article addresses the critical juncture that Mercosur is currently going through regarding the flexibilization of its trade policy, the future direction of the bloc, and the role assigned to this integration process in the development models of its member countries. To this end, the first section of this paper reviews achievements and pending debts, thirty years after the signing of the Treaty of Asunción, not only in economic and trade matters but also in political, social and identity issues. Then, the second section deals in depth with the discussion on the flexibilization of the bloc, the possibility of integration at different speeds, and the process of symbolic-discursive resignification that the transition from a customs union to a common market would entail. By way of conclusion, the third section takes up again what was discussed in the article and presents possible future scenarios.

## Keywords

Mercosur - flexibilization - regional integration - regulatory regionalism.

## Introduction

Mercosur covers a territory of 15 million square meters and more than 295 million inhabitants. It is the world's fifth largest economy and has trade agreements with partners representing 30 % of global GDP (Mercosur, 2021a). In addition, the regional bloc has established trade agreements with all South American countries (except for Guyana and Suriname), which would imply the de facto creation of a free trade area in South America. Because of these reasons, Mercosur should function as a platform that facilitates the leap from the local to the global, making its members more attractive interlocutors –and of greater weight– in the international arena. Thirty years after the signing of the Treaty of Asunción, Mercosur's founding milestone, not only a series of significant advances in terms of regional coordination and cooperation in different thematic areas can be highlighted, but also numerous pending debts that give rise to strong debates within the bloc regarding the future direction of the South American integration project.

This brief article proposes to address the present situation of the South American bloc, reviewing its past trajectory, the demands of its present, and the challenges of its future. The first section considers the achievements and pending debts of the first thirty years of the Mercosur project. The second section addresses the present challenges of the bloc and the debate on its future direction, discussing the demands for flexibilization and integration at different speeds. The final section recapitulates the main points discussed, presenting some possible future scenarios to coordinate the transition towards a more dynamic Mercosur that preserves, at the same time, its regionalist identity and essence in the concluding article.

### 30 years after the Treaty of Asunción: achievements and pending debts

As mentioned in the Introduction, Mercosur represents the fifth largest economy in the world, comprising a market of over two hundred and ninety-five million inhabitants and an area of nearly fifteen million square meters. According to its official website, since its creation, the main objective of the bloc has been to promote a common regional space that

generates new business and investment opportunities for its member states through their competitive integration into the world market (Mercosur, 2021a). To this end, the bloc has concluded numerous trade agreements with various countries and blocs of countries.

Since the 2000s, Mercosur has signed trade agreements with countries and extra-regional blocs such as India (2005), the Southern African Customs Union-SACU (2008), Israel (2007), and Egypt (2010). The bloc is currently in various stages of negotiations with Canada, South Korea, the Gulf Cooperation Council, Turkey, and Singapore, among other partners. It should also be noted that these latest rounds of agreements cover not only trade issues but also services, investment, government procurement, intellectual property, sustainable development, and state-owned enterprises, among other areas. Among these agreements, the one that has undoubtedly resonated the most in recent years has been the Association Agreement with the European Union, concluded in June 2019<sup>12</sup>. If ratified, this agreement would lead Mercosur countries to move towards more open economies during a ten-year transition period, progressively complying with an ambitious set of standards and regulations, not only in terms of reducing tariff and non-tariff barriers to trade, but also in phytosanitary, origin, labor, tax, and environmental areas. In turn, this process would make Mercosur a more attractive partner for third countries, facilitating the conclusion of new trade and strategic association agreements.

However, the process of ratification of the strategic partnership agreement with the European Union is currently at a standstill. Given the current scenario, its ratification by national parliaments on both sides of the Atlantic, as well as by the European Parliament per se, seems less and less likely. More specifically, Brazil's policy of deforestation of the Amazon has made the agreement unacceptable, under its current conditions, to the European green parties, which have allied themselves on this issue with labor parties, which are more reluctant to the agreement in order to protect agricultural and livestock production in their countries. As a result, some analysts point out that the conditions for ratification will not occur until 2023, after the recent elections in Germany are joined by those in

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<sup>12</sup> The economic chapter of the agreement was signed in 2019, while the political cooperation and dialogue chapter was signed on June 18, 2020. Therefore, the entire comprehensive strategic partnership agreement was finalized for discussion in 2020.

France and Brazil, and when Spain, one of the main promoters of this bi-continental association, assumes the presidency of the European Council. However, by that time, it will be necessary to analyze whether the prevailing political-ideological scenario in the Southern Cone will continue to be favorable to implementing a bi-regional association agreement that implies significant trade liberalization, or whether, on the contrary, the region will be more favorable to protectionist policies.

Along with the economic-trade aspect, Mercosur has developed several intra-bloc agreements on culture, education, employment, mobility, residence, social security, citizen protection, human rights, democracy, nuclear development, environment, judicial cooperation, extradition, consumer rights, and related border localities. In fact, the bloc has concluded more than one hundred internal agreements that are not directly related to trade in goods. The bloc seeks to transcend a purely economic-commercial vocation, advancing, cautiously but progressively, towards other areas of cooperation and integration. This entails the gradual consolidation of a network of epistemic communities (Haas, 1992) at the regional level, made up of experts and other stakeholders, who work together to share knowledge, information and lessons learned, promote cooperation, and coordinate the design of public policies at the educational, judicial, social protection, energy, infrastructure, tourism, and scientific-technological levels. In turn, this routine of joint work entails a gradual but sustained generation of shared interests in these thematic areas. In fact, within the Mercosur framework there is much more sustained cooperation at a technical level than is usually publicized and perceived. In other words, the fact that heads of state do not meet regularly does not imply that state officials (be they diplomats, technicians, judges, directors, or area secretaries) do not carry out regional projects together on a sustained basis (Feldmann et al., 2021).

Also noteworthy is the creation of the Mercosur Structural Convergence Fund (FOCEM), a regional mechanism for financing infrastructure and social development projects, designed to mitigate intra-bloc differences. FOCEM currently has a portfolio of 49 projects for a total amount exceeding US\$1.5 billion.

It is also worth highlighting the role that democracy has played in the process of building and consolidating Mercosur, as well as the role that the bloc plays in the defense and strengthening of democratic systems of government in the region. As early as 1992, the Declaration of Presidents of Las Leñas established the full validity of democratic institutions as an indispensable condition for the development of the Mercosur project. Subsequently, this aspiration materialized in the Ushuaia Protocol, which establishes the democratic system of government as a *sine qua non* requirement for admission and permanence in the bloc. Thus, a co-constitutive relationship is generated between Mercosur and the democratic system of government, in which the bloc acts as a sort of “protective shield” for the democratic system of its members (through the Ushuaia Protocol), and in which, in turn, democracy is considered the only form of government capable of fostering long-term regional integration, thus acting as a promoter of greater regional cooperation and coordination.

Finally, on the thirtieth anniversary of the bloc, in March 2021, the Mercosur Citizenship Statute was presented, a document that details the rights and opportunities for nationals, citizens and residents of the bloc, including the freedom to transit, study, work, live and retire in any of the member states (Mercosur, 2021b). This represents an important step in the gradual generation of a “Mercosur citizenship” identity, a debt still pending in this space.

In spite of the above, 30 years after the signing of the Treaty of Asunción, there are still many pending debts of this South American integration project.

Mercosur is a free trade area that trades very little with each other. While intra-bloc trade peaked in 1997, representing 25 % of the bloc’s total trade, it currently represents only 14 % (Bello, 2021). Furthermore, this 14 % is significantly lower than the 30 % global average of intra-bloc trade for regional integration agreements (Dinatale, 2021). For Mercosur member countries, the importance of the region as a trading partner has been steadily declining. Currently, the share of trade within the bloc is at an all-time low, while extra-regional exports represent eight times intra-regional trade. At the same time, Mercosur’s external tariff levels are high, raising the costs of the bloc’s foreign trade.

Although total trade has multiplied since the bloc's creation, a large part of this growth represents *commodity* exports to Asia. Furthermore, in recent years, the bloc's primarization trend has been accentuated by the growing importance of China as a trading partner of the region. As a result, Mercosur continues to be a net exporter of raw materials, which is seen as problematic by its members in terms of how much the bloc has actually contributed to the development and industrialization of the region's economies. Apart from the automotive sector, the region has not been able to generate industrial value chains or promote integrated industrial development that is competitive with the world.

In its economic and trade dimension, Mercosur seems to be a bloc with less and less relevance for its members which, in turn, acts more as a barrier than as a platform to promote trade between the region and the rest of the world. Moreover, when trading outside the region, exports are dominated by raw materials and products with little added value, discouraging efforts towards industrialization and regional productive integration. The combination of these problems (i.e. low level of intra-bloc trade + high external tariffs + primarization of exports) gives rise to contemporary debates on the balance of Mercosur thirty years after its creation and, more importantly, on the future direction of the bloc. Among these debates, the demand for the lowering of the Common External Tariff (CET) and for the flexibility of the bloc's negotiations with third countries stand out in particular. This is the subject of the next section.

### ***Quo vadis?* The future of Mercosur and the challenge of flexibilization**

The future of Mercosur will be closely linked to the answer to the question of the role assigned to the bloc by each of its members. As such, the discussion on the future of Mercosur seeks to elucidate how an integration process that is functional to the sustainable development of its constituent parts can be built. It is within this framework that the current discussion on the *flexibilization* of the bloc takes place.

At the center of this debate is the common external tariff, which represents the agreement of Mercosur members to charge the same rate to products from outside the



region regardless of where they enter through the Mercosur Common Nomenclature (NCM). In practice, the CET and the NCM serve to discriminate the level of protection for intra-zone products with respect to products from third markets. Currently, the bloc's CET averages 12.5 %, even reaching 35 % in some cases. In comparison, the average tariff level worldwide is 9.2 % (Dinatale, 2021).

In legalistic terms, the discussion on the flexibilization of the bloc conflicts with Decision 32/00, which establishes the need for the bloc to have “a common trade policy” and commits its members to jointly negotiate trade agreements with third parties. Therefore, behind the demands for greater flexibilization lies a profound criticism of the principle of consensus by which the bloc makes its decisions. This principle requires that any decision to be taken must have the agreement –or, at the very least, the acquiescence– of all member countries. On the contrary, the proposal for greater flexibility suggests that the members of the bloc may reach trade agreements with third countries without necessarily having the endorsement of its four members, thus allowing negotiations of one, two or three members with third partners.

The debate on Mercosur's flexibilization marks an intra-bloc break between those members more in favor of greater flexibilization in the future negotiations of the South American space and those more reluctant to support flexibilization measures that favor unilateral negotiations instead of as a joint actor<sup>13</sup>. This difference in positions became evident during the summit of presidents held on March 26, when the Uruguayan president, Luis Lacalle Pou, warned that Mercosur should not become “a burden” for the commercial progress of its members<sup>14</sup>.

At present, Uruguay is the member that is most critical of the current state of the bloc. As a result, the country advocates the revision of the common external tariff, pointing out that the numerous exceptions that are applied in practice end up delegitimizing the

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<sup>13</sup> It should also be noted that these discussions are being carried out by the four full members of Mercosur, without Venezuela, which joined as a full member in 2016 but was suspended in 2017 due to a breakdown in its democratic regime, or Bolivia, which is in the final stages of the membership process. This could lead to new problems in the future, should either of these two countries finally (re)join the bloc, as they will have had no say in this crucial moment of Mercosur's trade policy review and its future identity.

<sup>14</sup> *La Diaria*, 03/26/2021. Available at: <https://ladiaria.com.uy/politica/articulo/2021/3/lacalle-pou-dijo-que-el-mercosur-no-puede-ser-un-lastre-y-fernandez-respondio-si-somos-un-lastre-que-tomen-otro-barco/>

usefulness of the CET<sup>15</sup>. Uruguay proposes an “integration at different speeds”, based on a greater degree of flexibilization of the bloc that would give the individual Mercosur members a greater margin of decision making with respect to their trade policies with third parties. Furthermore, the recent announcement regarding the start of negotiations and a feasibility study for a free trade agreement between Uruguay and the People’s Republic of China has only increased the friction within the bloc which, under its current rules, does not allow bilateral agreements. This announcement has been followed, more recently, by another feasibility study, this time for a free trade agreement between Uruguay and Turkey<sup>16</sup>. Lacalle Pou’s Uruguay also wants to take advantage of the window of opportunity offered by Bolsonaro’s administration in Brazil (Chinese Dialogue, 2021), marked by a policy of greater economic and trade liberalization, to advocate for greater flexibility in the bloc; a window that may close in 2022, with the presidential elections in the Portuguese-speaking country, in which former President Lula da Silva is currently the main contender for the Planalto Palace.

In a similar vein, Brazil seeks a lowering of the CET as a means to recover the trade dynamism of the bloc and achieve greater international integration of Mercosur. Brazil believes that the consensus rule should not function as a permanent veto tool that prevents the opening and conclusion of negotiations with third parties. Clearly, by making use of its pro tempore presidency during the second half of 2021, Brazil has announced a unilateral 10 % reduction of its import tariffs on 87 % of goods and services, until the end of 2022. By doing this, Brazil is anticipating a move expected by the rest of Mercosur members, in a way, “marking their territory” to speed up the liberalization of the bloc and securing itself before next year’s presidential elections.

In March of this year, on the 30th anniversary of the Treaty of Asunción, while holding the pro tempore presidency of the bloc at that time, Argentina reaffirmed its

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<sup>15</sup> On April 26, 2021, Uruguay formally submitted for consideration by the Mercosur Council a document proposing: (a) the lowering of the CET, (b) a set of alternatives aimed at making the bloc’s negotiations with third partners more flexible, to allow negotiations on an individual basis, and (c) developing a joint plan for external negotiations. It should also be recalled that already in the second half of 2019 Brazil had submitted to the bloc a proposal for a generalized reduction of the CET.

<sup>16</sup> *El País*, December 22, 2021. URL: <https://www.elpais.com.uy/informacion/politica/lacalle-pou-creo-hay-crispacion-capaz-le-sirve-dar-manija.html>

commitment to a common trade policy and the bloc's vocation for joint negotiation. Along these lines, Argentina stresses that the reduction of the CET could be detrimental to the industrial and agro-industrial sectors if it is not approached in a gradual manner, so as not to erode the national productive structures of the bloc. Similarly, Paraguay currently supports the continuation of negotiations with third parties, seeking to separate discussions on external negotiations from those related to the review of the CET, and arguing that these are two separate issues that should be addressed separately. It should also be noted that this is the first time in 20 years<sup>17</sup> that the issue of flexibilization was brought to the negotiating table, as was pointed out by the Uruguayan Foreign Minister, Francisco Bustillo, during the March meeting.

At this point, the question arises: how restrictive is the implementation of the CET in practice? When we inquire into this matter, we can observe that the application of the CET is plagued by exceptions, different types of extensions, and non-compliance. For example, we can mention the transitional reduction for shortages, which allows the country that requests it to apply a lower rate than the CET (which is usually a rate of 2 %) for a renewable period of 12 months, and for a limited number of products. Looking at the period 2015-2019, Brazil obtained 212 exceptions, at an average of 42 per year, while Argentina implemented 80 exceptions, at a rate of 16 per year. In contrast, Uruguay implemented only 17 exceptions during the same period, equivalent to 3 exceptions per year, while Paraguay has not yet requested any (Bouzas, 2021). All these exceptions weaken the CET and represent a de facto relaxation of the trade policy of the member countries of the bloc, making the exception the rule.

So, if flexibilization is the norm in practice, why does the current debate on the formal flexibilization of the bloc generate so much friction? It can be argued that the cost of abandoning the customs union, at least at the formal level, transcends the economic-commercial plane to redefine Mercosur in the symbolic-discursive sphere. Indeed, the transition to a more flexible modality would entail to a certain extent the abandonment of a project of common strategic vocation, "lowering the price" of the identity of the bloc and

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<sup>17</sup> <https://www.lanacion.com.ar/opinion/el-mercosur-se-hunde-en-la-irrelevancia-nid25032021/>

the role it would play with respect to the national development of each of its members. As Bouzas (2021) rightly points out, leaving behind the customs union would mean, for the regional imaginary, the abandonment of a project of strategic vocation that encompasses areas that go beyond trade and the economy. Thus, breaking the Mercosur status quo is seen as a move that would have a negative impact on other areas of intraregional cooperation, although the reasons are not made explicit.

### Conclusion: Pathways to the future

This moment of *impasse* in Mercosur is read in different ways by the specialized literature. For some, it is a sign of the bloc's stagnation in an equilibrium of low cooperation, a stage that will be maintained in the coming years because it is useful to advocate regional integration in discursive-identity terms, but not in economic-trade terms. For others, the debate over the lowering of the CET and the defense of integration at different speeds marks the beginning of the end of a bloc that has long ceased to be functional to the development model of its members. Finally, some analysts see this critical juncture in Mercosur not as a moment of crisis but as a window of opportunity to rethink the bloc and move towards greater integration, seeking to exploit regional comparative advantages and minimizing the impact on its less competitive sectors, advance in the construction of regional value chains, integration in infrastructure and communication, the unification of standards and regulations, and the maintenance and strengthening of sustained political dialogue among its members.

The future path that the bloc will take in the next decade will depend, to a large extent, on the political-ideological orientation of those who will preside over its member countries in the coming years, and the role they give to the region within the development model they advocate for their societies. In other words, it will depend on how the different visions of Mercosur's purpose can be agreed upon (or not). Nevertheless, cooperation and policy coordination at the middle levels of government and among the more technical sectors of the region will continue, advancing in joint work in areas such as health, education, infrastructure, tourism, social security, among others. It is in this "functional"

cooperation where Mercosur's integration project becomes more visible, and where networks of regional actors interested in preserving and consolidating the integration project are generated.

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# Options for Mercosur

José María Arbilla

“If to do were as easy as to know what were good to do,  
chapels had been *churches*,  
and poor men’s cottages princes’ *palaces*”.  
*The Merchant of Venice*

## Introduction

The call to reflect on the future of Mercosur is more than welcome. There is no lack of diagnoses on its current problems. It is much more challenging to formulate suggestions, not to mention the difficulties of its implementation.

However, any recommendation must be based on a good analysis. It is therefore necessary to begin by building this starting point, albeit as briefly as possible.

Traditionally, the reasons for Mercosur’s stagnation have been attributed to an absence of “demand” or “supply” for integration, its institutional deficiencies, or in an idiosyncratic lack of adherence to the commitments undertaken. It cannot be denied that these factors play a role, sometimes an important one. But, it can be postulated that they have been enhanced by more powerful underlying reasons.

Once these reasons have been identified, it is easier to outline the constituent elements of two options (consolidating the customs union or forming a free trade area), to which intermediate options could be added. The current Mercosur is one of these options, but not as the product of a planned balance of instruments, rights, and obligations, but as the consequence of successive advances, blockages, and non-compliance.

From an Argentine perspective, the transition from the current Mercosur to the desired or possible Mercosur requires, as a first step, the definition of a development model, to then evaluate whether this model is compatible with the interests of the partners. The

possibility of reaching a consensus on a common development model depends on what kind of Mercosur can be built for the future.

### Why has supply and demand for more Mercosur failed?

Mercosur was born out of the political will of the governments and only later was the demand for greater integration generated<sup>18</sup>. In 1991, the creation of Mercosur combined the interest of the four partners in stimulating competitiveness through the enlarged market, the creation of a platform for their international integration, and the creation of a new market for the four countries<sup>19</sup>, locking in pro-market reforms<sup>20</sup>, and consolidating democracy<sup>21</sup>.

Mercosur has not been lacking in attempts to implement a customs union. Its construction requires harmonizing or eliminating instruments or regimes that support certain sectors, eliminating barriers to intra-zone trade and consolidating the Common External Tariff (CET), among other requirements of economic integration. Over the years, different work programs were negotiated: the “Las Leñas Action Plan” (CMC Decision No. 01/92), the “Consolidation of the Customs Union and Transit to the Common Market” (CMC Decision No. 13/93), the “Asunción Program” (CMC Decision No. 9/95), the “2004-2006 Work Program” (CMC Decision No. 26/03), and finally the “Program for the Consolidation of the Customs Union” (CMC Decision No. 51/10).

All of them faced three main challenges. One, the problems of implementing a cross-interest agenda. Two, a growing divergence of interests among the bloc’s partners. And finally, a lack of coordination between the internal and external agendas. As a consequence

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<sup>18</sup> Malamud, A. (2005). “Presidential Diplomacy and Institutional underpinnings of Mercosur: an Empirical Examination”. *Latin American Research Review*. 40 (1): 138-64.

<sup>19</sup> Kegel, P.; Amal, M. (2013). “Perspectivas das negociações entre o Mercosul e a União Europeia em um contexto de paralisia do sistema multilateral e da nova geografia econômica mundial”. *Revista de Economia Política*. 33 (2). abril/junho 2013. pp. 341-359, pag. 344.

<sup>20</sup> Perales, J. (2003). A Supply-side Theory of International Economic Institutions for the Mercosur. In Finn Laursen (ed.). *Comparative Regional Integration: Theoretical Perspectives*. Aldershot, Ashgate.

<sup>21</sup> Lorenzo, J. (2006). *Obstacles to Total Economic Integration in Regional Trade Blocs: The Case of Mercosur*. Honors College Theses. Paper 43.

of these three elements, the level of compliance with successive programs had diminishing returns.

Regarding implementation, it should be noted that in many cases the measures or regimes to be modified or eliminated benefit a certain sector or sectors of a Mercosur member state to the detriment –real or perceived– of another sector of another member state. The reform of the CET, the elimination of trade defense tools in intra-zone trade, the elimination of asymmetries in production incentives, the special import regimes, the elimination of double charging of the CET and the distribution of customs revenue make up a complex geometry where the perception of a “zero sum” prevails.

The various programs agreed upon have included a list of these issues, on which progress was sought in a way that balanced the efforts of each member state (for example, the deadlines set for the fulfillment of the various objectives of decision 51/10). In practice, mistrust has predominated. In most cases, each member state has refused to move forward on an aspect of the work program that requires its flexibility, for fear of not receiving reciprocal treatment on another issue of interest to it, but which requires a concession from the rest.

Gómez Mera points out that the demands emanating from economic interest groups intervened to weaken the cooperation<sup>22</sup>. However, the author also points out that, although the demands of the economic actors put intra-Mercosur relations under tension, the rupture of the rules of the game occurred when macroeconomic factors intervened in the same way<sup>23</sup>.

This leads to the second problem, the growing divergence of interests and policies. Paraguay, and Uruguay in particular, have increasingly focused on increasing their exports as a vehicle for growth (meat, sugar, dairy products, cellulose pulp). Brazil has been modifying its trade policy towards increasing degrees of economic openness. This gradual reorientation responds not only to changes in the political blocs in power, but fundamentally to a highly consensual diagnosis in the business sector of these countries

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<sup>22</sup> Power and Regionalism in Latin America. University of Notre Dame Press.

<sup>23</sup> Idem, pág. 199.

that their long-term prosperity depends on an agenda of industrial competitiveness, rather than on protection against imports. Successive statements by Brazilian businessmen, for example, show a change of attitude towards Brazil's economic insertion since the beginning of the last decade<sup>24</sup> and <sup>25</sup>.

Argentina, on the contrary, has historically had a lower degree of coordination between the orientations of the business sector and the public policy decisions of successive administrations. Perhaps it would be more correct to say that trade policy has tended to respond to the interests of a sector or group of sectors that were closer to the interests of the electoral base of successive administrations. Trade policy has functioned as an imperfect substitute for industrial policy –in the absence of more effective instruments– when it has not been the dependent variable of macroeconomic imbalances or doctrinaire positions. The result has been a trade policy that has oscillated between protectionism and openness.

A third problem derived from the two previous ones is the low synergy between the bloc's internal and external agendas. However, these two dimensions are completely interrelated. It is not essential, although it would be desirable, that in each area the level of intraregional integration should be higher than with third countries. But there must be coherence that avoids discrimination, trade diversions, perforations and, above all, wasting the potential of the common market for competitiveness and investment. Some simple examples are rules of origin, public procurement, and geographical indications.

### **What can explain the persistence of these three problems?**

Mercosur's structural problem is the loss of a common model of economic development. In the case of four peripheral economies that depend for their growth on capital and technology and external markets, this is very similar to saying that Mercosur's main problem has been the absence of a common model of international integration.

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<sup>24</sup> Confederação Nacional da Indústria, Mapa Estratégico da Indústria 2013-2022. Ano 2012.

<sup>25</sup> FIESP, Documento de Posição. Propostas de integração externa da indústria. FIESP. Ano 2014.

Globalization has changed the conditions under which the companies and economies of developing countries can progress in the world economy. The need to improve the competitiveness of the economy as a whole and of certain key players in the value chain requires new competencies at the level of companies (innovation, management, marketing) but also of economic policies.

Far from being a world of opportunities for all, the phenomenon of value chains is a way of redesigning the distribution of labor in which the positioning in each part of the chain determines the income obtained by companies or nations<sup>26</sup>.

Globalization has favored “light” integration, which prioritizes the diversification of suppliers and markets or incorporation into a world production pole (such as Mexico in the North American production pole, the European countries around Germany, and the Asian economies around China and Japan). On the contrary, the combination of globalization and peripheral integration (the case of the Mercosur countries) has modified the conditions for the survival of customs union models based on the development of industrial capabilities via relatively protected expanded markets.

For a good part of the bloc’s existence, both sectors with predominant export interests and sectors with predominant market interests in the four countries obtained advantages from Mercosur’s existence.

The agricultural and food sector –the net exporter of Mercosur– has long been interested in joint negotiations, where it was possible to extract additional concessions thanks to the attractiveness of the Argentine and, to a much greater extent, the Brazilian market. But, many industrial sectors, particularly in Argentina and Brazil, have prospered under the common external tariff.

For various reasons, particularly the greater importance of imports in production chains and the emergence of global consumption and production poles in Asia, globalization has increased the centrifugal tendencies of regional integration schemes.

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<sup>26</sup> Kaplinski, R. (2005). *Mondialisation, Poverty and Inequality*. Malden, Polity Press.

Mercosur in its current state is less vital for certain sectors of the economies of Argentina, Brazil, Paraguay, and Uruguay.

The economies of the Mercosur member states are developing economies with low integration in value chains, and when they do achieve this, it is generally as suppliers of raw materials at the beginning of the production chain located outside Mercosur's borders. The most dynamic and competitive sectors have a decreased interest in developing regional integration and a greater interest in an open trade policy that enhances their access to world markets.

In addition, the economies of the four founding countries have had very different performances over the last thirty years. The attitude of important productive sectors in each of the member countries towards globalization, and their perception of it as an opportunity or a challenge, has been influenced by macroeconomic conditions and productive structures that have taken divergent paths.

Even some sectors that favor the domestic market have lost interest in the bloc. The competitiveness differentials between domestic production and imports from third countries are also found between domestic production and that of other members of the bloc. The absence of instruments to address these competitiveness differentials is behind the difficulties encountered in eliminating non-tariff barriers in intra-zone trade.

Brazil retains the conditions to aspire to become the center of some of the regional value chains in South America<sup>27</sup>, but its own projection in Latin American markets rivals China<sup>28</sup>. In order to compete in these markets and even in its own, part of the Brazilian business community is demanding an economic opening that will allow it to incorporate inputs at low costs. In the view of Brazilian business leaders, the recovery of the economy's competitiveness and the productive and technological development of industry require Brazil's integration into the world. A country with consistent global connections produces

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<sup>27</sup> Baptista Maduro, L. y Polonia Rios, S. (2014). "Mercosur: ¿Llegó el momento de replantear el modelo?" Boletín Informativo Techint N° 345, Nov. 2014.

<sup>28</sup> IEDI (2015). O Comércio Bilateral Brasil-China e a Produção Industrial Brasileira. Carta IEDI n. 674. [http://www.iedi.or.g.br/cartas/carta\\_iedi\\_n\\_674.html](http://www.iedi.or.g.br/cartas/carta_iedi_n_674.html).

more efficiently, innovates, and generates better jobs<sup>29</sup>. In contrast, Argentina seems to concentrate its competitiveness in sectors linked to natural resources and services. Its industry shows a weak export capacity to world markets and even to Mercosur.

These centrifugal tendencies have created the need for strong macroeconomic coordination and public policies for investment and industrial development more pressing within the framework of an integration project, elements that were relatively neglected in Mercosur's original design.

### **Two schematic options and some intermediate options**

Mercosur's consolidation problems are the consequence of an initial scheme that was devoid of the assumptions on which it should be based. Mercosur is stuck in an intermediate zone in which it is not advancing towards its foundational objectives, but neither is it reorganizing itself towards more modest objectives. Thus, the bloc is the victim of unilateral and uncoordinated measures.

The first alternative to preserve Mercosur as a customs union as a deep economic integration project, requires a common project among the founding partners regarding their economic development model and their international integration.

This project is the most complex and difficult and requires the greatest effort and willingness to give up one's own interests in favor of common interests. This willingness is quite diminished after several years of disappointments. In a more domestic key, it requires, first that Argentina collectively defines its own model to try, second, to reconcile it with the other member states.

If the path to consolidate the customs union is blocked by the absence of this common project, a second option would be to redesign Mercosur as a free trade area reinforced with some elements of economic integration based on the geographic proximity of its member states.

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<sup>29</sup> Confederação Nacional da Indústria (2019) Agenda internacional da indústria.

This second option is simpler, since it consists of yielding to the obstacles that have been encountered over the years. Mercosur has been slowly moving towards this option. But it has done so by opening gaps in the customs union based on national or sectoral interests, without planning and often by unilateral measures without consensus. The result is that Mercosur's internal coherence has been diminished. It is not only an "imperfect customs union", but a dysfunctional customs union.

In between these two options, other options with an intermediate level of ambition could be imagined. To paraphrase Tolstoy, all perfect customs unions look alike, but every imperfect customs union can be imperfect in its own way. The central point is the consistency between the level of ambition of the different objectives and instruments. Intra-zone free trade without harmonization of incentives and macroeconomic coordination is an undesirable scenario, just as a common trade policy without guarantees of access to the enlarged market is not useful.

### **What would it take to form a customs union?**

The development of the customs union requires the incorporation of tools to prevent and resolve conflicts of interest among the partners and to build common or at least non-incompatible interests among the partners. Apart from the political will and the definition of a development model (which will be discussed later), some practical tools should be implemented:

1. Government agencies at the national level lack any incentive to abandon their legal frameworks, institutional traditions, and "constituencies". The agencies of each member state, precisely because they must fulfill their legal mandate, often fuel conflicts of interest with technical arguments rather than resolve them. Even in its best moments, the dynamics of integration were defined by presidential intervention, which drove the process and gave it shape (Malamud, 2005)<sup>30</sup>. But political will alone is insufficient. By nature, it is too sporadic –there will always be a new problem that

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<sup>30</sup> Malamud, A. (2005). Op. cit., pág. 158.



demands its attention– and too superficial –it cannot process problems that are of enormous diversity and technical specificity<sup>31</sup>.

The customs union cannot progress without a decision-making system and a dispute settlement mechanism that eliminates deadlock and the perennality of problems<sup>32</sup>. One of its main limitations is that, unlike in the European Union, the dispute settlement system is closed to citizens or companies<sup>33</sup>. The member states have preferred to avoid using the system for various reasons, including the political cost and the expectation of compliance. However, the mechanism is not available to companies, non-governmental organizations and citizens who could be the first stakeholders in compliance with the bloc's rules.

2. Historically, one of the most important sources of tension in Mercosur has been short-term changes in relative competitiveness. These emerge from swings in macroeconomic variables. A functional customs union needs some degree of macroeconomic policy coordination, in particular public deficit, inflation, and exchange rate targets. The Macroeconomic Coordination Group lacks the periodicity, competencies, and legal instruments to do so and should be strengthened along these lines.

3. Another factor that has prevented the deepening of the bloc is the asymmetries in competitiveness in the long term. Mercosur needs a common framework for tax incentives and a harmonization of industrial policy instruments with a dual objective: horizontal competitiveness and sectoral policies. For example, a true common automotive policy that focuses on the transition to electric vehicles and not on trade administration.

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<sup>31</sup> Clulow, G. (2017). La Diplomatie Présidentielle Dans l'Institutionnalité du Mercosur. Atelier: Les crises institutionnelles, les leaderships présidentiels et les élections en Amérique latine. Congrès Des associations francophones de science politique Montréal, 17-19 mai, 2017.

<sup>32</sup> Bouzas, R. (2004). "La dinámica institucional y normativa: un balance". Boletín Informativo Techint No. 315. Septiembre-diciembre 2004. pp. 63-81. Número dedicado al Mercosur.

<sup>33</sup> Malamud, A. (2008). "La agenda interna del Mercosur: interdependencia, liderazgo, institucionalización". Jaramillo, G., Los nuevos enfoques de la integración: más allá del nuevo regionalismo, pp. 115-137. Quito: FLACSO Sede Ecuador.

4. Most of Mercosur's internal conflicts derive from tensions between consolidated sectors. The bloc is still imprisoned by national conflicts of interest characteristic of the second industrial revolution. Few incentives have been created for the development of new sectors with non-conflicting interests linked, for example, to the digitalization of the economy. The common external tariff and rules of origin need to be revised to define regional value chains for certain sectors and global chains for others. Similarly, Mercosur would need a common policy on telecommunications and digital services.

5. Another missing element in a customs union is a connectivity policy at all levels. Mercosur should have a common plan regarding the development of its infrastructure and not development projects that compete with each other for customs or port revenues, for example. As the case of the European Union shows, there is no common policy without common funds. Mercosur would need a common fund for the development of the bloc's internal connectivity at all levels (road infrastructure, digital connectivity).

6. Another disintegrating element of Mercosur has been the failure to create a truly expanded market. If companies in the member states find it easier or more profitable to export to third countries than to their partners, there will be little incentive to consolidate the customs union. This requires eliminating non-tariff barriers to intra-zone trade, among others:

The establishment of a Mercosur animal and plant health agency (which will not replace the four national agencies) but will ensure the equivalence of control systems and allow the elimination of sanitary and phytosanitary controls for intra-zone trade.

Adoption of a "new approach" approach to technical regulations in the European Union. That is, harmonization limited to safety requirements and the principle of recognition of products manufactured under standards conforming to those requirements.

7. Another element of tension in Mercosur has been the different views on the speed and level of ambition of the external agenda. As the external agenda took precedence over the internal agenda, the temptation to eliminate the principle of joint negotiations increased. The customs union requires the definition of a long-term external agenda and a common negotiating mandate on the objectives and content of trade negotiations.

The external agenda cannot be decoupled from the economic growth model. Trade negotiations require a consensus on the sectors that will be excluded from trade liberalization, those that will be exposed to external competition and will be financed in various ways for their growth (investment in R&D, infrastructure, or subsidies), the sectors that do not need strong sectoral incentives, and the sectors where imports will play the most important role, whether as consumer goods or as inputs for production processes.

The European Union is a typical case. Agriculture and agricultural production are protected and subsidized by the common agricultural policy. Sectors such as energy, steel and forestry have been the subject of sectoral renewal policies. Other sectors benefit from horizontal digitalization, innovation, and sustainability policies. Other sectors such as clothing, household appliances and electronics are imported from Asia or the Mediterranean. Mercosur needs to make its own sectoral choices based on its own economic structure and social fabric.

At the same time, external negotiations require a consensus on which trade agreement instruments stimulate economic growth and which do not. The negotiating positions of the most important players in international trade in the areas of intellectual property, rules of origin and investment are modeled on their comparative advantages and their positioning in global value chains. Mercosur should also define the combination of negotiating positions that maximizes its interests.

8. The common trade policy needs all member states to reap benefits, but also to share the costs. The common trade policy allows more benefits to be extracted from

trade negotiations, especially for those Parties with smaller market size, but it is slower. Arbitrating this dilemma is easier if there are also sufficient incentives derived from participating in the enlarged Mercosur market. Mercosur's external trade policy requires a dynamic internal agenda.

These measures should be part of a legislative package sanctioned by the four Congresses. Decisions made by the executive powers are easily reversible if they are not legislatively sanctioned. This leads to another of the problems of the bloc, the dispersion of political representation. The four Congresses have very little participation in the bloc's agenda and have in fact little relationship among themselves. At least, they have very little in relation to what would be necessary for them to participate in the integration process and act as promoters of the bloc.

### Free trade area option

As can be seen, the option of a true customs union requires a level of ambition, political will and consensus that has so far been difficult to sustain over time.

If this project cannot or will not be implemented, the modification of the Treaty of Asunción should be evaluated to define new objectives and instruments. In this redefinition, coherence between the internal and external agenda is important. A free trade area does not require a common external trade policy, but neither does it require the liberalization of all trade or the elimination of intra-zone trade defense instruments.

A free trade area could provide:

- that each country defines its agenda for external negotiations;
- sets their national tariffs;
- applies intra-zone trade defense measures, including safeguards;
- that the objectives of the Treaty could also be reviewed in relation to the elimination of trade administration and monitoring tools;
- exclusions of products and sectors from free trade;

- a complete revision of the rules of origin with a focus on possible trade triangulation;
- from the institutional point of view, Mercosur's management structure, its representative bodies, and its dispute settlement system (Permanent Review Tribunal) could be simplified.

This would in no way prevent the entry into force of the protocol on government procurement, electronic commerce and geographical indications and the conclusion of the 8th round of services liberalization. These commitments in general terms would barely bring intra-zone relations up to the level of commitments being negotiated with third parties.

Considering that, even in the hypothesis of a free trade zone, it would be an association between countries that share a common geographical space, the reformulated Mercosur should still contain instruments for the development of the physical interconnection infrastructure.

Apart from these two ideal types (full customs union or free trade area) and considering the difficulties in achieving one and the disadvantages of the other, several intermediate options could be found as a result of an agreement between the States parties. All these options should contemplate one of the basic principles of the Treaty of Asuncion, that is, the balance between rights and obligations.

So far Mercosur contains numerous flexibilities in both intra-zone and extra-zone trade. These include exceptions to the Common External Tariff, temporary regimes and elements of flexibility already existing in external negotiations (for example with LAIA countries or the bilateral entry into force of some agreements).

At the internal level, the particularity of these "flexibilities" is that they are transitional mechanisms towards full customs union and are treated as temporary exceptions. Externally, the bilateral negotiation of trade agreements with third countries outside Latin America could not be considered as temporary exceptions. By the nature of these commitments, they are permanent perforations. Therefore, it is desirable that the

intermediate options be designed according to the degree of “flexibility” that is decided to be agreed upon in the internal negotiations.

The more “flexible” the external trade policy, the less ambitious the intra-zone integration objectives may be. There are few additional flexibilities that can be agreed upon without necessarily requiring the modification of the Treaty of Asunción.

### The development model

It has been hypothesized that Mercosur’s main problem is the absence of a development model. The reason for addressing this issue separately is that, at least in the case of Argentina, it is a definition that is prior and common to any of the options pursued.

This definition seems clearer in the cases of Paraguay, Uruguay and even Brazil and prioritizes a more active external agenda and an internal agenda concentrated on intra-zone free trade instruments, without major elements of economic integration or the construction of a common market.

An economic growth model requires a consensus that is currently absent. This is not a particularity of Argentina. Development models are often implicit choices, the result of sometimes traumatic historical processes such as revolutions, dictatorships and even lost wars. Sometimes this consensus hides only the impossibility of reversing a development path. The recipe for economic growth is not easy to find; there is no defined combination of policies that generate sustained economic growth. Even the success stories are subject to different interpretations<sup>34</sup>.

Tavares de Araujo draws two prescriptive conclusions from his analysis of the Brazilian case<sup>35</sup>. The first is that the competitiveness of national industries depends not only on their capacity to launch new products and reduce production costs, but also on public policies that increase the efficiency of the various segments of the service sector, especially

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<sup>34</sup> Rodrik, D. (2018). *Straight Talk on Trade: Ideas for a Sane World Economy* Princeton, pág 225.

<sup>35</sup> Tavares de Araujo, J. (2013). “Fragmentação da produção e competitividade internacional: o caso brasileiro”. *Revista Brasileira de Comércio Exterior*. No. 115. Abril - Junho de 2013. [http://www.funccex.org.br/publicacoes/rbce/material/rbce/115\\_JTA.pdf](http://www.funccex.org.br/publicacoes/rbce/material/rbce/115_JTA.pdf)

transportation logistics, the communications system, financial intermediation, quality certification, auditing and conflict resolution. The second is that the formulation of selective industrial policies, aimed at promoting sector-specific comparative advantages, has never been as relevant as it is today, given the volatility of competitive conditions<sup>36</sup>.

It may be possible to list some basic elements:

1. Argentina has much to gain in competitiveness of its production just by achieving macroeconomic stability with a competitive exchange rate and low inflation. There is probably no more effective industrial policy. Price and exchange rate stability will also help prevent trade and investment displacement tensions among Mercosur partners.
2. Long-term growth and the increase in value added depend more on the creation of innovation environments, the design of targeted aid and the development of infrastructure than on the creation of market reserves via tariffs or tax exemptions. It is necessary to identify the sectors that will drive growth, those that have the potential to be competitive but require sectoral policies to achieve it and those that will need protection because of their systemic problems, but which for social reasons must be preserved.
3. Argentina has much to gain from a significant increase in investment in education at all levels. Our country's performance in knowledge-based services (KBS) is proof of these competitive advantages. But KBS cannot be the swan song of the Argentine education system. Authors such as Mazzucato show that historically the development of new technological sectors was preceded by strong public investment in research (although not every type of R&D has an impact on growth)<sup>37</sup>. The articulation between the educational and R&D systems of the Mercosur member states is still in its infancy, in comparison with other experiences such as the European one.

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<sup>36</sup> Idem.

<sup>37</sup> Mazzucato, M. (2011) *The Entrepreneurial State: Debunking Public vs. Private Sector Myths*, Anthem Press, pág. 51.

4. Modern evolutionary economic geography<sup>38</sup> stresses the importance of economic diversification based on the use of organizational and technological factors at the firm level and their interaction with academic and governmental stakeholders<sup>39</sup>. Focusing Mercosur integration on these new sectors, rather than on sectors with structural competitiveness problems, would help move the bloc's agenda away from a zero-sum game.

From the point of view of the Argentine interest, transforming Mercosur into a free trade area would only save the step of reconciling our country's project with that of the other Mercosur partners. It does not avoid the need for a definition of our own. Without macroeconomic stability and a genuine competitiveness agenda, any alternative –be it more open or more protectionist, within the framework of a customs union or a free trade area– will be doomed to failure.

From the point of view of the interests of all the member states, the future of Mercosur must be decided by consensus, as established in the treaties (Asunción, Ouro Preto). Unilateral measures only hinder the construction of a common future, under whatever format.

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<sup>38</sup> Boschma, Ron & Frenken, Koen. (2011). The Emerging Empirics of Evolutionary Economic Geography. *Journal of Economic Geography*. 11. 295-307. 10.1093/jeg/lbq053.

<sup>39</sup> Binz, C., Truffer, B., & Coenen, L. (2016). Path creation as a process of resource alignment and anchoring: industry formation for on-site water recycling in Beijing. *Economic Geography*, 92(2), 172-200. <https://doi.org/10.1080/00130095.2015.1103177>, p. 27.



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