REPORT

MERCOSUR

2006 (Second Semester) - 2007 (First Semester)

Integration and Trade Sector
Institute for the Integration of Latin America and the Caribbean - IDB-INTAL

Inter-American Development Bank
MERCOSUR Report N° 12, February 2008

Intal

MERCOSUR Report
Nº 12

REPORT

MERCOSUR

2006 (SECOND SEMESTER) - 2007 (FIRST SEMESTER)

Inter-American Development Bank
Integration and Trade Sector
Institute for the Integration of Latin America and the Caribbean IDB - INTAL
Esmeralda 130, 11th and 16th Floors C1035ABD Buenos Aires, Argentina
Ph. (54 11) 4 323-2350 fax (54 11) 4 323-2365
E-mail: pubint@iadb.org. http://www.iadb.org/intal

The authors are responsible for ideas and opinions hereby expressed which may not necessarily reflect policies and/or positions from IDB or INTAL.

Published in Argentina

Institute for the Integration of Latin America and the Caribbean IDB - INTAL
MERCOSUR Report Nº 12
1ª ed. - Buenos Aires: IDB-INTAL. February, 2008.
130 p.; 28 x 21 cm.

ISBN 978-950-738-277-2

1. Desarrollo Económico - Mercosur I. Título
CDD 338.9

Editing Coordination: Susana Filippa
Editing: Julieta S. Tarquini

Since the Treaty of Asunción was signed in 1991, the Southern Common Market has become a pilot case for assessing the successes and challenges of this ambitious initiative. This work is embedded in a broader framework of IDB/INTAL's activities in integration processes in Latin America and the Caribbean as part of the Vice-Presidency for Countries (VPC), coordinating its tasks with the Integration Sector of the Bank's Vice-Presidency for Sectors and Knowledge (VPS).

Through this annual report, IDB/INTAL aims to facilitate access to information for a potential readership interested in MERCOSUR, spanning the public, private, and academic sectors, and the subregional community as a whole. We also endeavor to go beyond the subregional interest aroused by MERCOSUR by facilitating its circulation in the international community via the publication of the Report in English, in addition to the bloc's official languages, Spanish and Portuguese.

Report 12 covers the second half of 2006 and the first half of 2007. The initial draft was prepared by Gustavo Svarzman and Ricardo Rozemberg, with a working group consisting of Alejo Espora assisted by Aníbal Córdoba Sosa. Romina Gayá and Alejandro Ramos were responsible for the macroeconomic Chapter. The final Report was coordinated and edited by Ricardo Carciofi and Uziel Nogueira, INTAL Director and Senior Integration Economist respectively, with the assistance of Romina Gayá and Alejandro Ramos.

Readers are invited to send their comments and/or suggestions on how to improve the scope and focus of future publications to help us continue to live up to the expectations prompted by previous reports.

ABBREVIATIONS AND ACRONYMS

ADEFA	Association of Automobile Manufacturers of Argentina *(Asociación de Fabricantes de Autos de Argentina)*
AFARTE	Association of Argentine Electronics Terminals Manufacturers *(Asociación de Fábricas Argentinas Terminales de Electrónica)*
AFJP	Retirement and Pension Fund Administrator *(Administradora de Fondos de Jubilaciones y Pensiones)*
BCB	Central Bank of Brazil *(Banco Central de Brasil)*
BCP	Central Bank of Paraguay *(Banco Central de Paraguay)*
BCRA	Central Bank of the Argentine Republic *(Banco Central de la República Argentina)*
BCU	Central Bank of Uruguay *(Banco Central del Uruguay)*
BCV	Central Bank of Venezuela *(Banco Central de Venezuela)*
BEA	Bureau of Economic Analysis
BIT	Information Processing and Telecommunications Goods *(Bienes de Informática y Telecomunicaciones)*
BONAR	Bonds of the Argentine Nation *(Bonos de la Nación Argentina)*
b.p.	Basic Points
c.a.	Cumulative Annual
CADEA	Argentine Chamber of Aerosol *(Cámara Argentina del Aerosol)*
CADIVI	Commission of Foreign Exchange Administration *(Comisión de Administración de Divisas)*
CAF	Andean Development Corporation *(Corporación Andina de Fomento)*
CAFAEMEH	Argentine Chamber of Electrical and Mechanical Household Appliances *(Cámara Argentina de Fabricantes de Aparatos Eléctricos y Mecánicos para el Hogar)*
CAFAGAS	Argentine Chamber of Gas Appliance Manufacturers *(Cámara Argentina de Fabricantes de Artefactos de Gas)*
CAM	MERCOSUR Customs Code *(Código Aduanero del MERCOSUR)*
CCM	MERCOSUR Trade Commission *(Comisión de Comercio del MERCOSUR)*
CET	Common External Tariff
CMC	Common Market Council *(Consejo del Mercado Común)*
COPOM	Monetary Policy Committee *(Comité de Política Monetaria)*
CPI	Consumer Price Index
CRPM	Commission of Permanent Representatives of MERCOSUR *(Comisión de Representantes Permanentes del MERCOSUR)*
CU	Customs Union
DDC	Developed Countries
DECEX	Foreign Trade Department *(Dirección de Comercio Exterior)*
DGC	Developing Countries
DGEEC	General Directorate of Statistics, Surveys, and Censuses *(Dirección General de Estadísticas, Encuestas y Censos)*
DNCI	National Directorate of International Accounts *(Dirección Nacional de Cuentas Internacionales)*
DNCN	National Directorate of National Accounts *(Dirección Nacional de Cuentas Nacionales)*
DNI	National Directorate of Industries *(Dirección Nacional de Industrias)*
EAP	Economically Active Population
ECA	Economic Complementation Agreement
ECLAC	Economic Commission for Latin America
ECPI	Extended Consumer Price Index

ELETROS	National Association of Electric & Electronic Products Manufacturers *(Associação Nacional de Fabricantes de Produtos Eletroeletrônicos)*
EMBI	Emerging Markets Bond Index
FDI	Foreign Direct Investment
FIV	Venezuela Investment Fund *(Fondo de Inversión de Venezuela)*
FND	Federal National Debt
FOCEM	MERCOSUR Structural Convergence Fund *(Fondo para la Convergencia Estructural del MERCOSUR)*
FOGADE	Deposits Guarantee Fund *(Fondo de Garantía de Depósitos)*
FONDEN	National Development Fund *(Fondo de Desarrollo Nacional)*
FONPLATA	Financial Fund for the Development of the River Plate Basin *(Fondo Financiero para el Desarrollo de la Cuenca del Plata)*
FUNCEX	Foreign Trade Study Center Foundation *(Fundação Centro de Estudos do Comércio Exterior)*
GANAEC	High Level Group to Examine the Consistency and Dispersion of the Current Structure of the Common External Tariff *(Grupo de Alto Nivel para Examinar la Consistencia y Dispersión de la Actual Estructura del Arancel Externo Común)*
GAP	Growth Acceleration Program
GATT	General Agreement on Tariffs and Trade
GDFI	Gross Domestic Fixed Investment
GDP	Gross Domestic Product
GMC	Common Market Group *(Grupo Mercado Común)*
GSTP	Global System of Trade Preferences *(Sistema Global de Preferencias Comerciales)*
IBGE	Brazilian Institute of Geography and Statistics *(Instituto Brasileiro de Geografia e Estatística)*
IDB	Inter-American Development Bank
IDB/INTAL	Institute for the Integration of Latin America and the Caribbean
IMEF	MERCOSUR Training Institute *(Instituto de Formación del MERCOSUR)*
IMF	International Monetary Fund
INDEC	National Institute of Statistics and Censuses *(Instituto Nacional de Estadísticas y Censos)*
INE	National Statistics Institute *(Instituto Nacional de Estadística)*
INMETRO	National Institute of Metrology, Standardization and Industrial Quality *(Instituto Nacional de Metrologia, Normalização e Qualidade Industrial)*
IPEA	Institute of Applied Economic Research (*Instituto de Pesquisa Econômica Aplicada)*
ISM	MERCOSUR Social Institute (*Instituto Social de MERCOSUR*)
IVSS	Venezuelan Institute of Social Security *(Instituto Venezolano de Servicios Sociales)*
JICA	Japanese International Cooperation Agency
LAIA	Latin American Integration Association
LEBAC	Central Bank Bills *(Letras del Banco Central)*
LNAP	Previous Non-Automatic Import Licenses *(Licencias No Automáticas Previas de Importación)*
MAC	Competitive Adaptation Mechanism *(Mecanismo de Adaptación Competitiva)*
MECON	Ministry of Economy and Production *(Ministerio de Economía y Producción)*
MERCOSUR	Southern Common Market *(Mercado Común del Sur)*
MRI	Monetary Regulation Instruments
MSME	Micro, Small, and Medium Enterprises
n.a.	Not Available
NAFTA	North American Free Trade Agreement
NCM	MERCOSUR Common Nomenclature *(Nomenclatura Común del MERCOSUR)*
n.d.	No Data

NFTC	National Foreign Trade Commission *(Comisión Nacional de Comercio Exterior)*
NIR	Net International Reserves
NOBAC	Central Bank Notes *(Notas del Banco Central)*
ODM	MERCOSUR Democracy Observatory *(Observatorio de la Democracia del MERCOSUR)*
OPEC	Organization of the Petroleum Exporting Countries
PAM	MERCOSUR Automotive Policy *(Política Automotriz de MERCOSUR)*
PAMA	MERCOSUR Foot-and-Mouth-Free Action Program *(Programa de Acción MERCOSUR libre de Fiebre Aftosa)*
PAMI	Comprehensive Health Care Program *(Programa de Atención Médica Integral)*
PARLASUR	MERCOSUR Parliament *(Parlamento del MERCOSUR)*
PAV	Protocol of Venezuelan Membership of MERCOSUR *(Protocolo de Adhesión de Venezuela al MERCOSUR)*
PDVSA	Venezuela Petroleums Inc. *(Petróleos de Venezuela Sociedad Anónima)*
PIP	Pilot Investment Project
PLC	Trade Liberalization Program *(Programa de Liberalización Comercial)*
p.p.	Percentage Points
REER	Real Effective Exchange Rate
SACN	South American Community of Nations
SECEX	Secretariat of Foreign Trade (*Secretaria de Comércio Exterior*)
SELIC	Special System for Settlement and Custody *(Sistema Especial de Liquidação e Custodia)*
SICE	Foreign Trade Information System *(Sistema de Información Sobre Comercio Exterior)*
SM	MERCOSUR Secretariat *(Secretaría del MERCOSUR)*
SME	Small And Medium Enterprise
TOT	Terms of Trade
TPR	Permanent Review Tribunal (*Tribunal Permanente de Revisión)*
UNASUR	Union of South American Nations *(Unión de Naciones Suramericanas)*
VPC	Vice-Presidency for Countries
VPS	Vice-Presidency for Sectors and Knowledge
WCO	World Customs Organization
WG	Working Group
WTO	World Trade Organization
YOY	Year-on-Year

INSTITUTIONAL STRUCTURE OF MERCOSUR

COMMON MARKET COUNCIL (CMC)

MINISTERIAL MEETINGS

- Agriculture (RMA)
- Culture (RMC)
- Economies and Central Bank Presidents (ECBPMM)
- Education (RME)
- Industry (RMI)
- Justice (RMJ)
- Environment (RMMA)
- Mines and Energy (RMME)
- MERCOSUR Ministers and High Authorities in Science, Technology, and Innovation (RMACTIM)
- Ministers and Social Development Authorities (RMADS)
- Health (RMS)
- Labor (RMT)
- Tourism (RMTUR)

GROUPS

- MERCOSUR Group for the Creation of the Social Institute (GISM)
- High Level Group for MERCOSUR Employment Growth Strategy (GANEMPLE)
- High Level Group to Examine the Consistency and Dispersion of the Current Structure of the CET (GANAEC)
- High Level Group on Overcoming Asymmetries in MERCOSUR (GANPESA)
- Ad Hoc High Level Group for Institutional Reform (GANRI)
- Working Group for the Negotiation of the Membership Process of the Bolivarian Republic of Venezuela (GTVENE)
- Ad Hoc Working Group for the Incorporation of the Republic of Bolivia as a MERCOSUR Member Country (GTBO)
- Special Working Group on Biofuels (GTEB)

Commission of Permanent Representatives of MERCOSUR (CRPM)

Meeting of High Authorities in the Area of Human Rights (RADDHH)

Consultative Forum of MERCOSUR Municipalities, Federated States, Provinces, and Departments (FCCR)

MERCOSUR Training Institute (IMEF)

Policy Consultation and Consensus-Building Forum (FCCP)

COMMON MARKET GROUP (GMC)

WORKING SUBGROUP

- Communications (SGT 1)
- Institutional Aspects (SGT 2)
- Technical Regulations and Conformity Evaluation (SGT 3)
- Financial Matters (SGT 4)
- Transport (SGT 5)
- Environment (SGT 6)
- Industry (SGT 7)
- Agriculture (SGT 8)
- Energy (SGT 9)
- Labor Matters, Employment and Social Security (SGT 10)
- Health (SGT 11)
- Investments (SGT 12)
- Trade Electronic (SGT 13)
- Mining (SGT 15)

SPECIALIST MEETINGS

- Family Agriculture in MERCOSUR (REAF)
- MERCOSUR Film and Audiovisual Authorities (RECAM)
- Application Authorities in Drugs, Prevention of Drug Abuse, and Drug Rehabilitation (RED)
- Science and Technology (RECyT)
- Social Communication (RECS)
- Cooperatives (REC)
- Official MERCOSUR Ombudsmen (REDPO)
- Integration Infrastructure (REII)
- Youth (REJ)
- Women (REM)
- MERCOSUR Public Ministries (REMPM)
- Internally Controlled Government Organisms (REOGCI)
- MERCOSUR Joint Trade Promotion (REPCCM)
- Tourism (RET)
- Government Entities for Nationals Resident Overseas.

AD HOC GROUPS

- MERCOSUR Customs Code (GAHCAM)
- Concessions (GAHCON)
- Consultation and Coordination for WTO and SGPC Negotiations (GAH OMC-SGPC)
- External Networking (GAHRE)
- Sanitary and Phytosanitary (GAHSF)
- Sugar Sector (GAHSZ)
- Agricultural Biotechnology (GAHBA)
- Cigarette Trade in MERCOSUR (GAHCC)
- Border Integration (GAHIF)
- MERCOSUR Domain (GAHDM)
- 'MERCOSUR Structural Convergence Fund' Experts (GAHE-FOCEM)

MERCOSUR Public Contracting Group (GCPM)

Services Group (GS)

MERCOSUR Social Labor Commission (CSLM)

Automotive Committee (CA)

MERCOSUR Technical Cooperation Committee (CCT)

Technical Meeting for the Incorporation of the MERCOSUR Regulatory Framework (RTIN)

SAM Budgetary Matters Group (GAP)

MERCOSUR TRADE COMMISSION (CCM)

TECHNICAL COMMITTEES

- Tariffs, Nomenclature, and Goods Classification (CT 1)
- Customs Matters (CT 2)
- Trade Rules and Disciplines (CT 3)
- Competitiveness-Distorting Public Policies (CT 4)
- Defense of Competition (CT 5)
- MERCOSUR Technical Committee 6 on Foreign Trade Statistics (CT 6)
- Consumer Defense (CT 7)
- Trade Defense and Safeguards Committee (CDCS)

MERCOSUR PARLIAMENT (PM)

SOCIAL AND ECONOMIC CONSULTATIVE FORUM (FCES)

MERCOSUR ADMINISTRATIVE AND LABOR TRIBUNAL (TAL)

MERCOSUR PERMANENT REVIEW TRIBUNAL (TPR)

MERCOSUR CENTER FOR THE PROMOTION OF DEMOCRACY (CMPED)

MERCOSUR Observatory for Democracy (ODM)

MERCOSUR SECRETARIAT (SM)

CONTENTS

EXECUTIVE SUMMARY

In an international context that has started showing signs of increased instability, the pace of global economic growth seems not to have been significantly affected, at least at the time of writing the present report. Growth forecasts for the global economy for this year are only slightly below those for 2006 (5.2% as against 5.4%). World trade continued to expand faster than GDP growth, while foreign direct investment (FDI) flows made up the ground they lost in 2001-2003, approaching the record values of 2000. Although, toward mid-2007, there was serious disruption in the international financial market, the swift, emphatic reactions of the central banks of the United States and Europe are highly likely to contain the more negative effects of this on the dynamics of the world economy. There was also continuous growth in much of the developing world, particularly China.

In the essentially favorable international framework of the reference period, the economies of MERCOSUR Member Countries continued to expand slightly faster than the global average (6.7% in 2006 and 5.8% in 2007). Expansion was combined with continued favorable macroeconomic results. Although a considerable element in this performance relates to the exceptional values of the major exports, there are additional structural and internal factors that also explain the phenomenon (e.g. a reduction in the burden of national debt).

This phase of sustained growth and greater macroeconomic solvency in the bloc has been the result of individual countries' policies. There are no explicit regional macro coordination measures. Similarly, if a good deal of fiscal policy generally coincides in the countries of the region, the same is not true of exchange and monetary matters. Thus, while inflation is below official targets in Brazil, rising prices are cause for concern in the other countries. While some countries have made efforts to give official priority to the preservation of the nominal exchange rate (as in Argentina), others have seen their currency undergo continuous appreciation (as in Brazil).

Yet, interestingly, the phase of growth in the region has been accompanied in the period by an emphatic process of job creation. Thus, for the first time in over a decade, unemployment currently affects less than 10% of the economically active population (EAP) across the bloc's economies.

In this scenario, MERCOSUR trade flows saw considerable dynamism in 2006-2007, both in intrazone terms and in relation to the rest of the world. The bloc's total exports accordingly grew almost 16% in 2006 (18% in the first half of 2007), whereas purchases grew 24% and 25% respectively, with a credit balance stabilizing at around US$54b. This expansion even outperforms the one seen in the early days of integration, a period marked by unilateral trade liberalization in all the Member Countries, in parallel with the constitution of MERCOSUR and the elimination of intrazone tariffs. Whereas total flows effectively grew at an annual average rate of 11.5% between 1991-1997, they grew at 19.7% in 2002-2006. This "acceleracionist" trend was also seen in intrazone exchange, which reached US$25.8b in 2006, 22% up on the previous year.

In this context, Brazil consolidated its exchange surplus with the other partner countries in 2006-2007, in spite of which, largely as a result of the sharp appreciation of the real, there was an incipient shift in its trade relations with MERCOSUR, with Brazilian imports from the region growing faster than sales to the other partners. This change is a distinct positive for the integration process considering the absolute dimension of the Brazilian economy. In fact, sectoral trade tensions, which had been one of the most prominent issues on the regional agenda in recent year, have tailed off noticeably, largely as a result of this general phenomenon.

In relation to the rest of the world, MERCOSUR's trade balance with Asia (the only region it has a deficit with, of around US$1.9b for the first half of 2007) worsened. This process has brought reactions from Member Countries' public and private sectors (particularly Argentina and Brazil's), manifested in the implementation of various trade administration measures toward Asia in general and China in particular.

On the other hand, MERCOSUR has in recent years made up some of the ground it lost in terms of attracting foreign capital to boost production, with FDI rising almost US$25.1b in 2006. Nevertheless, net investment flow was negative for the first time in history, in response to the internationalization of some of Brazil's main economic groups and, to a much lesser extent, of Argentina. Indeed, Brazilian firms' investments overseas reached US$28.2b in the past year (and Argentine firms' US$2.1b), with the MERCOSUR countries being important destinations for this capital.

The positive regional environment, coupled with the favorable global context, has created a favorable climate for progress on certain issues on the MERCOSUR internal agenda. One of the most important questions in 2006-2007 has been the channeling of the problem of asymmetries within the bloc, an issue that, though present in the integration process from the outset, only became a priority on the internal agenda a couple of years ago.

Accordingly, as a result of the different proposals and initiatives originally submitted by the smaller partner countries, and later by Brazil and Argentina, it was eventually agreed to draw up a Strategic Plan for the formal treatment of these differences in relative development. A work program was set up to remove non-tariff restrictions on intrazone trade and certain regulatory frameworks linked to origin requirements for intrazone trade were relaxed, as an initial response to some of the demands of the bloc's smaller economies.

In addition to this, specific action designed to promote greater production integration of partner countries have begun to be implemented. This includes the start of work on designing a regional supplier development program, a joint project with the MERCOSUR automobile/auto parts network, the implementation of the Film and Audiovisual Sector Competitiveness Forum, and a business coordination program for the tourist sector.

But far and away the most outstanding event this year was the approval of the first budget and effective implementation of the MERCOSUR Structural Convergence Fund (FOCEM), an instrument that exhibits unambiguous regional solidarity and recognizes the structural asymmetries between the less developed countries and/or regions. The materialization of contributions and the approval of the first fifteen projects are of fundamental importance to the bloc and would have been more difficult to bring off in a less favorable regional (economic and political) and international context.

Equally, there was also notable progress in the realm of institutions, such as bringing the Constitutive Protocol of the Parliament of MERCOSUR into effect in February 2007, the preparation of the first Consultative Opinion of the Permanent Review Tribunal (TPR), and the TPR report on the proportionality of countervailing measures applied by Uruguay against Argentina in the tire sector. Likewise, the creation of the MERCOSUR Social Institute (ISM), the MERCOSUR Training Institute (IMEF), and the MERCOSUR Democracy Observatory (ODM), initiatives emerging from the Commission of Permanent Representatives of MERCOSUR (CRPM), are further examples of progress in the bloc's institution-building process.

Finally, the internal agenda in the period covered by this report includes agreements on questions as far-reaching and wide-ranging as the Common External Tariff (CET), especially the headway made in implementing Common Market Council (CMC) Decision 54/06 establishing the elimination of double CET levying on extrazone products circulating within the bloc, the "mercosurization" of certain special import regimes, and the creation of a Regional Fund geared to funding the development of SMEs.

Although tangible breakthroughs have already been made in some of these areas, their full execution in others still depends on programmatic commitments and on administrative and technical decisions whose real effectiveness and scope should be evaluated and improved upon.

At the level of trade negotiations or understandings with third countries or blocs, MERCOSUR has been working on the processes of incorporating Venezuela and Bolivia. The sides hope to conclude the negotiations as soon as possible.

Certain events in regional and international policy occurring toward the end of our period may, in the near future, lend greater dynamism and relevance to the bloc's external relations agenda. For one thing, the failure of the two main trade powers to reactivate multilateral negotiations at the G4 meeting in Potsdam in July 2007 creates a more favorable environment for the reactivation of the MERCOSUR/European Union (EU) negotiation. Furthermore, this agenda has been stimulated by events such as the signing of the Strategic Association Agreement between Brazil and the EU at the start of July, President Kirchner's official visit to Mexico (and the signing of a strategic association agreement between Argentina and Mexico) toward the end of that month, and President Lula's visit to Mexico and various Central American countries.

In summary, the regional and international context in which the negotiating process developed over the past year was favorable and conducive to progress in the various different areas linked to policy harmonization and the coordination of common action, in the realms of both the internal agenda and third country relations, and in the materialization of sustainable production integration. In this context, MERCOSUR will benefit if it manages to pull off some of the more ambitious elements in its external negotiations, including the expectations regarding the expansion of the bloc.

CHAPTER I. MACROECONOMIC OVERVIEW

Although the international context has begun to show greater signs of instability, the macroeconomic environment during 2006 and the first half of 2007 continued to be favorable for MERCOSUR countries in terms of greater demand for its exports and record lows in interest rates.

The MERCOSUR economies remained in an expansive phase and grew on average 6.7% in 2006 and 5.8% in 2007, according to preliminary estimates.[1] In contrast with similar growth periods, such as the first half of the 1990s, MERCOSUR countries -except Uruguay- combined the increase in gross domestic product (GDP) in recent years with a surplus in the balance of payments current account. Obtaining these surpluses is linked to the price of raw materials and its impact on the evolution of the terms of trade (TOT). This was positive for Argentina, Brazil and Venezuela, but harmful to the smaller economies.

In fiscal policy, MERCOSUR countries continue to record positive primary results and to reduce the burden of national debt on GDP. In monetary and exchange terms, on the other hand, there is no uniform standard in the bloc. While inflation is below the official target in Brazil, the rise in retail prices is cause for concern in the other countries. In Paraguay and Uruguay, the Central Banks are more disposed to applying restrictive measures to contain inflation, while in Venezuela the money sign will be replaced, while maintaining the fixed exchange rate. In Argentina, policy remains implicitly geared to preserving the nominal exchange rate at somewhere around its current level.

Per capita GDP continued its upward trend throughout MERCOSUR, although the disparity in the pace of growth -slower in Paraguay and Brazil- widened the subregional income gap. For the first time in over a decade, unemployment affected less than 10% of the economically active population (EAP) of the bloc's economies.

A. The international environment

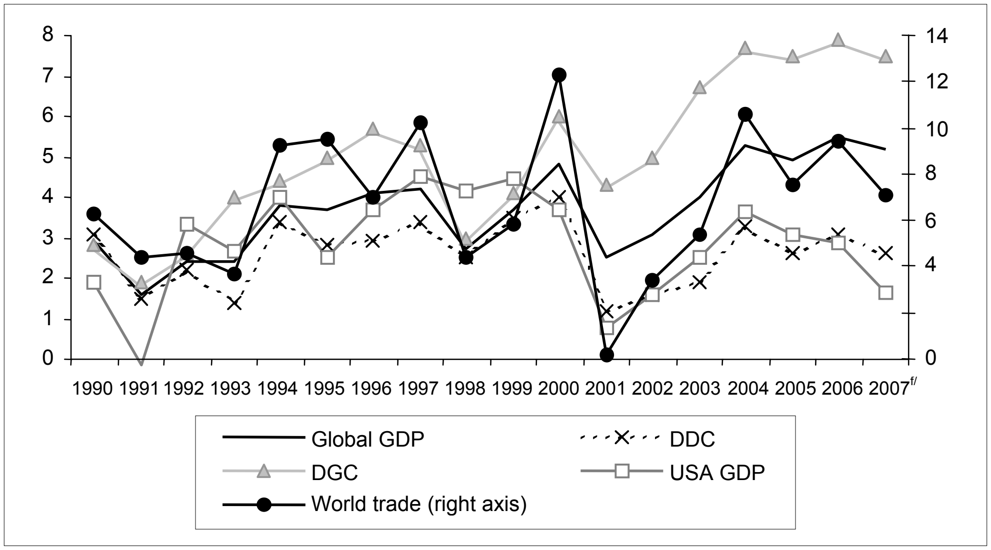
The world economic context

The world economy has, in recent years, seen intense demand and activity, high prices for raw materials, and low interest rates a state of affairs that has, in general, favored developing countries. In MERCOSUR, this environment has been beneficial for expansion, although the improvements in prices have stimulated the larger economies and had certain negative effects on the smaller ones, with rising prices for energy and other commodities. By mid-2006, raw materials and money markets began to show signs of volatility and tensions were aroused over the excessive borrowing that has characterized certain spheres of the world financial system. Up to the first half of 2007, these problems did not seem to have significantly affected expansion of world GDP, however. In October, the International Monetary Fund (IMF [2007b]) forecast that global growth would be around 5.2%, as against 5.4% in 2006.[2] As in previous years, much of this dynamism was attributed to emerging economies, while developed countries showed a slower trend in expansion than in the 1990s (Figure 1).

1 Figures represent the simple average of the five countries in the bloc.

2 This rate is the result of adding national rates through purchasing power parities, the IMF's methodology of choice. Using market exchange rates, growth in 2006 is 3.8% and, in 2007, 3.5%.

FIGURE 1
GROWTH IN GDP AND WORLD TRADE
Real YOY % variation



Notes: DDC = developed countries. DGC = developing countries. f/ Forecasts.

Sources: IMF, BEA, Klein & Mak [2007].

During the first half of 2007, average US GDP grew 1.7% YOY, as against 2.9% in 2006. This cooling of the world's major economy was to do with the weakness of non-residential investment and private consumption (which had been significantly bolstering activity) and, from the sectoral viewpoint, with the crisis in the real estate market that followed the boom in the sector caused by the relaxation of monetary policy aimed at avoiding the deepening of the 2001 recession.

Due to the densely interwoven nature of the world financial system, this situation has become a focal point for various global tensions. The abrupt deceleration in house prices from mid-2006 has depleted the balances of families and various financial intermediaries (not only from the United States), among which are assets from this sector. This has indirectly increased the perceived risk in credit markets and market volatility, all of which heralds a less benign phase in financial conditions worldwide.

Furthermore, the Japanese and European economies also slowed their expansion during the first half, though less so than the United States. On the other hand, among developing countries, the dynamism of China increased during 2007, with growth of 11.2% being forecast, as against 10.5% in 2006 (Klein & Mak [2007]). The momentum of world demand from Chinese imports has remained steady, although its exports have well and truly outperformed its external purchases.

Box 1

ASPECTS OF THE INTERNATIONAL FINANCIAL CRISIS

At the start of August 2007, a major disturbance affected several segments of the world credit market after a French bank froze the outlay of several investment funds. Exposure to assets linked to the declining US mortgage market hit this entity hard -not the first to be affected by these circumstances. However, the case abruptly pushed up general risk assessment, forcing the world's main central banks (notably the European Central Bank and the US Federal Reserve) to inject liquidity on a massive scale in order to meet levels of demand normally channeled into the interbank market. Several benchmark rates rose significantly and stock market indicators began to slide rapidly. The inadequacy of these operations a few days later spurred the Federal Reserve to lower its discount rate from 6.25% to 5.75% and, by mid-September, this rate and that of federal funds had been cut by 50 b.p., the latter standing at 4.75%. In a little over a month, then, an international financial environment characterized by abundant liquidity and concern over inflation gave way to another one marked by a credit crunch and bailouts by the monetary authorities.

The recent macroeconomic evolution of the United States and certain practices in the financial sector are at the heart of this turnaround. It is well-known that, intending to contain the effects of recession, monetary policy since 2001 stimulated growth based on household consumption and inflated real estate. The liberalism of the monetary market did not, however, prompt significant growth in non-residential investment, as the economy had seen significant capital overinvestment during the 1990s. In finances, faced with a situation of abundant liquidity and low rates, the search for profitability spurred the banks to develop extremely high-risk intermediation models, among them, certain off-balance investment vehicles, with assets propped up by mortgage loans. The crisis has made it abundantly clear that the structure of liabilities and assets of many of these "vehicles" displays significant temporary mismatches, creating short-term liabilities supported by assets that take a long time to mature and, in several cases, bear higher levels of risk than initially anticipated. In a rising market, these models (with "pyramidal" or "Ponzi-type" features) ensure that payment flows are covered by income from the expansion of assets. But the decline of real estate prices in the United States, as early as 2006, and the correlative insolvency crisis in the most risky segments of the mortgage market weakened income flows, thus creating a pressing need for cash to pay off short-term liabilities. The absence of markets to liquidate the complex assets developed brought an added element of panic and uncertainty in the credit market. The scale of bailouts by the central banks is an indication of the scope of international banking's commitment in this kind of operation.

The short-term consequences for MERCOSUR countries have been relatively light, but are not insignificant. In Argentina, the crisis pushed up interest rates and demand in the foreign exchange market, fuelled by capital outflows, which required interventions from the Central Bank of Argentine Republic (BCRA) to defend the peso, with concomitant effects on the level of reserves. In Brazil, the crisis caused a brief lull in the overall appreciation of the real against the dollar and also had a negative impact on the price of internationally traded debt securities. In Venezuela, due to depreciation of dollar bonds and volatility, issues of Southern Bond III were suspended in August, thus pushing up the unofficial dollar price. Paraguay and Uruguay felt no significant effects from the crisis and, however, in the countries that were affected, the solidity of their external sector allowed authorities to keep control of the situation. The US Federal Reserve's aggressive policy of rate cutting brought about a decompression of some of these tensions in mid-September, which, among other things, enabled Southern Bond III to be issued.

However, other wider-ranging consequences of the crisis should not be overlooked. The cutting of interest rates in the United States intensified the depreciation of the dollar, with possible inflationary consequences there and damage to its function as the currency of world reserves. Moreover, the real estate crisis and credit problems may entail a significant tailing off of activity in the United States with major consequences for the world economy and, accordingly, for key markets in the resilience of MERCOSUR countries' external sectors like primary products. The cost of funding is another variable that is likely to undergo a rise in the future.

In keeping with falling world economic growth, there has been a certain cooling of trade in goods and services. This grew approximately 7% in 2007, as against an annual average of 9.2% for the previous three years (IMF estimates). The behavior of the commodities markets also reflects this trend. Excluding oil, the price of a basket of raw materials representative of Latin American exports grew 9.6% in the first half of 2007 (ECLAC estimates), while in 2006 these prices rose 19.6% overall.

Conversely, the oil price in the first half of 2007 was almost 4% up on the second half of 2006, when it fell 2.8% on the first half. This rise corresponds to climatic factors and, in particular, to cuts in production due to technical and geopolitical causes, and to decisions by the Organization of the Petroleum Exporting Countries (OPEC) geared to shoring up the price. The uncertainty and tension of the oil market in recent years, as well as energy matrix diversification policies in developed countries, have had an impact on the prices of products traditionally for food, such as biofuel inputs. Although such a state of affairs favors most MERCOSUR countries' external accounts, it also implies forcing up food prices.

The international scenario, then, is contradictory for MERCOSUR countries. On the one hand, the good prospects for prices of certain primary products like oil, soya, and corn favor economies that are net exporters of these products, but harm those that are net importers. On the other hand, should it deepen, the weakening of the international financial situation increases the risk of a reversal not only in the favorable conditions enjoyed for several years in this area, but also of the pace of activity in the world economy caused by an extremely intense adjustment in the United States. So far, however, the various episodes of financial turbulence have been negotiated smoothly thanks to the lower macroeconomic vulnerability the countries enjoyed, in both external and fiscal accounts.

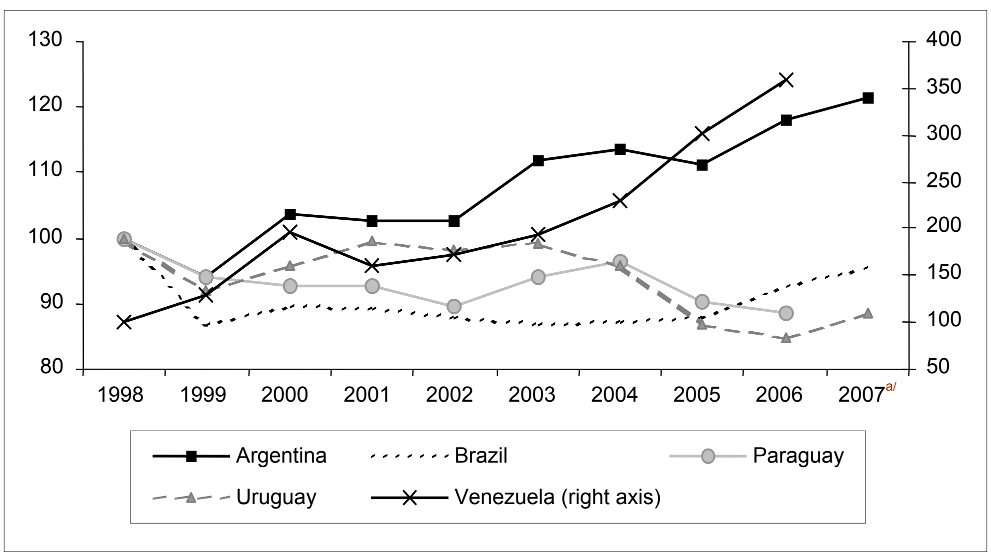
B. MERCOSUR in the international environment

External demand and terms of trade

Although the effect of sustained world demand has kept the demand of the main MERCOSUR exports steady, its effect on different members' TOT has been uneven. In 2006 and the first half of 2007, TOT continued to improve in Argentina (8.9%), Brazil (8.3%), and particularly Venezuela (19.4% in 2006) due to the impact of oil prices. Oil was largely responsible for the decline in this ratio experienced by Paraguay and Uruguay (2% and 2.2% respectively over 2006), as they are net importers of oil. However, in Uruguay, the TOT recovered slightly during the first quarter of 2007 (Figure 2).

In this context, MERCOSUR trade continued to expand sustainedly. Total exports (including intrazone trade) grew by 15.6% YOY in 2006 and by 18.2% YOY in the first half of 2007, while more dynamic imports grew 23.9% and 25.4% respectively. Intrabloc trade during the first half of 2007 grew faster than sales to the rest of the world, at 22% in 2006 and 25.4%.[3]

FIGURE 2
MERCOSUR: TERMS OF TRADE
1998 Indexes = 100



Note: [a/] First half data for Argentina and Brazil, first quarter data for Uruguay. No information on Paraguay and Venezuela for 2007.

Source: Author's own compilation using INDEC, FUNCEX, BCU, and ECLAC data.

[3] For further development of the subject, see Chapter II of this Report. These figures do not include Venezuela.

The balance of payments current account

During 2006 and the first half of 2007, the MERCOSUR current account again displayed uneven results, reflecting the differences in trade performance and the evolution of the TOT.

Although the three largest economies in MERCOSUR continued to display current account credit balances, the surplus in 2007 was lower than previous years due to the decline in the balance of trade in goods. According to preliminary estimates, the surplus stood at 2.6% of GDP in Argentina and 0.8% in Brazil, down on 2006, when they reached 3.8% and 1.3% respectively. A similar situation occurred in Venezuela, which, thanks to the high oil price, obtained a positive result of around 14.9% of GDP during 2006 and around 8% of GDP in the first half of 2007.[4]

In Paraguay and Uruguay, however, the current account displayed a rising deficit (representing 2% and 2.4% of GDP respectively during 2006), largely as a consequence of falling TOT.

The results of the MERCOSUR countries' balance of payments current account in 2003-2006 are linked to the evolution of trade in goods, in which variations in TOT play an extremely important role.

Looking at the evolution of this balance in relation to the cycle, Argentina, Brazil, and Paraguay obtained a surplus during a period of expansion thanks to the improved TOT, contrasting with previous situations in which economic growth brought with it a weakening of the external sector. This was the case in 1991-1994, a period comparable with 2003-2006 in terms of these countries' growth (Table 1).

TABLE 1
MERCOSUR: GDP GROWTH, CURRENT ACCOUNT BALANCE, AND VARIATION IN TERMS OF TRADE
1991-1994 and 2003-2006 - % average

Country	1991-1994		2003-2006		TOT[c/]
	GDP[a/]	Current account[b/]	GDP[a/]	Current account[b/]	
Argentina	7.9	-2.7	8.9	3.8	18.3
Brazil	2.8	0.2	3.3	1.3	14.4
Paraguay	3.4	-0.6	3.8	0.7	-3.5
Uruguay	5.3	-1	6.9	-0.7	-17.7
Venezuela	3.3	-0.5	7.4	15.1	121

Notes: [a/] Cumulative annual real GDP % variation.
[b/] Current account balance as % of GDP.
[c/] % variation across both periods.

Source: Author's own compilation using ECLAC data.

TOT variation's dominant role in the current account result can be illustrated through the hypothetical calculation of this balance in relation to GDP between 2003 and 2006 had export and import prices of different reference periods prevailed and all the rest remained constant.[5] To do this, three stages were selected that displayed different characteristics: the last crisis (1999-2002), a period during which the economy grew at a pace similar to today's (1991-1994), and a "long-term" average (1980-2002).

4 Estimates are based on private expectations surveys carried out by the central banks in Argentina and Brazil's case.

5 That is to say, quantities exported and imported and the other components of the current account are assumed to have followed suit, albeit with different price levels.

The results of the exercise (Table 2) show Venezuela as the main winner in the improved TOT. Indeed, the three hypotheses give rise to a significant decline in its current account balance, even moving into deficit when the prices of the long-term average and those at the start of the 1990s are taken into account, a time when the world recession had depressed the oil market. Albeit to a lesser extent, Argentina and Brazil's balance also worsens while the TOT of previous periods holds steady. Paraguay and Uruguay, on the other hand, would have seen significant improvements in their current account balance had the TOT remained at the levels of previous periods. In all three scenarios, Uruguay appears to be the worst hit, obtaining surplus results instead of the deficit recorded with current prices.

Finally, this exercise highlights the fact that the current account's positive performance in the current context of the partner economies' growth is related to structural factors that go beyond the unprecedented moment the countries are experiencing in terms of the values of their main exports rather than imports. Indeed, the fact that the current account balance remained in surplus or equilibrium in all countries, even when "long-term" TOT are taken into account is a positive sign, all the more so in economies that have traditionally seen stop-and-go cycles largely determined by sharp imbalances in their external accounts.

TABLE 2
MERCOSUR: CURRENT ACCOUNT BALANCE
2003-2006 average. As % of GDP with export and import prices for selected periods

Country	Current prices	1980-2002 prices	1991-1994 prices	1999-2002 prices
Argentina	3.8	0.9	0.9	1.2
Brazil	1.3	0	-0.3	0.6
Paraguay	0.7	1.3	2.5	1.5
Uruguay	-0.7	4.2	3.7	0.4
Venezuela	15.1	-0.3	-3.3	1.8

Source: Author's own compilation using ECLAC data.

Capital flows[6] *and variation in international reserves*

The context of world liquidity meant that capital kept flowing into certain countries in the bloc during 2006. The net capital inflow in Paraguay and Uruguay was explained by similar quantities of direct investment and financial investment (portfolio and other investments) and stood at record levels in both countries (6.2% and 14.8% of GDP respectively). Although Argentina saw an influx of funds destined for the non-financial public sector and the private sector, the advance cancellation of its debt with the IMF at the start of 2006 translated into a net capital outflow of around 2.1% of GDP.

In 2006, Brazil's capital and financial account produced a surplus of 1.6% of GDP, a level similar to the previous year's, though substantially different in composition. In 2005, this surplus reflected a higher proportion of FDI (FDI), whereas it was explained in 2006 by the inflow of short-term capital, aided by the interest rate differential, lower levels of risk, and expectations of appreciation of the real. In fact, for the first time in history, due to the sharp rise in Brazilian foreign investment, FDI was negative. this investment in Brazil increased tenfold in relation to 2005, to US$27,300m or 2.6% of GDP, largely as a result of a Brazilian mining company's purchase of a Canadian company.[7]

6 The above results of the capital and financial accounts include errors and omissions.

7 For further information on FDI, see Chapter II of this Report.

During the first half of 2007, Brazil's capital and financial account surplus was ten times what it was the previous year. This improvement was due to rises in net FDI and short-term investment. It should be stressed that both flows recorded maximum values for the first half of the year. Driven by the purchase of shares in Brazilian companies and fixed income securities, net short-term investments (portfolio investment, derivatives, and other investments) totaled US$35,200m, while net FDI reached US$24.3m between January and June.

In the first six months of 2007, Argentina's capital and financial account saw an influx of almost US$8b, contrasting with the deficit in the first half of 2006 due to the above settlement of the debt with the IMF. Financial investment (portfolios and other investments) became more dynamic (particularly in shares and other debt securities), while FDI was 46.9% down on the same period for the previous year.

The behavior of Venezuela's capital and financial account is closely related to the considerable positive current account balance, 15.1% of GDP in 2003-2006. The flip side of this high surplus is a debit balance distributed between the capital and financial account and the accumulation of international reserves. It is important to note that, as the oil exports of the government oil company, *Petróleos de Venezuela Sociedad Anónima* (PDVSA)[8] are the main factor explaining the current account surplus, the government has a high decision margin regarding how much of this surplus becomes official assets (international reserves) and how much is destined for real or financial investments overseas. Since 1999, there has been a net outflow of capital, which in 2006 reached 12.4% of GDP. This balance reflects both the increase in Venezuelan assets overseas and the reduction of external liabilities. Although, in previous years, this account registered net income under the heading of FDI, it became negative in 2006 (-2% of GDP) as a result of investments abroad and falling FDI in Venezuela.

During 2006, all MERCOSUR countries except Argentina again accumulated international reserves, in line with the target of reducing external vulnerability in a context of growing uncertainty at the global level. In GDP, Uruguay recorded the highest increase in reserves (12.4%), followed by Paraguay (4.2%), Brazil (2.9%), and Venezuela (2.6%). Venezuela has modified its policy regarding the accumulation of reserves, which fell US$10b in August 2007 (against the US$37b maximum at the end of 2006) due to their reallocation to the National Development Fund (FONDEN).[9] In Argentina, although international reserves fell at the start of 2006 due to the advance IMF payment, they recovered quickly, a process that continued into 2007.

C. Macroeconomic developments in MERCOSUR[10]

The expansive phase of the MERCOSUR economic cycle is continuing apace: according to preliminary calculations, GDP in 2007 rose 5.8% on average (6.7% in 2006), one of the highest rates in the last decade.[11] As in previous years, Argentina, Uruguay, and Venezuela continued to grow faster than Brasil[12] and

[8] Net public oil exports in 2003-2006 averaged US$32m p.a., or 24.4% of GDP.

[9] The FONDEN is a state-owned enterprise set up in 2005 to bring the reserve assets surplus within "optimum levels" set by the authorities. The limitation on the growth of reserves seeks to ease the monetary problems created by accumulation and to utilize these resources for importing equipment for development projects.

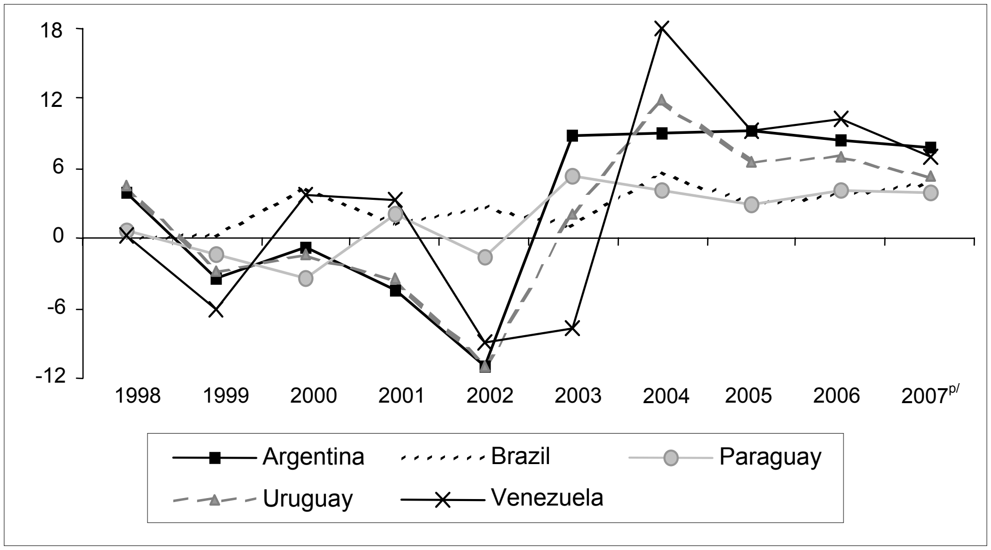
[10] Barring indications to the contrary, the forecasts and estimates contained in this chapter correspond to the median of the private expectations survey carried out by the central banks (Argentina, Brazil and Uruguay) and to calculations by ECLAC (Paraguay and Venezuela).

[11] Simple average for all five countries.

[12] In March 2007, the Brazilian Institute of Geography and Statistics (IBGE) made known its new methodology for calculating national accounts, enabling the evolution of the Brazilian economy to be estimated more accurately. Among the main methodological modifications are the adoption of the year 2000 as an initial reference, the expansion of information sources, the updating of volume indexes, and changes in the manner of measuring certain activities, mainly in financial services and public administration. For further information, see CONAC [2007]. All national accounts data in the current report is based on the new estimates.

Paraguay. During the first half of 2007, internal demand was the main driving force behind the expansion, as the lower cost of credit and increased total wage bill boosted consumption and investment (Figure 3).

FIGURE 3
MERCOSUR: GROSS DOMESTIC PRODUCT
Real YOY - % variation



Note: f/ Forecasts from market expectations surveys by the Central Banks of Argentina, Brazil, and Uruguay, and from ECLAC (Paraguay and Venezuela).

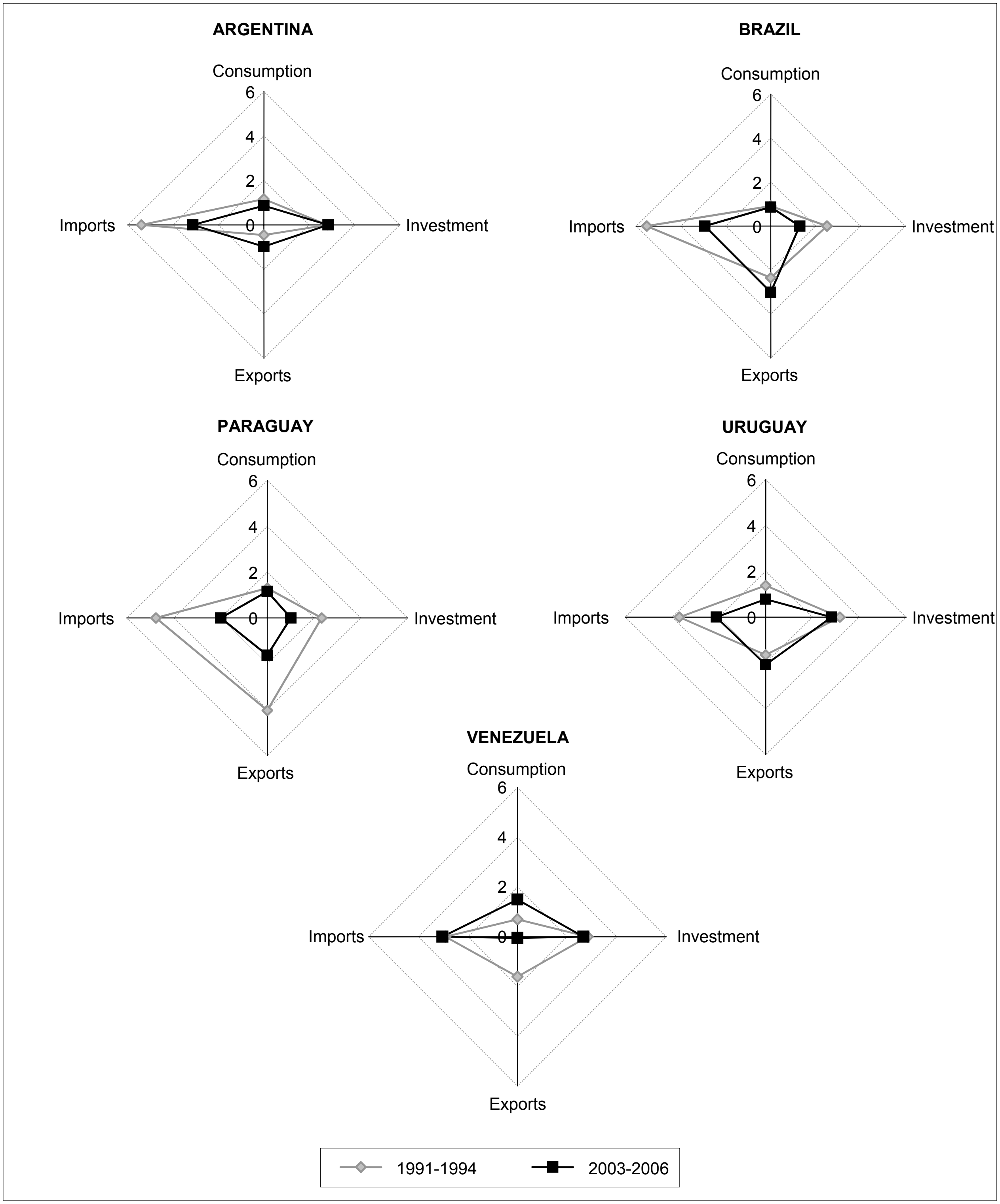
Sources: MECON-DNCN, BCB, BCP, BCU, and ECLAC.

As mentioned earlier, the pace of growth in recent years is comparable to the first half of the 1990s. However, upon analyzing the different spending components' product-elasticity (consumption, investment, exports, and imports) as measured at constant prices,[13] important differences are seen, which to an extent stem from the contrast between both stages in the result of foreign trade (Figure 4).

Consumption's contribution to growth in Argentina, Brazil, and Uruguay was relatively limited over 2003-2006. Indeed, this component's product-elasticity is below 1, demonstrating these countries' efforts to save. In Argentina and Uruguay, this behavior contrasts with 1991-1994, when consumption was more dynamic. The higher contribution to the increase in GDP in both countries currently comes from investment, while export elasticity is rising and import elasticity is falling.

[13] Product elasticity is the ratio of the rate of variation in the aggregate and the product in the same period. It thus measures the intensity of growth in the different spending components in terms of the rise in GDP.

FIGURE 4
MERCOSUR: PRODUCT ELASTICITY OF THE MAIN SPENDING COMPONENTS
1991-1994 and 2003-2006



Notes: Consumption = public + private. Investment = gross fixed capital formation + variation in stocks. Exports and imports include goods and services.

Source: Author's own compilation using ECLAC data.

In Brazil, where consumer sensitivity to fluctuations in GDP remains at levels similar to the early 1990s, the difference lies in the destination of these savings: while it was formerly investment that contributed most to the rise in GDP, this role today belongs to net exports. However, the trend began to reverse in 2006, as internal demand became more dynamic and the external sector is contributing negatively to expansion.

In Paraguay and Venezuela, on the other hand, consumption's product-elasticity is above 1. In Paraguay, it is the most dynamic component, as the contribution of net exports is negative and investment shows unitary elasticity, falling to under half that of 1991-1994.

Venezuela is the only country where GDP growth in recent years is substantially greater than at the start of the 1990s and where the most pronounced contrasts are between the sources of growth. Indeed, the rate of expansion of GDP in Venezuela in 2003-2006 more than doubled that of the start of the previous decade, during which it experienced the adverse effects of world recession and the weakening of the oil market. However, consumption made a greater contribution to the increase in GDP -which more than doubled its product-elasticity across the two periods- as well as a higher negative contribution in net exports due to the almost zero contribution of external sales. The sharp gain in its international acquisitive capacity (in its TOT) is therefore what sustains this form of growth.

It should be remembered that, with the exception of Venezuela, the elasticity of imports in 2003-2006 is lower than 1991-1994, an equal result of trade liberalization policies with abundant external financing in the early 1990s, the competitiveness achieved after significant sectoral investment (for example, in agroindustries), and the exchange crises between 1999 and 2002. Argentina, Brazil and Uruguay also displayed greater export elasticity in the second period than the first, another indication of their enhanced competitiveness. These factors, together with the evolution of the TOT, are without a doubt behind the improvement in the balance of payments current account in those countries.

D. Economic policies: instruments and results

Fiscal policy

In line with the events of recent years, MERCOSUR's primary result in 2006 and the first half of 2007 remained in surplus. Nevertheless, during the first half of 2007, the balance declined slightly against the same period in 2006 in all countries except Brazil. Although there is no up-to-date information for Venezuela, the primary surplus fell considerably during 2006. This result is insufficient to account for interest payments in Brazil, Uruguay, and Venezuela. It should be stressed that the burden of interest in Argentina has fallen substantially after the swap of the default national debt. Paraguay, on the other hand, continues to record a financial surplus in the framework of compliance with the targets set in its agreement with the IMF (Table 3).

Argentina undertook a major pension reform to expand its public system. Indeed, the estimates for 2007 indicate an improved result resulting from extraordinary income from this reform of over 1% of GDP. Preliminary calculations indicate that the primary surplus during 2007, including this impact, could be around 3.3%.[14]

[14] Between April and December 2007, the pension reform allowed members of Retirement and Pension Fund Administrators (AFJPs, private system) to move to the (state) social security system. This also involved the transfer of the accumulated contributions or "stock" for men over 55 and women over 50 who have not reached a given level of saving in the private pension funds system. Lastly, it laid down that anyone not opting for a retirement system will be automatically assigned to the state system, rather than an AFJP.

In 2007, the Brazilian government cut its consolidated primary surplus target from 4.25% to 3.75% of GDP by incorporating expenditure relating to the Growth Acceleration Program (GAP), a package of measures designed to stimulate the dynamism of the Brazilian economy without jeopardizing fiscal sustainability.[15]

In mid-2007, Uruguay began to implement a series of tax reforms designed to simplify the current system by removing fifteen national taxes, creating new taxes, and altering existing ones. Among the most relevant features are the introduction of the tax on corporate as distinct from earned and capital income, and cuts in taxes on consumption. According to official estimates, the reform will cut tax revenue by 0.6% of GDP.

In recent years, the oil boom has enabled Venezuela to boost its tax revenue considerably in terms of GDP. Nevertheless, during 2006, the primary surplus of the restricted public sector[16] fell to 0.6% of GDP, as against an average of 6.2% during the three previous years. This decline due to greater dynamism in public spending was reflected in the appearance of a financial deficit.

TABLE 3
MERCOSUR: MAIN FISCAL INDICATORS
% of GDP

Country	Period	Primary[a/]	Interest[a/]	Financial Result[a/]	National Debt[b/]
Argentina	2006	3.5	1.8	1.8	64
	2006 1st ½	4	1.5	2.6	--
	2007 1st ½	3.8	1.7	2.1	59.3
Brazil	2006	3.9	6.9	-3	44.9
	2006 1st ½	5.1	7.4	-2.3	--
	2007 1st ½	5.3	6.3	-1	44.3
Paraguay	2006	1.5	1	0.5	n.d.
	2006 1st ½	4.4	1	3.4	--
	2007 1st ½	4.2	0.8	3.4	n.d.
Uruguay	2006	3.8	4.4	-0.6	71
	2006 1st ½	4.3	3.9	0.4	--
	2007 1st ½	3.2	4.4	-1.1	66.7
Venezuela	2006	0.6	2.1	-1.5	24.3
	2006 1st ½	n.d.	n.d.	n.d.	--
	2007 1st ½	n.d.	n.d.	n.d.	17.8

Notes: n.a.=not available.

[a/] Argentina: Central Government. Due to a change in methodology, the figures for 2007 exclude coparticipable resources and resultant spending. For comparative purposes, the data for the first half of 2006 also exclude coparticipation. Brazil and Uruguay: Consolidated Public Sector. Paraguay: Central Administration. Venezuela: Restricted Public Sector. In the case of Brazil, the data for the first half are from January-August.

[b/] Argentina: Total gross debt of the National Public Sector, not including US$27b from the debt with creditors that did not accept holdouts, equivalent to 19.5% of GDP for the first half of 2007. Brazil: Consolidated Public Sector Liquid Debt (CPSLD). Uruguay: Gross debt of the Global Public Sector. Venezuela: Gross national debt. The data for 2007 are from the first half for Argentina, Brazil and Venezuela, and the first quarter for Uruguay.

Sources: Author's own compilation using data from the Treasury and Finances Secretariats (Argentina), the Treasury Ministry, IPEA (Brazil), BCP (Paraguay), the Ministry of Economy and Finances (Uruguay), and Ministry of Finances (Venezuela).

---

15 Among other items, the GAP includes investments in infrastructure, channeling of resources into the Pilot Investment Project (PIP), improvement of the tax system, extension of credit, and improvement of the investment climate. The target for the consolidated primary surplus excluding the GAP remains 4.25%.

16 The Central Budgetary Government, PDVSA, includes a sample of non-financial public sector companies, the Venezuelan Institute of Social Services (IVSS), the Deposits Guarantee Fund (FOGADE, an entity for liquidating nationalized bank assets after the 1994 crisis), and the Venezuela Investment Fund (FIV, a residual entity of the privatization program).

All MERCOSUR countries[17] are continuing to reduce their national debt in terms of GDP, the highest indicators belonging to Uruguay and Argentina. Unlike other countries in Latin America, where the debt is gaining share in local currency, in Argentina all the new debt issues made during 2006 and over 80% of those in 2007 correspond to obligations denominated in foreign currencies. Nevertheless, the proportion of national debt in pesos remains constant due to the impact of inflation on index-linked instruments.

During 2006 and the first half of 2007, the Brazilian government continued to extend the average term for borrowing and replacing the internal debt as adjusted by the exchange rate and the rate of the Special System for Settlement and Custody (SELIC) with fixed income securities or index-linked to the price index, an objective that has been facilitated by the context of foreign exchange appreciation.

In 2006, Uruguay carried out a voluntary swap of its national debt, which enabled it to achieve a more sustainable deadline structure, and, in November, completed the process of advance cancellation of its debt with the IMF, begun in the first quarter.

Monetary and exchange policy, inflation, and exchange rate

There are more pronounced differences between MERCOSUR countries in monetary and exchange terms than in fiscal policy (Table 4).

Monetary policy in Argentina continues to be geared to propping up the nominal exchange rate. The net result of the BCRA's intervention in the foreign exchange market has been a rise in international reserves, which currently stand at record levels. These purchases of foreign currency force the Central Bank to contain the inflationary effect of monetization by putting in place instruments involving a financial cost. In the first half of 2007, this type of operation reached an unprecedented scale, when 80% of the money issue associated with the increase in reserves was sterilized.

TABLE 4
MERCOSUR: MAIN MONETARY AND EXCHANGE INDICATORS

Indicator	Argentina		Brazil		Paraguay		Uruguay		Venezuela	
	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007
Inflation[a/]	9.8	8.5	3.1	4	12.5	6.8	6.4	8.5	17	19.4
Nominal exchange rate[b/]	1.7	0.7	-5.9	-10.1	-12.6	-4.2	3.4	-2.1	0	0
Real effective exchange rate[b/]	-0.6	2.2	-2.2	-8.8	-17.2	3.1	6.4	-2	-10.3	-3.2
International reserves (import months)[c/]	11.3	13.6	11.3	17.2	3.8	4.4	7.8	8.9	12.8	7.2

Notes: [a/] YOY variation of the Consumer Price Index (CPI). The data for 2007 are from forecasts (a survey of private expectations by the Central Banks for Argentina, Brazil, and Uruguay, and prepared by ECLAC for Paraguay and Venezuela).
[b/] End-of-period variation. Positive variations indicate depreciation and negative variations, appreciation. The data for 2007 are from the first half.
[c/] End-of-period. The data for 2007 are from the first half.

Sources: Author's own compilation using ECLAC, BCRA, BCB, BCP, BCU, and BCV data.

[17] No information is available for Paraguay.

Thus, the nominal exchange rate has remained high, escaping the regional trend toward foreign exchange appreciation. Despite having higher inflation levels than its main trading partners, the nominal depreciation of the peso against these countries' currencies meant that it recorded only a very slight real appreciation in 2006 and even depreciated during the first half of 2007.

The Consumer Price Index (CPI) was up 9.8% during 2006, while according to official calculations retail prices rose 3.9% in the first half of 2007. To ease inflationary tensions, the government resorted to such measures as price agreements, export restrictions and bans on certain products, and curbing the rise in public tariffs. Modifications to CPI measurement methodology, which has been the source of some controversy, were also stipulated.[18]

Brazil's retail inflation fell during 2006 for the fourth year running and, for the first time since implementation of the inflation targeting scheme, price variation was lower than the target (3.1% as against 4.5%). During the first half of 2007, the Extended Consumer Price Index (ECPI) accumulated a rise of 2.1% and, although it began to speed up in the third quarter, forecasts for 2007 indicate that the rate will again be below the target set by Monetary Policy Committee (COPOM) of around 4%.

To stimulate economic growth, keeping in mind the fact that inflation is under control, the COPOM continued to relax monetary policy, although it slowed the pace of interest rate cuts due to the pressure of domestic demand, accelerating inflation, and greater international financial instability. In September 2007, the SELIC stood at 11.25%, accumulating a 850 b.p. fall since the first decrease two years ago.

As a consequence of the balance of payments results, the nominal exchange rate fell again during 2006 (5.9%) and the first half of 2007 (10.1%), the lowest since October 2000. To alleviate the appreciation of the real, the Central Bank of Brazil (BCB) stepped up its intervention by purchasing foreign currency in the cash market and the placement of exchange swaps (the acquisition of dollars in the future market) in order to dispel any speculation and reduce volatility.

The nominal appreciation of the real (not just against the dollar, but against other currencies) and inflation higher than several of Brazil's main trading partners', steepened the drop in the Real Effective Exchange Rate (REER) (2.2% in 2006 and 8.8% in 2007). Certain labor -intensive activities have begun to suffer the impact of currency revaluation, since they having trouble exporting and competing with imported production, although sales to the domestic market remain dynamic due to growth in domestic demand.

During the second half of 2006, Paraguay saw an acceleration of retail prices leading to an annual inflation rate of 12.5%, several points above the target set by the Central Bank of Paraguay (BCP) of 5% with a ± 2.5 p.p. tolerance margin. Although, in the first half of 2007, the CPI dropped 1.1%, the fall is due to seasonal variations and other specific factors, and fresh acceleration is forecast for the second half, taking inflation for 2007 to 6.8%, well within the IMF range.

To curb the appreciation of the *guaraní* caused by the influx of capital, the BCP raised the local daily foreign currency trading limit and continued to intervene in the foreign exchange market. The exchange rate has continued to fall, however, in nominal and real terms against its main trading partners: the REER fell 17.2% in 2006, despite depreciating 3.1% in the first half of 2007.

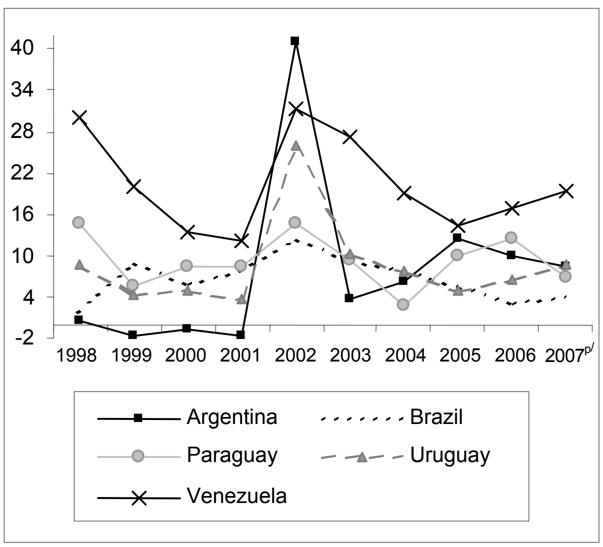
[18] Given the difficulties surrounding the official information, several private forecasts were circulated. Using different methodologies, they suggested a higher rate of inflation, as do the official CPI data for the interior of the country, where the calculation method underwent no changes.

The acquisition of foreign currency by the BCP has boosted net international reserves (NIR) to 21.6% of GDP, way above the average for the last decade (12.6%). Some of these purchases are sterilized through monetary regulation instruments (MRI).

Economic growth, restrictions on supply, the profit margin restructuring in certain sectors, and rigidities in the labor market continue to put pressure on Uruguayan price levels and thus complicate the handling of monetary policy. During 2006, the variation in the CPI rose to 6.4% and, in the first half of 2007, accumulated a rise of around 5.5%. To alleviate this inflationary pressure, the COPOM decided to slow the pace of growth of means of payment (M1) from 15% to 9%. Preliminary calculations indicate that retail inflation for 2007 would be around 8.5%.

During the first half of 2007, the appreciation of the Uruguayan *peso* (2.1%) partially offset the rise in the previous year's exchange rate (3.4%). In real effective terms, it was down 6.4% against the currencies of its main trading partners in 2006, but then rose 2% in the first half of 2007.

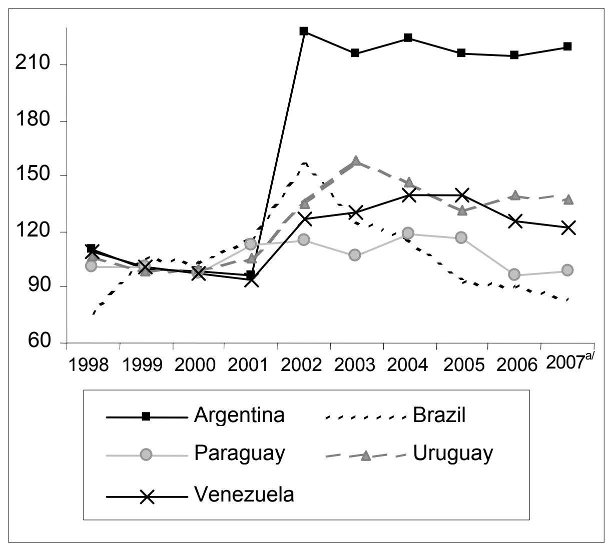
FIGURE 5
MERCOSUR: RETAIL INFLATION
End-of-period YOY CPI variation



Notes: [f] Forecasts.

Sources: INDEC, BCRA, IBGE, BCB, BCP, BCU, INE (Venezuela), ECLAC, and IMF.

FIGURE 6
MERCOSUR: REAL EFFECTIVE EXCHANGE RATE
End-of-period 2000 Indexes=100



Notes: [a] First half data.

Source: ECLAC.

In Venezuela, between 2006 and the first seven months of 2007, the notes and coins in circulation grew, in nominal terms, at a YOY average rate of 33% and, in real terms, at 19% YOY in the context of the accumulation of reserves due to the oil boom and the expansion of public spending.

In order to contain the inflationary effects of the expansion, the authorities have used a variety of absorption mechanisms, such as the increase in reserves on deposits, the placement of instruments by the Central Bank of Venezuela (BCV) and of different kinds of dollar bonds obtainable in bolívars by the Ministry of Finances. There is also a price control policy. The CPI grew 11.8% YOY in 2006 and accelerated progressively to almost 19% by mid-2007. As part of a set of anti-inflation policies, the money sign is to be replaced by the "strong bolívar", equivalent to 1,000 bolívars, as of January 1, 2008.

Since February 2003, there has been exchange control implemented by the Commission of Foreign Exchange Administration (CADIVI) to provide resources for common transactions. The nominal exchange rate has, since April 2005, been set at 2,150 bolívars to the dollar. In fact, the high import coefficient lends great weight to this price as a nominal anchor. Although the circulation of foreign currency is restricted, operations are authorized with securities issued or sold by the government, and denominated in currencies other than the bolívar. Some of these instruments were used during 2006 and 2007 to absorb liquidity, in particular the issues of the "Southern Bonds" (consisting of Venezuelan and Argentine bonds previously acquired by the government),and a PDVSA bond. In a context where the government has an abundance of external assets available, these measures establish a mechanism to ration them within the domestic market and channel financial transactions of private agents with non-residents.

Inflationary acceleration has been responsible for a loss of external competitiveness: in the first six months of 2007, the REER fell 3.2%, whereas 2006 had seen a 10.3% real effective appreciation in the bolívar.

E. Incomes and employment

Per capita GDP continues to rise in all MERCOSUR countries, increasing 21.6% on average in 2006 and 2007 as measured at current prices, and 5.8% p.a. in real terms. The highest growth rates at constant prices were seen by Argentina and Venezuela (7.1% and 6.8% c.a respectively), followed by Uruguay (5.7% c.a.). Brazil successfully speeded up the pace of its expansion of GDP per inhabitant against the previous three years, but the annual average rise was 2.8%, widening the gap with the other partners. Something similar happened with Paraguay, where GDP per inhabitant again grew more slowly in 2007 than its partners' (1.9% c.a. in 2006 and 2007). With these results, Paraguay's *per capita* GDP in 2007 represented just 21.1% of the average for the four remaining countries, still below pre-crisis levels.[19]

Unemployment fell again in Argentina, Uruguay, and Venezuela during 2006, but rose slightly in Brazil and Paraguay. In the first half of 2007, unemployment was down in all countries (there is no up-to-date information for Paraguay) and, for the first time in over a decade, it affected less than 10% of the EAP across MERCOSUR (Figure 7).[20]

The rise in employment, it should be remembered, per point of GDP growth is down on previous years. However, registered employment-product elasticity is higher than non-registered, with a consequent drop in levels of informal labor.

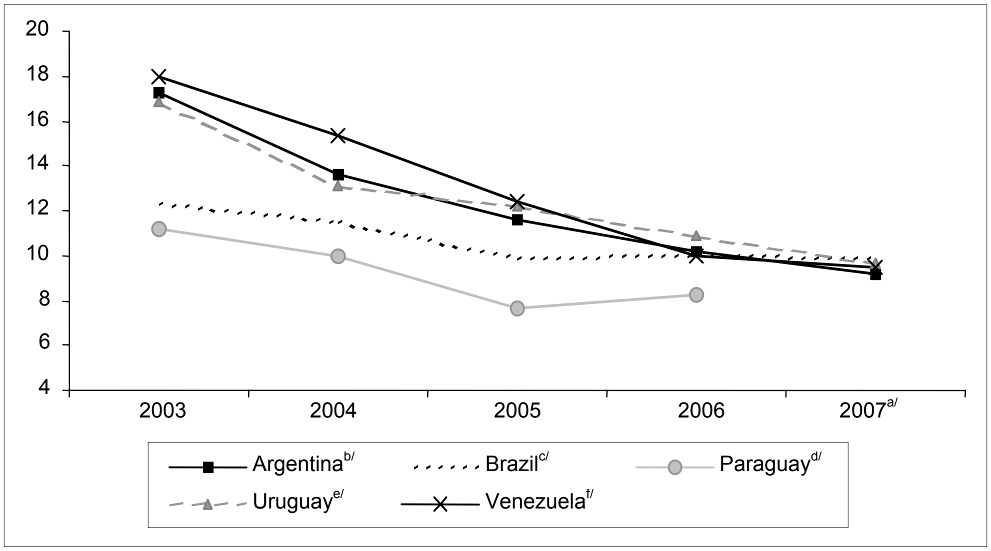
Despite expanding during 2006 and the first half of 2007, real average wages in MERCOSUR have still not made up for the ground they lost and only in Argentina were they above the pre-crisis maximum of 6.2%. In the other countries, real wages have still not rallied. Compared to the higher levels of previous years, real average wages accumulated losses of 20.7% in Venezuela, 16.6% in Brazil, 16.1% in Uruguay, and 2.6% in Paraguay.[21] On the other hand, income distribution continues to improve, although inequality in the region as a whole remains high.

[19] Figures measured at constant prices for the year 2000. Source: Authors' own compilation of their forecasts and ECLAC data.

[20] In Argentina's case, if beneficiaries of social plans performing a related labor consideration are counted as unemployed, unemployment stands at 9.2%; if they are deemed unemployed, unemployment rises to 10.3%.

[21] The maxima were recorded in Brazil in 1998, in Uruguay in 1999, and in Paraguay and Venezuela in 2001. Source: ECLAC.

FIGURE 7
MERCOSUR: UNEMPLOYMENT RATE
% of EAP



Notes: [a/] First half data. Not available for Paraguay.
[b/] Urban areas. Beneficiaries of social plans performing related labor considerations are considered employed.
[c/] Six metropolitan areas.
[d/] Urban total.
[e/] Urban total. In 2006 the National Survey of Households was expanded to also include rural areas. Therefore, the figures from this year are not comparable with previous years (urban total).
[f/] National total.

Sources: INDEC, IBGE, INE, and ECLAC.

F. Conclusions

In spite of growing instability in the international environment, the external context remained generally favorable for MERCOSUR countries, whose activity continued to expand sustainedly. Nevertheless, the international financial situation does to an extent increase the likelihood of a reversal in the sound performance of the world economy in recent years and, accordingly, in the context of strong international demand and low interest rates for MERCOSUR countries.

Over and above this external factor, the region's economies continued to see significant dynamism and a favorable macroeconomic balance in the last year and half. Thus, MERCOSUR is facing this cycle with its fiscal and external accounts in better shape than at other similar growth periods, a phenomenon that generates a minor macroeconomic vulnerability within the bloc, even though there are indications of a degree of deterioration in all countries' public accounts, except Brazil.

This process of growth has generated jobs and, as a result, unemployment is below two digits for the first time in over a decade. *Per capita* GDP continues to expand in all the countries in the bloc, while income distribution has seen some improvement. Levels of inequality, however, remain high.

Contents

ANNEX I

Table AI.1
MERCOSUR: GROSS DOMESTIC PRODUCT
Real YOY - % variation

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela	MERCOSUR[a/]
1998	3.9	0	0.6	4.5	0.3	1.9
1999	-3.4	0.3	-1.5	-2.8	-6	-2.7
2000	-0.8	4.3	-3.3	-1.4	3.7	0.5
2001	-4.4	1.3	2.1	-3.4	3.4	-0.2
2002	-10.9	2.7	-1.5	-11	-8.9	-5.9
2003	8.8	1.1	5.4	2.2	-7.7	2
2004	9	5.7	4.1	11.8	17.9	9.7
2005	9.2	2.9	2.9	6.6	9.3	6.2
2006	8.5	3.7	4.2	7	10.3	6.7
2007[f/]	7.8	4.7	4	5.4	7	5.8

Notes: [a/] Simple average for the five countries.
[f/] Forecasts from the survey of market expectations carried out by the Central Banks of Argentina, Brazil, and Uruguay, and prepared by ECLAC for Uruguay and Paraguay.

Sources: MECON-DNCN, BCRA, IBGE, BCB, BCP, BCU, and ECLAC.

Table AI.2
MERCOSUR: TERMS OF TRADE
1998 Indexes = 100

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela	MERCOSUR[a/]
1998	100	100	100	100	100	100
1999	94	86.8	94.2	91.9	129.1	99.2
2000	103.5	89.4	92.6	95.8	195.3	115.3
2001	102.7	89.2	92.8	99.6	160.5	109
2002	102.4	87.9	89.5	98.3	171.1	109.9
2003	111.8	86.7	93.9	99.1	192.8	116.9
2004	113.5	87.2	96.6	95.7	230.7	124.7
2005	111.3	88	90.2	86.9	301.6	135.6
2006	118	92.5	88.4	85	360.2	148.8
2007[b/]	121.3	95.3	n.a.	88.5	n.a.	n.a.

Notes: [a/] Simple average for the five countries.
[b/] First half.
n.a. = not available.

Sources: INDEC, FUNCEX, and ECLAC.

TABLE AI.3
MERCOSUR: PRODUCT ELASTICITY[a/] OF THE DIFFERENT AGGREGATE DEMAND COMPONENTS
Period average

Country/Bloc and aggregate demand component	Cumulative annual variation		Product elasticity	
	1991-1994	2003-2006	1991-1994	2003-2006
MERCOSUR[b/]				
GDP	4.5	6		
Consumption[c/]	5.2	6.3	1.1	1
Investment[d/]	12.6	14.4	2.7	2.1
Exports[e/]	7.6	7.9	2	1.6
Imports[f/]	20.7	16.3	4.5	2.6
Argentina				
GDP	7.9	8.9		
Consumption[c/]	9.2	7.7	1.2	0.9
Investment[d/]	22.1	25.2	2.8	2.8
Exports[e/]	3.6	8.7	0.5	1
Imports[f/]	42.7	27.8	5.4	3.1
Brazil				
GDP	2.8	3.3		
Consumption[c/]	2.6	2.9	0.9	0.9
Investment[d/]	7	4.3	2.5	1.3
Exports[e/]	6.5	10	2.4	3
Imports[f/]	15.4	9.8	5.5	2.9
Paraguay				
GDP	3.4	3.8		
Consumption[c/]	4.4	4.3	1.3	1.2
Investment[d/]	7.8	3.8	2.3	1
Exports[e/]	13.6	6.1	4	1.6
Imports[f/]	16.1	7.5	4.8	2
Uruguay				
GDP	5.3	6.9		
Consumption[c/]	7.3	5.3	1.4	0.8
Investment[d/]	16.9	19.3	3.2	2.8
Exports[e/]	8.8	14.2	1.7	2.1
Imports[f/]	19.6	14.4	3.7	2.1
Venezuela				
GDP	3.3	7.4		
Consumption[c/]	2.3	11	0.7	1.5
Investment[d/]	9.4	19.5	2.8	2.7
Exports[e/]	5.3	0.4	1.6	0.1
Imports[f/]	9.7	22.2	2.9	3

Notes: [a/] Product elasticity: ratio of the average rates of variation of the aggregate and GDP in 2003-2005. Variables measured at constant prices for 2000. All elasticities are positive.
[b/] Simple average for the five countries.
[c/] Consumption: private spending and government spending in final consumption.
[d/] Investment: gross domestic capital formation = gross domestic fixed capital formation + variation in stocks.
[e/] Exports: including goods and services.
[f/] Imports: including goods and services.

Source: Author's own compilation using ECLAC data.

TABLE AI.4
MERCOSUR: CONSUMER PRICE INDEX
YOY - % variation

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela	MERCOSUR[a/]
1998	0.7	1.7	14.6	8.6	29.9	11.1
1999	-1.8	8.9	5.6	4.2	20	7.4
2000	-0.7	6	8.4	5.1	13.4	6.4
2001	-1.5	7.7	8.4	3.6	12.3	6.1
2002	41	12.5	14.6	25.9	31.2	25.1
2003	3.7	9.3	9.3	10.2	27.1	11.9
2004	6.1	7.6	2.8	7.6	19.2	8.7
2005	12.3	5.7	9.9	4.9	14.4	9.4
2006	9.8	3.1	12.5	6.4	17	9.8
2007[f/]	8.5	4	6.8	8.5	19.4	9.5

Notes: [a/] Simple average for the five countries.
[f/] Forecasts from the survey of market expectations carried out by the Central Banks of Argentina, Brazil, and Uruguay, and prepared by ECLAC for Uruguay and Paraguay.

Sources: INDEC, BCRA, IBGE, BCB, BCP, BCU, INE, and ECLAC.

TABLE AI.5
MERCOSUR: REAL EFFECTIVE EXCHANGE RATE
End-of-periods 2000 Indexes = 100

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela	MERCOSUR[a/]
1998	110.1	76.8	101.2	107	109	100.8
1999	100.4	105.3	101	98.7	100.9	101.2
2000	99	103.7	97	99.7	97.5	99.4
2001	96.9	115.8	113	105.8	93.9	105.1
2002	227.6	156.4	114.9	134.8	127.3	152.2
2003	215.9	126.1	107.2	157.9	130.6	147.5
2004	224.1	116.7	118.1	146.2	139.9	149
2005	216.3	93	116	131.7	140	139.4
2006	215	90.9	96	140.1	125.7	133.6
2007[b/]	219.7	83	99	137.4	121.6	132.1

Notes: [a/] Simple average for the five countries.
[b/] First half.

Sources: ECLAC.

TABLE AI.6
MERCOSUR: *PER CAPITA* GDP
In US$ at constant prices for 2000

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela	MERCOSUR[a/]
1998	8,239	3,373	1,427	6,378	5,134	4,910
1999	7,874	3,349	1,370	6,151	4,736	4,696
2000	7,730	3,444	1,291	6,019	4,819	4,661
2001	7,315	3,439	1,285	5,774	4,891	4,541
2002	6,456	3,454	1,253	5,100	4,378	4,128
2003	6,961	3,424	1,269	5,176	3,968	4,160
2004	7,518	3,542	1,290	5,747	4,596	4,539
2005	8,131	3,574	1,296	6,084	4,939	4,805
2006	8,732	3,656	1,326	6,498	5,359	5,114
2007[f/]	9,324	3,775	1,346	6,799	5,635	5,376

Notes: [a/] Simple average for the five countries.
[f/] Forecasts.

Sources: ECLAC and author's own forecasts.

TABLE AI.7
MERCOSUR: RATE OF UNEMPLOYMENT
As % of EAP

Year	Argentina		Brazil[b/]	Paraguay[c/]	Uruguay[d/]	Venezuela[e/]	MERCOSUR[f/]
	a1/	a2/					
2003	17.3	22.7	12.3	11.2	16.9	18	15.1
2004	13.6	18.1	11.5	10	13.1	15.3	12.7
2005	11.6	14.8	9.8	7.6	12.2	12.4	10.7
2006	10.2	12.3	10	8.3	10.9	10	9.9
2007[g/]	9.2	10.3	9.9	n.a.	9.7	9.4	9.5

Notes: [a1/] Urban areas. Beneficiaries of social plans performing related labor considerations are considered employed.
[a2/] Urban areas. People whose main occupation depends on a social plan are considered unemployed.
[b/] Six metropolitan areas.
[c/] Urban total.
[d/] Urban total. In 2006 the National Survey of Households was expanded to also include rural areas. Therefore, the figures from this year are not comparable with previous years (urban total).
[e/] National total.
[f/] Simple average for the five countries. In Argentina's case, it takes the rate corresponding to note a1/.
[g/] First half.
n.a.: not available.

Sources: INDEC, IBGE, INE, and ECLAC.

CHAPTER II. DEVELOPMENTS IN TRADE AND FOREIGN DIRECT INVESTMENT[22]

In 2006 and the first half of 2007, MERCOSUR's trade in goods continued to increase sustainedly, both in terms of intrazone flows and trade with the rest of the world. The aggregate result remained in surplus (as a consequence of Argentine and Brazilian surplus), despite falling for the first time in five years. Trade within the bloc was generally dynamic, with record levels of exports and imports in all four countries.

Intra-MERCOSUR trade showed the highest growth rates. Unlike previous years, the momentum over the last eighteen months was due to Brazilian purchases within the bloc. However, the largest economy continues to obtain surplus results *vis-à-vis* the other partners and the only country to have succeeded in reducing its bilateral deficit is Argentina. In a context of strong asymmetries, this situation continues to generate debate over asymmetries between its members, particularly in the smaller countries.

Two features stand out in extrazone trade: on the one hand, the growing trade relevance of LAIA countries and, on the other, the appearance of the deficit with Asia, after several years during which MERCOSUR saw surplus results with all main trade blocs. The last point is closely linked to trade with China, a country that has acquired great importance as a partner, in its capacity as an importer of raw materials and an exporter of labor-intensive manufactured goods. The sharp increase in imports of Chinese products by MERCOSUR countries has given rise to various calls for trade administration.

Although trade with Venezuela is still not very significant, it continues to expand apace, particularly the dynamism of exports to this destination. Furthermore, although the Caribbean country has a limited share in the bloc's total imports, it has become a strategic supplier of energy.

For the first time, net FDI in 2006 was negative as a result of the sharp rise in Brazilian investments in the rest of the world. It should be stressed that Argentina and Uruguay have, in recent years, become two of the main destinations for Brazilian FDI flows. The influx of FDI from abroad continued to increase in all MERCOSUR countries except Argentina, although it remains below 1990s levels and is growing more slowly than world FDI flows and FDI flows to other developing countries.

A. MERCOSUR trade

Overall performance of the four countries

In a favorable international context, MERCOSUR's trade in goods during 2006 and the first half of 2007 continued to expand sustainedly, as it has been since 2003. In 2006, both aggregate exports and imports for the four countries reached record levels (US$190b and US$135.5b respectively). These records would be broken again during 2007.

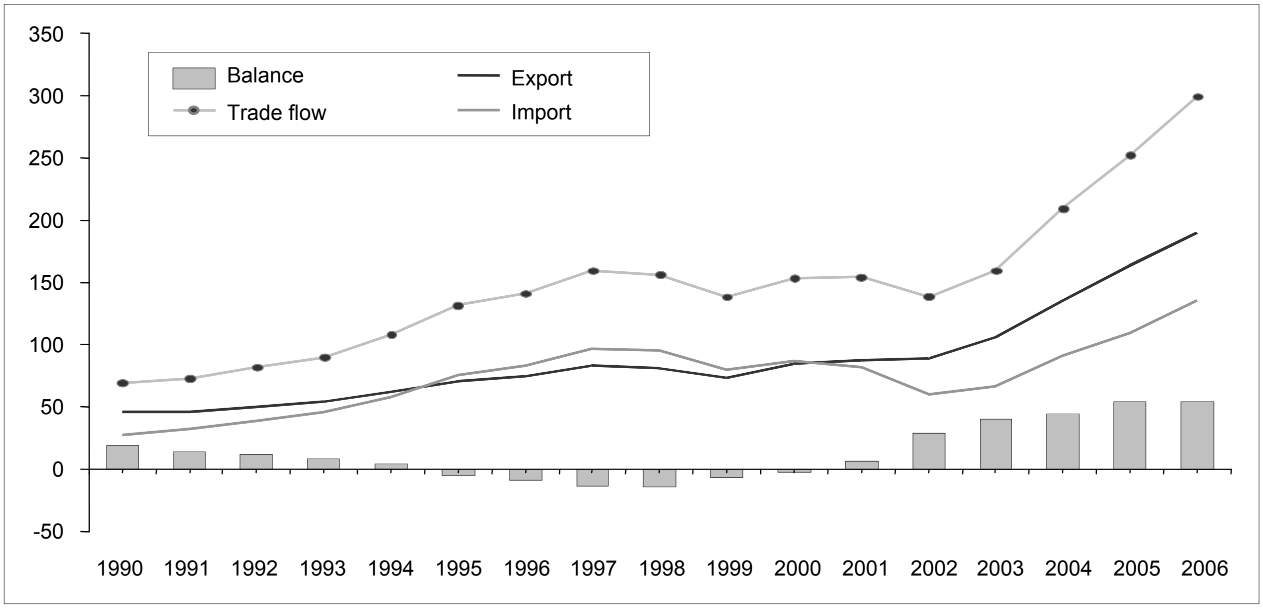
The bloc's external sales were up 15.6% in 2006 and 18.2% YOY during the first six months of 2007, driven by global economic growth. As in recent years, the dynamism of world demand stimulated both the increase in volumes sent abroad and a rise in the prices of the main exports.

Furthermore, unlike in 2005, imports expanded faster than external sales (23.9% in 2006 and 25.4% YOY in the first half of 2007), largely as a result of the sound performance of MERCOSUR economies. This fact translated into a reduction of the trade in goods surplus in 2006 (the first time in five years). However,

[22] Methodological note: As Venezuela's membership process is not yet complete and trade tariffs and rules have not therefore been modified, the text refers to the bloc's flows for the original four partners. Specific observations are, however, made about Venezuela. This also applies to the subsequent chapters.

this balance remained high in historical terms (US$53,900m). The surplus dropped again slightly in the first half of 2007.

FIGURE 8
MERCOSUR TRADE IN GOODS[a/]
1990-2006 - US$ Billions



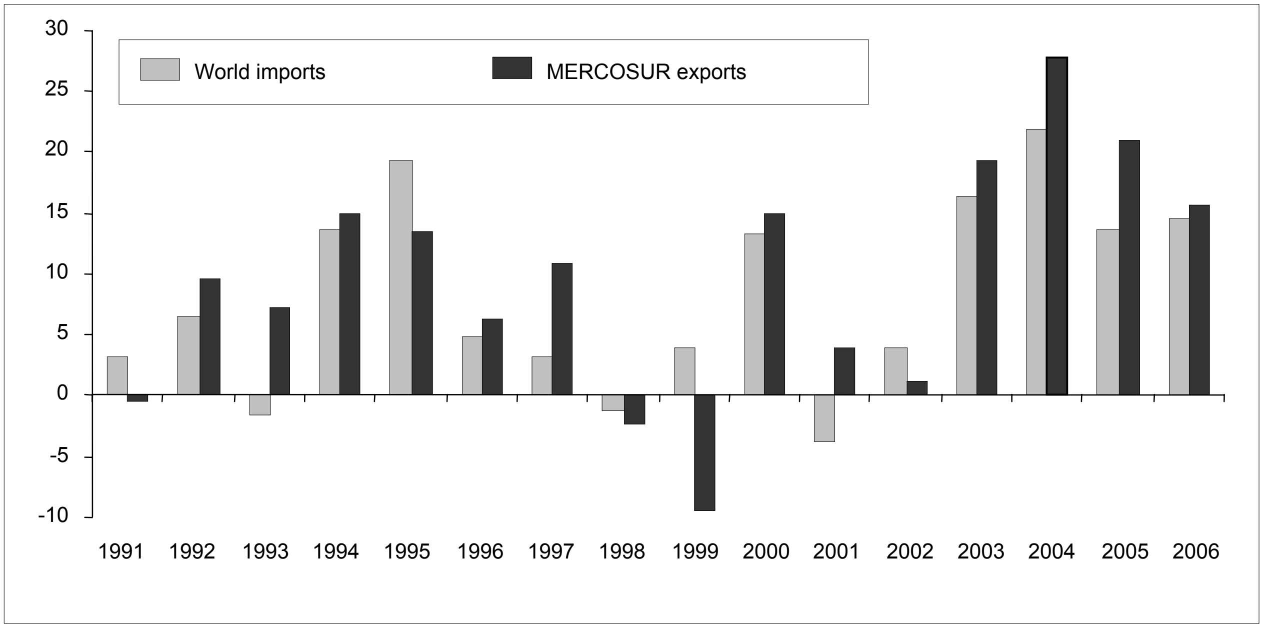
Note: [a/] Total exports and imports for the four countries, excluding intrazone trade.

Sources: INDEC, SECEX, and Central Banks of Paraguay and Uruguay.

The dynamism of MERCOSUR trade in recent years not only contrasts with the stagnation seen during the crisis, but also outperforms growth in the first half of the 1990s, when trade expanded rapidly in the context of the implementation of the integration process and the unilateral opening of member countries to the rest of the world (Figure 8).

Although, since 2003, MERCOSUR exports have been expanding faster than world trade, boosting the bloc's market share to 1.8%, against an average of 1.5% between 1991 and 2002, the growth differential in its external sales compared to world imports fell substantially during 2006 (Figure 9). Similarly, MERCOSUR's export performance has been lower than other emerging economies, particularly when it comes to quantities. The possible deceleration of GDP and world trade will no doubt put the South American bloc's export capacity to the test over the coming years.

FIGURE 9
GROWTH IN MERCOSUR GOODS EXPORTS AND WORLD GOODS IMPORTS
1990-2006 - Expressed as %



Sources: INDEC, SECEX, Central Banks of Paraguay and Uruguay, and IMF.

Evolution of intra-MERCOSUR and extrabloc trade compared

The expansion of trade in 2006 and the first half of 2007 was seen in both intra-MERCOSUR trade and trade with extrazone countries (Table 5).

TABLE 5
MERCOSUR INTRABLOC AND EXTRABLOC TRADE FLOWS OF GOODS
2005-2007[a/] - US$ Billions

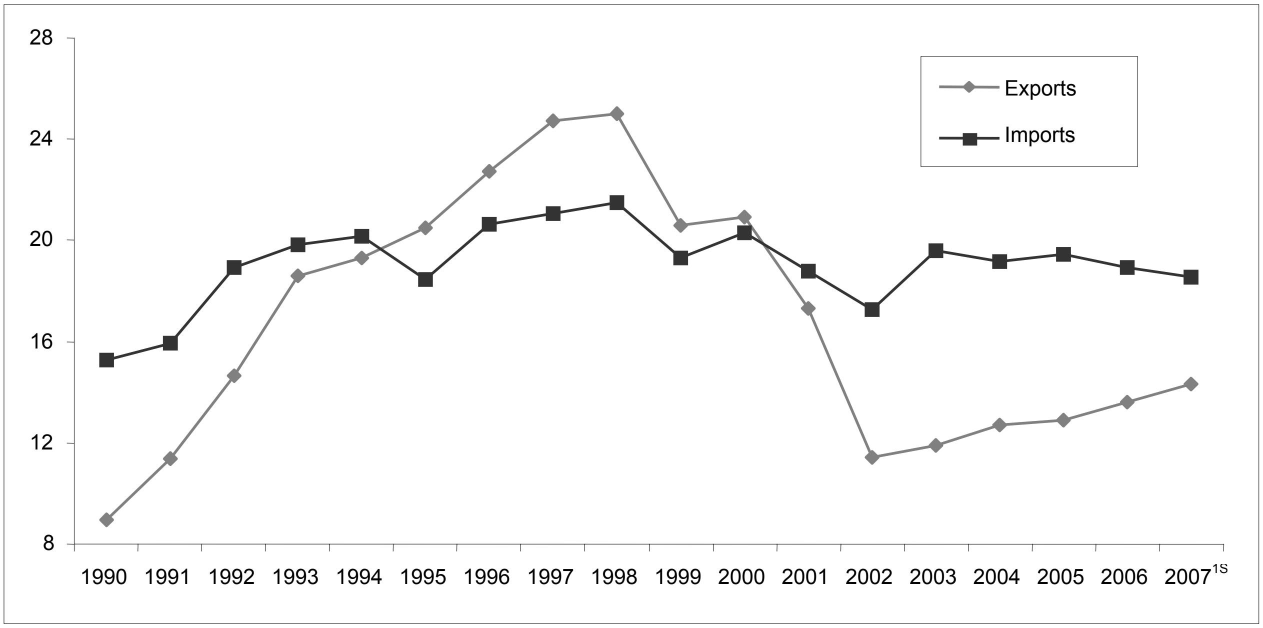
	2005	2006	% Variation	1st ½ 2006	1st ½ 2007	% Variation
Intrabloc						
Exports	21.15	25.794	22	11.559	14.489	25.4
Extrabloc						
Exports	142.651	163.617	14.7	74.158	86.814	17.1
Imports	88.117	109.887	24.7	50.15	63.112	25.8
Total						
Exports	163.800	189.411	15.6	85.717	101.304	18.2
Imports	109.398	135.551	23.9	61.761	77.468	25.4
Balance	**54.403**	**53.86**	**-1**	**23.956**	**23.836**	**-0.5**

Note: [a/] 2007 is for the 1st ½ only.

Sources: INDEC, SECEX, and Central Banks of Paraguay and Uruguay.

Interestingly, while the bloc's share in total imports slowly fell to 18.5%, MERCOSUR's market share in exports rose, though only to 14.3%, well below the maximum of the late 1990s, when exports ended up representing a quarter of the total (Figure 10).

FIGURE 10
RATIO OF INTRABLOC TRADE IN GOODS TO TOTAL MERCOSUR TRADE
1990-2007 [a/] - Expressed as %



Note: [a/] 2007 is for the 1st ½ only.

Sources: INDEC, SECEX, and Central Banks of Paraguay and Uruguay.

This is explained, on one the hand, by the differential impact of the 1999-2002 crisis on export flows (which grew slowly) and import flows (which were down in all points of origin). Thus, as MERCOSUR members increased their shipments to the rest of the world, their sales to partners fell and their relative importance with them. On the other hand, the shift in relative prices following the devaluations of MERCOSUR currencies triggered a sharp rise in the quantities exported to the rest of the world, preventing the rapid recovery of intrabloc trade translating into a marked rise in the share of the total exported. This effect was reinforced by the rise in the international prices of raw materials (predominant in exports to the rest of the world) above that of the prices of manufactured goods (more significant in intrazone trade).

- Intra-MERCOSUR trade -

Intra-MERCOSUR exports rose 22% in 2006 and 25.4% over the first half of 2007, faster than 2005 and displaying better performance than total exports. In line with trends since 2003, Brazil continued to see surplus results vis-à-vis the other partners.[23] Brazil's surplus in MERCOSUR in 2006 stood at US$5b, 7% higher than 2005.

[23] For a detailed analysis of this subject, see MERCOSUR Report 11.

Over the previous years, growth in intrazone trade was mainly driven by sales from Brazil to the rest of the bloc. In 2006 and the first half of 2007 however, Brazilian purchases from the other members of MERCOSUR gained in dynamism, increasing 27.1% and 26.8% YOY respectively. These rates are in excess of Brazilian sales to the bloc and are the highest in the last decade.

Despite this, the only country that has been able to reduce the bilateral deficit with Brazil is Argentina.[24] During 2006 and the first half of 2007, the dynamism of Argentine exports of manufactured goods to its neighbor (automotive industry, milling, etc.) remained steady, while shipments of primary products (cereals, copper ore) and, under the fuels heading, carburants. A parallel slowing of imports from Brazil was seen in all headings, higher than that recorded in purchases from the rest of the world. This behavior could have been helped by the continuous real depreciation of the peso against the Brazilian real (17.7% in the eighteen months analyzed).

TABLE 6
INTRABLOC TRADE FLOWS OF GOODS IN MERCOSUR BY COUNTRY
2005-2007[a/] - US$ Billions

	2005	2006	% Variation	1st ½ 2006	1st ½ 2007	% Variation
Exports	**21.15**	**25.794**	**22**	**11.559**	**14.489**	**25.4**
Argentina	7.709	9.949	29.1	4.433	5.49	23.8
Brazil	11.746	13.986	19.1	6.267	7.596	21.2
Paraguay	912	917	0.5	424	889	109.7
Uruguay	783	942	20.3	435	514	18.2
Imports	**21.281**	**25.662**	**20.6**	**11.611**	**14.356**	**23.6**
Argentina	11.02	12.686	15.1	5.887	7.213	22.5
Brazil	7.054	8.967	27.1	3.867	4.904	26.8
Paraguay	1.576	1.827	15.9	0.829	1.072	29.3
Uruguay	1.631	2.182	33.8	1.028	1.167	13.5
Balance						
Argentina	-3.311	-2.737	-17.3	-1.454	-1.723	18.5
Brazil	4.692	5.019	7	2.400	2.693	12.2
Paraguay	-0.664	-0.091	37	-0.405	-0.183	-54.8
Uruguay	-0.848	-1.24	46.2	-0.593	-0.653	10.1

Note: [a/] 2007 is for the 1st ½ only.

Sources: INDEC, SECEX, and Central Banks of Paraguay and Uruguay.

Paraguay and Uruguay's deficit with the largest partner, on the other hand, continues to deepen. Although the balance of intrabloc trade should not *a priori* be cause for concern, the systematic appearance of positive results from Brazil has, in recent years, stimulated the debate over asymmetries within the bloc.

On the one hand, the persistence of the deficit is due to Paraguay and Uruguay's difficulties placing their products in the regional market, rather than other destinations. This could be explained by the type of products demanded by each partner. Paraguay and Uruguay's greater comparative advantages are concentrated in primary products, revealing the existence of an export structure complementary with the rest of the world and

[24] See Tables AII.1, AII.3 and AII.4, Annex II.

competitive with regional partners. Thus, while commodities encounter dynamic demand in extrazone markets, the most successful headings in Argentine and Brazilian imports are not supplied by the smaller economies, since intra-MERCOSUR trade barriers limit the development of manufacturing activities in Paraguay and Uruguay, where economies of scale are more important.[25]

In fact, the most important and dynamic headings in Paraguay's exports to MERCOSUR during the period analyzed correspond to agricultural products like vegetable oils, flours, and cereals. Also, the engine driving Paraguayan shipments to the bloc is not Brazil, but Argentina. In Uruguay's case, cereals (rice, wheat, barley) and certain manufactured products like rubber and plastics are important.

The smaller economies' imports are densely concentrated in products originating in MERCOSUR. The bloc's share in Uruguay's external purchases was 45.7% in 2006 (slightly up on the previous two years), while in Paraguay it stood at around 34.8%. However, in this case, MERCOSUR's share in Paraguay's imports was over 20 p.p. down on the previous five-year average, as Asian countries gained market share.

The most important, fastest-growing categories in Paraguayan purchases from MERCOSUR correspond to manufacturing products such as machinery, vehicles, and fertilizers, originating mainly in Brazil. Uruguayan imports from the bloc include fuels and manufactured goods, particularly automobiles and auto parts, and plastics. In other words, the products in which Argentina and Brazil have intermediate comparative advantages (compared to Paraguay and Uruguay, but not the rest of the world) are of great importance in terms of the small countries' purchases from the bloc, a trend facilitated by the structure of the CET.

- Extra-MERCOSUR trade -

Over the last eighteen months, MERCOSUR continued to expand its trade with all its main extrazone partners. Although exports grew more slowly compared to 2005, they rose 14.7% in 2006, and 17.1% YOY during the first half of 2007. In imports, the pace of expansion increased compared to 2005, with rates of close on 25% YOY in these periods. Extrabloc trade remained in surplus, although this fell slightly against the previous year. The greater dynamism in imports over exports was seen in trade with almost all partners (Table 7).

Analysis of these trade flows shows two important facts. On the one hand, the Latin American Integration Association (LAIA) countries[26] gained in importance as MERCOSUR trading partners. These movements may, to an extent, be due to the faster pace of growth in the Latin American economies compared to the world average and to the expansion of trade in energy products between the two blocs. Although exports to LAIA during the first half of 2007 grew less than the average, it should be stressed that this market has become an important export destination for MERCOSUR. Indeed, it absorbs 12.3% of extrazone shipments, 5 p.p. up on 2004.

On the other hand, as of 2006, a loss balance is seen in trade with Asian countries, a highly significant fact, since over the previous three years, MERCOSUR had recorded surpluses with all its main trading partners. It should be stressed that, while the relevance of Asia as a destination for external sales is growing slowly, its share in imports increased by over 5 p.p. in 2004-2007 to become MERCOSUR's foremost supplier. This increase in the importance of Asia as a supplier is at the expense of the EU, NAFTA countries, and the rest of the world.

[25] See Chapter II of MERCOSUR Report 11.

[26] MERCOSUR countries and Mexico, as part of the North American Free Trade Agreement (NAFTA), are excluded from the bloc.

Undoubtedly, the evolution of trade with the Asian bloc is closely linked to the performance of trade with China, a country which, in 2006, represented 40% of trade with that region as a whole. Indeed, by virtue of its scale, geopolitical importance, and pace of economic expansion, China is at the center of practically every discussion relating to current and future trends in world trade patterns, and MERCOSUR is no an exception to this trend.

TABLE 7
EXTRABLOC TRADE FLOWS OF MERCOSUR GOODS BY SELECTED REGIONS
2005-2007[a/] - US$ Billions

	2005	2006	% Variation	1° S 2006	1° S 2007	% Variation
Exports	**142.65**	**163.617**	**14.7**	**74.157**	**86.814**	**17.1**
NAFTA	35.914	38.356	6.8	17.925	18.116	1.1
EU	34.657	39.82	14.9	18.022	22.955	27.4
LAIA[b/]	16.705	20.764	24.3	9.404	10.707	13.9
Asia	25.683	28.591	11.3	12.946	15.962	23.3
Rest of the world	29.692	36.085	21.5	15.859	19.075	20.3
Imports	**88.118**	**109.887**	**24.7**	**50.149**	**63.113**	**25.8**
NAFTA	20.25	23.691	17	10.794	13.722	27.1
EU	23.68	26.788	13.1	12.415	15.567	25.4
LAIA[b/]	5.116	8.062	57.6	3.643	4.299	18
Asia	22.164	30.825	39.1	13.901	17.818	28.2
Rest of the world	16.909	20.522	21.4	9.397	11.706	24.6
Balance	**54.532**	**53.73**	**-1.5**	**24.008**	**23.702**	**-1.3**
NAFTA	15.664	14.665	-6.4	7.132	4.394	-38.4
EU	10.977	13.033	18.7	5.607	7.388	31.8
LAIA[b/]	11.589	12.702	9.6	5.761	6.408	11.2
Asia	3.519	-2.234	-163.5	-0.955	-1.857	94.5
Rest of the world	12.783	15.564	21.8	6.462	7.368	14

Notes: [a/] 2007 is for the 1st ½ only.
[b/] Except MERCOSUR and Mexico.

Sources: INDEC, SECEX, and Central Banks of Paraguay and Uruguay.

The dynamism of the bloc's trade with China in recent years has been astonishing. The Asian country has gone from representing 1% of the bloc's exports and 0.6% of imports in 1991, to 6.4% and 8.8% in 2006. In terms of levels, the figures for the evolution of trade are even more astounding. Brazilian and Argentine exports to China went from US$473m in 1991 to US$11.9b at the end of 2006, A 25-fold increase. Imports, on the other hand, climbed from US$184m to US$11.1b, 60 times 1991 levels.

Another distinctive feature of trade with China is that this country has reached a surplus position against MERCOSUR as a whole and is on its way to consolidating this bilaterally with each member. Although Argentina still has a small positive balance, import and export growth rates suggest it will be very difficult to close even 2007 in positive territory.

In recent years, the MERCOSUR-China trade pattern has clearly been determined by each party's relative factorial abundance. In other words, while MERCOSUR exports goods intensive in natural resources to the Asian country (raw materials, energy, and processed agricultural produce), its imports from that origin are concentrated in labor-intensive manufactured goods. Therefore, although China offers a great opportunity for MERCOSUR exports as an importer of commodities, a significant part of MERCOSUR's manufacturing sector (mainly labor-intensive activities) tends to highlight the risks associated with this country's production/export potential and its negative implications for the region.

TABLE 8
TOTAL TRADE FLOWS OF MERCOSUR GOODS TO CHINA
2005-2007[a/] - US$ Billions

	2005	2006	% Variation	1st ½ 2006	1st ½ 2007	% Variation
Exports	**10.220**	**12.09**	**18.3**	**5.385**	**7.158**	**32.9**
Argentina	3.193	3.508	9.9	1.64	2.149	31
Brazil	6.835	8.402	22.9	3.660	4.915	34.3
Paraguay	0.07	0.02	-71.4	0.011	0.006	-45.5
Uruguay	0.122	0.16	31.1	0.074	0.088	18.9
Imports	**8.502**	**12.88**	**51.5**	**5.588**	**8.213**	**47**
Argentina	2.238	3.122	39.5	1.321	2.04	54.4
Brazil	5.355	7.99	49.2	3.494	5.21	49.1
Paraguay	0.667	1.417	112.4	0.622	0.764	22.8
Uruguay	0.242	0.351	45	0.151	0.199	31.8
Balance	**1.716**	**-0.789**	**-146**	**-0.204**	**-1.055**	**417.2**
Argentina	0.955	0.386	-59.6	0.319	0.109	-65.8
Brazil	1.48	0.413	-72.1	0.166	-0.295	-277.7
Paraguay	-0.598	-1.397	133.6	-0.612	-0.758	23.9
Uruguay	-0.121	-0.191	57.9	-0.077	-0.111	44.2

Note: [a/] 2007 is for the 1st ½ only.

Sources: INDEC, SECEX, and Central Banks of Paraguay and Uruguay.

In fact, the abrupt increase in purchases of products like textiles, clothing, footwear, and toys from China have caused a reaction from the MERCOSUR public and private sectors (mainly in Brazil and Argentina), leading to trade administration measures, some imposed unilaterally by MERCOSUR countries, other agreed previously with the Chinese government.

In February 2006, Brazil signed a voluntary export restriction agreement with the Chinese government for 70 textile and clothing products. Even so, 18 Chinese products are currently subject to anti-dumping duties. Similarly, tariffs for the clothing sector increased in 2007 from 20% to 35% (a measure still subject to approval from MERCOSUR) and new criteria were adopted to step up sanitary, technical, and quality controls on Chinese imports of toys, electrical and electronic products, and others. Along the same lines, a list of reference prices was established for clothing imports from China, on which the duties are applied.

Among the measures adopted by Argentina are the implementation of reference prices, non-automatic licenses, anti-dumping duties, import certificates for footwear parts, purses, suitcases, and bags, and greater security and quality requirements for external tire purchases. Likewise, the listing of products to enter the country through more control-intensive Specialist Customs was expanded, incorporating the likes of bicycles and bicycle parts, information processing and electronic items, clocks, and hardware. Lastly, the need was established to submit original invoices translated into Spanish and validated by the country of origin's customs service, when the declared prices of imports are below the Customs' reference value.

In short, trade between MERCOSUR countries and China promises to continue in years to come somewhere between dynamism and flow "administration". Undoubtedly, recent trade performance with this region raises queries about the future, especially as regards the potential results of a pattern of specialization according to which MERCOSUR countries remain anchored in the exploitation of essentially static comparative advantages.

Venezuelan membership of MERCOSUR and trade flows

In mid-2006, the Protocol of Adherence of Venezuela to MERCOSUR was signed in Caracas, which, at the time of writing this Report, was still pending approval by the Paraguayan and Brazilian Congresses.[27] Although MERCOSUR's trade in goods with Venezuela is still not very significant, it has displayed significant dynamism in recent years, even though trade barriers have not begun to be dismantled. During 2006 and the first half of 2007, the bloc's surplus with the Caribbean country increased, reflecting trends in the two largest economies, as Paraguay and Uruguay continue to record loss balances (Table 9).

The four MERCOSUR countries' exports to Venezuela have been growing sustainedly (60.5% YOY in 2006 and 37.9% during the first half of 2007) and the bloc currently accounts for 12% of the Caribbean country's total imports. The greater dynamism of sales to this destination, as compared to shipments to the rest of the world, reveals the Venezuelan market's potential for the MERCOSUR products, particularly manufactured goods (automobiles and auto parts, pharmaceutical products, foods, plastics, paper and cardboard, etc.), which constitute most of the country's exports. One of the main countries that might be affected by MERCOSUR's gain in market share in Venezuela, it should be remembered, is Colombia, as a traditional supplier of similar products under preferential tariff conditions.

TABLE 9
MERCOSUR TRADE IN GOODS WITH VENEZUELA
2005-2007[a/] - US$ Billions and %

	2005	2006	% Variation	1st ½ 2006	1st ½ 2007	% Variation
Exports	2.778	4.458	60.5	1.856	2.558	37.9
Argentina	0.513	0.806	57.1	0.308	0.471	52.9
Brazil	2.224	3.565	60.3	1.516	2.014	32.8
Paraguay	0.007	0.009	30	0.001	0.032	3,937.5
Uruguay	0.034	0.078	132	0.031	0.041	33
Imports	0.551	1.355	146.1	0.711	0.641	-9.9
Argentina[b/]	0.045	0.024	-46.7	0.016	0.014	-15
Brazil	0.255	0.592	132.2	0.247	0.188	-23.9
Paraguay	0.006	0.140	2,356.1	0.001	0.130	11,718.2
Uruguay	0.245	0.599	144.5	0.447	0.309	-30.9
Balance	2.227	-3.104	-239.4	-1.145	-1.927	68.4
Argentina	0.468	-0.782	-267.1	-0.292	-0.457	56.5
Brazil	1.969	-2.974	-251	-1.269	-1.836	44.7
Paraguay	0.001	0.131	9,961.5	0	0.098	24,325
Uruguay	-0.211	0.521	-346.6	0.416	0.268	-35.6

Notes: [a/] 2007 is for the 1st ½ only.
[b/] This value does not include Argentine imports of fuel oil and other fuels from Venezuela because, for technical reasons, the INDEC does include them as being specifically allocated to that country.

Source: INDEC, SECEX, and Central Banks of Uruguay, Paraguay and Venezuela.

---

27 See Chapter III of this Report.

On the other hand, MERCOSUR imports from Venezuela exhibited strong growth during 2006 (146.1%), but fell 9.9% during the first half of 2007.[28] In general terms, Venezuela's importance as a supplier of the bloc is relatively limited for all countries except Uruguay, which absorbs almost half the bloc's purchases from this origin. However, in terms of energy, Venezuela has become an important trading partner and, in fact, fuels represent almost the entirety of imports from the country in Argentina, Paraguay and Uruguay, and over 60% in Brazil.

B. Evolution of trade by country

During 2006 and the first half of 2007, goods exports and imports continued to expand in all four MERCOSUR countries, reaching record levels in all cases. As in previous years, Argentina and Brazil recorded surplus results, while the balance remained negative in Paraguay and Uruguay (Table 10).

External sales rose relatively steadily during 2006. The increase in Brazil, slightly above average for the bloc, enabled it to win a record market share of MERCOSUR's external shipments (72.6%). During the first half of 2007, the strong growth in Paraguayan exports is prominent, as is the slowing of Uruguayan external sales. In both periods, shipments abroad rose more slowly in Argentina than the rest of the bloc.

Imports, on the other hand, increased faster than exports in all countries during 2006, and in Argentina and Brazil in the first half of 2007. In both periods, Paraguay and Brazil exhibited the highest growth rates.

TABLE 10
TOTAL MERCOSUR TRADE FLOWS OF GOODS
2005-2007[a/] - US$ Billions and %

	2005	2006	% Variation	1st ½ 2006	1st ½ 2007	% Variation
Exports	**163.8**	**189.411**	**15.6**	**85.717**	**101.304**	**18.2**
Argentina	40.387	46.083	14.1	21.849	24.546	12.3
Brazil	118.308	137.47	16.2	61.057	73.214	19.9
Paraguay	1.688	1.906	12.9	0.927	1.508	62.7
Uruguay	3.417	3.952	15.7	1.884	2.036	8.1
Imports	**109.398**	**135.551**	**23.9**	**61.761**	**77.468**	**25.4**
Argentina	28.662	34.126	19.1	15.6	19.42	24.5
Brazil	73.606	91.396	24.2	41.524	52.62	26.7
Paraguay	3.251	5.254	61.6	2.37	3.02	27.4
Uruguay	3.879	4.775	23.1	2.267	2.408	6.2
Balance	**54.402**	**53.86**	**-1**	**23.956**	**23.836**	**-0.5**
Argentina	11.725	11.957	2	6.249	5.126	-18
Brazil	44.703	46.074	3.1	19.533	20.594	5.4
Paraguay	-1.564	-3.348	114.1	-1.443	-1.512	4.8
Uruguay	-0.462	-0.823	78.1	-0.383	-0.372	-2.9

Note: [a/] 2007 is for the 1st ½ only.

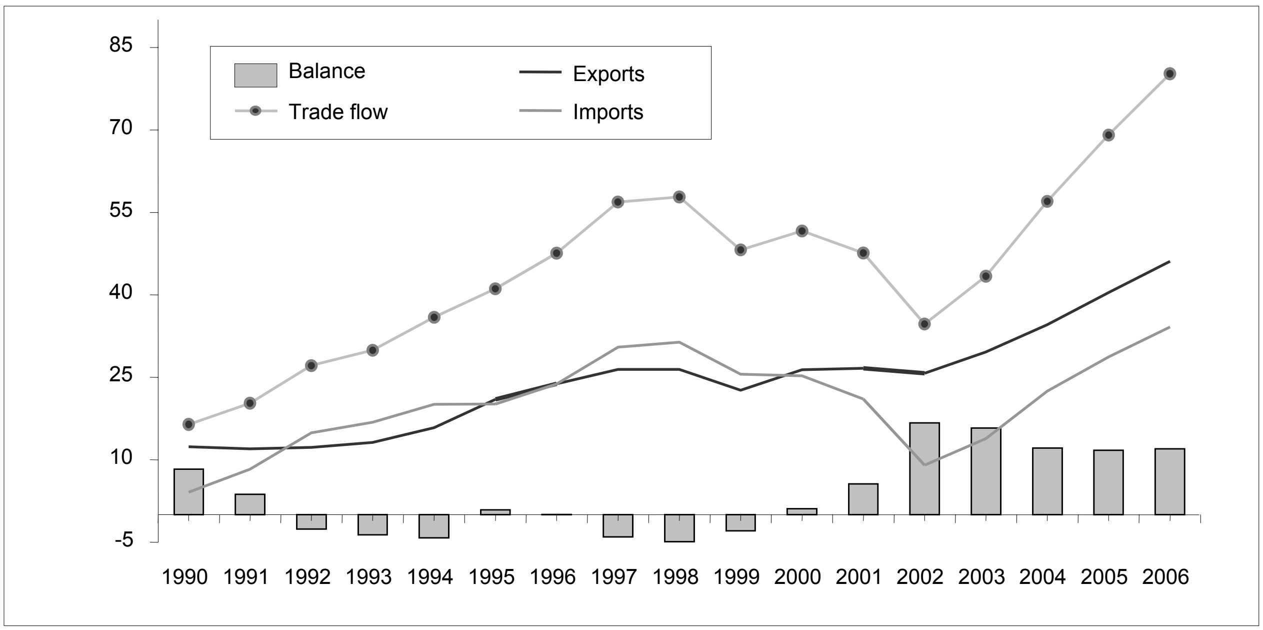
Sources: INDEC, SECEX, and Central Banks of Paraguay and Uruguay.

[28] Figures do not include Argentine imports of fuel oil and other fuels from Venezuela because, for technical reasons, the INDEC does include them as being specifically allocated to that country.

Argentina

Argentina's foreign trade flows continue to rise persistently, consolidating the upward trend observed since 2003 (Figure 11). Exports rose 14.1% in 2006 and 12.3% during the first half of 2007, totaling US$48.8b in the twelve months to June 2007 and almost doubling levels during the crisis. Unlike 2005, prices rather than quantities contributed to the rise in external sales. Manufactured goods remained the most dynamic heading, while fuel and energy shipments slowed in 2006 and fell in 2007 (Box 2).

FIGURE 11
ARGENTINA: TRADE FLOWS OF GOODS
1990-2006 - US$ Billions



Source: INDEC.

Imports amounted to near US$38b in the same period, 320% up on 2002 levels. The most significant rises corresponded to purchases of automobiles, consumer goods, capital goods, and their parts and accessories. Unlike exports, the momentum came mainly from increased physical volumes.

With these results, trade in goods remained in surplus at around US$12b during 2006, while during the first half of 2007, this surplus fell 18% YOY. As in 2005, Argentina recorded positive trade balances with all its main trading partners except MERCOSUR.

However, attention must be drawn to the fact that the rise in exports was driven by sales to MERCOSUR, which were considerably more dynamic than extrazone shipments. In the case of imports, however, the highest growth rates were shown by purchases outside the bloc, especially from Asian countries and the EU. For Argentina, MERCOSUR is significant both as a destination for exports (21.6%) and an origin for its imports (37.2%).[29]

[29] See Table AII.1, Annex II.

BOX 2
ARGENTINA'S ENERGY BALANCE AND ITS REGIONAL IMPLICATIONS

Argentina's trade in goods surplus is sustained to a significant extent by its "energy surplus". Indeed, its positive fuel and energy balance went from 25% of the total in 2002 to almost 50% in 2006, while the surplus in the remaining products fell significantly, in both absolute and relative terms. However, in 2007, Argentina's commercial trade is displaying some alterations (Table 11). Over the first half, fuel and energy exports dropped 18% (especially shipments of oil, gas oil, and gas), while imports rose 19%, driven by more purchases of gas oil, fuel oil, and electricity. Thus, the 'energy' surplus fell almost a third, its share in the total surplus falling by almost 5 p.p. This situation worsened early in the third quarter of 2007, when the balance in fuels and energy went into deficit for the first time in fifteen years, while imports rose 150% YOY.

This shift in the energy trade pattern is explained by strong growth in internal demand, which cannot be met by local supply. In fact, while oil and gas reserves and production exhibit a downward trend, their consumption has been increasing sustainably, spurred on by the growth of the automotive fleet, industry, the primary sector, and electrical generation. Gas saw a significant rise in residential demand in 2007 in a context of restrictions on electrical supply. These factors boosted electrical energy imports from MERCOSUR countries and reduced liquid fuel and gas exports considerably, mainly to Chile.

Although growth in energy imports is expected to slow in the coming months as certain specific problems are solved, it is highly likely that the surplus of Argentina's trade in goods will fall accordingly. Unless there is a shift in the trend of internal production, Argentina could in the medium term go from being a net exporter of fuel and energy to being a net importer. This would entail major changes. At the internal level, the Treasury could begin to lower inflows due to withholdings on hydrocarbons exports, while inflationary tensions would rise (due to fuel imports at international prices) or the pressure to sustain the current model of subsidies geared to curbing domestic prices rises. At the regional level, Argentine energy imports from other MERCOSUR members and countries such as Bolivia would continue to increase, while the supply, guaranteed to various parts of the region over the past decade, particularly in the case of gas to Chile, would fall. This situation raises the challenge of expanding investments in infrastructure to meet the changes anticipated in the trade pattern in this segment, placing the issue of energy integration at the heart of the debate for the regional agenda looking to the future.

TABLE 11
ARGENTINA: THE ENERGY BALANCE'S IMPACT ON THE TOTAL BALANCE OF GOODS
2005-2007[a/] - US$ Billions

	2005	2006	% Variation	1st ½ 2006	1st ½ 2007	% Variation
Exports	**40.387**	**46.083**	**14.1**	**21.849**	**24.546**	**12.3**
Fuels and energy	7.026	7.621	8.5	3.807	3.137	-17.6
Rest	33.361	38.462	15.3	18.042	21.409	18.7
Imports	**28.662**	**34.126**	**19.1**	**15.6**	**19.42**	**24.5**
Fuels and energy	1.542	1.729	12.1	0.805	0.954	18.5
Rest	27.12	32.397	19.5	14.795	18.466	24.8
Balance	**11.725**	**11.957**	**2**	**6.249**	**5.126**	**-18**
Fuels and energy	5.484	5.892	7.4	3.002	2.183	-27.3
Rest	6.241	6.065	-2.8	3.247	2.943	-9.4

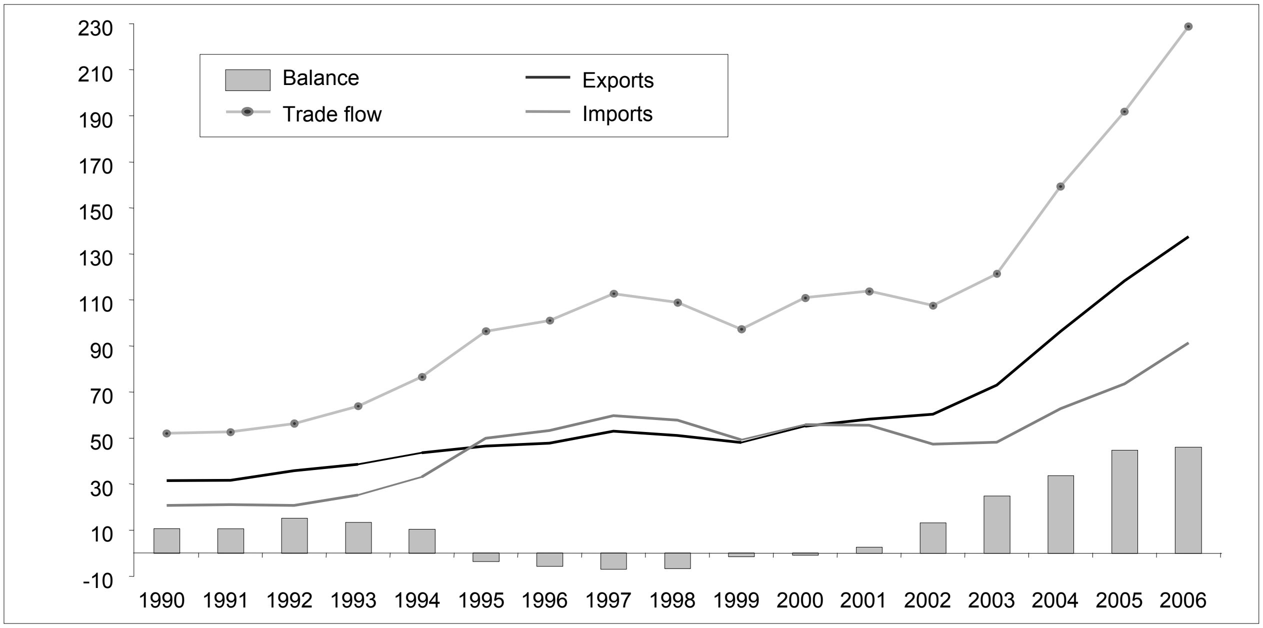
Note: [a/] 2007 is for the 1st ½ only.

Source: INDEC.

Brazil

Brazilian trade in goods again grew sustainedly during 2006 and the first half of 2007. Unlike previous years, imports rose faster than exports (Figure 12). In spite of this, the trade surplus continued to grow for the seventh year running, reaching record levels (US$47.1b in the twelve months to June 2007). Brazil recorded positive results with all its main trading partners except the Asian countries.

FIGURE 12
BRAZIL: TRADE FLOWS OF GOODS
1990-2006 - US$ Billions



Source: SECEX.

External sales were up 16.2% YOY in 2006 and 19.9% in the first half of 2007, totaling US$149.7b in the twelve months to June 2007. Over the last year and half, exports were fuelled mainly by rising prices, unlike previous years when growth in quantities had a predominant effect. Shipments of all categories increased, particularly the performance of semi-manufactured goods in 2006 and exports of raw materials in 2007.

Imports totaled US$102.5b (12 months rolling to June 2007), after increasing 24.2% YOY in 2006 and 26.7% during the first half of 2007. Rises were seen in all headings, particularly consumer goods, both durable and non-durable, in both periods. As in Argentina, the growth in physical volume fuelled the expansion of imports. Thus, after showing rather erratic behavior in the years following the 1999 devaluation of the real, import-product elasticity recently rose sharply, exceeding the average for the past decade.

In the case of both exports and imports, Brazil's trade with MERCOSUR was more dynamic than with extrazone countries.[30]

Paraguay

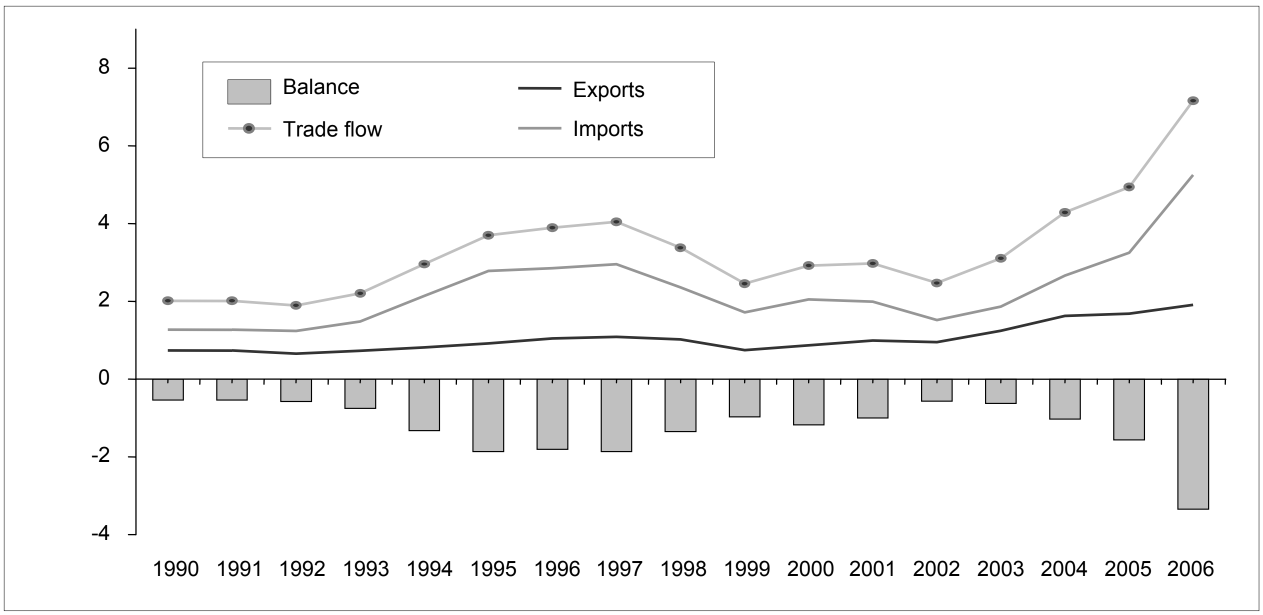
After several years of decline and stagnation, Paraguayan exports rose 12.9% during 2006 and 62.7% in the first half of 2007, enabling the country to increase its share in the bloc's total exports from 1% to 1.5%. This strong recovery over recent months was generalized in the main products for export, particularly the performance of agricultural goods and manufactured goods based on natural resources. Thus, Paraguay's external sales reached a record US$2.5b in the twelve months ending in June 2007 (Figure 13).

[30] See Table AII.2, Annex II.

Imports, on the other hand, were up 61.6% in 2006 and 27.4% during the first half of 2007, rising by US$5.9b in the same period. Although they recorded increases in all headings, the momentum of automobiles and capital goods was particularly noticeable. With these results, Paraguay's trade in goods deficit more than doubled during 2006 (US$3.35b) and continued to rise during 2007. The debit balance is generalized with all main trading partners other than the rest of the world.

Exports to destinations outside MERCOSUR rose sustainedly, while shipments to the bloc (almost half the total) showed no change in 2006, although they doubled during the first half of 2007. During 2006, extrazone purchases also rose faster than imports from MERCOSUR, while growing more evenly between January and June 2007. The greater dynamism was due to products originating in Asia in 2006 and the LAIA countries during the first half of 2007.[31]

FIGURE 13
PARAGUAY: TRADE FLOWS OF GOODS
1990-2006 - US$ Billions



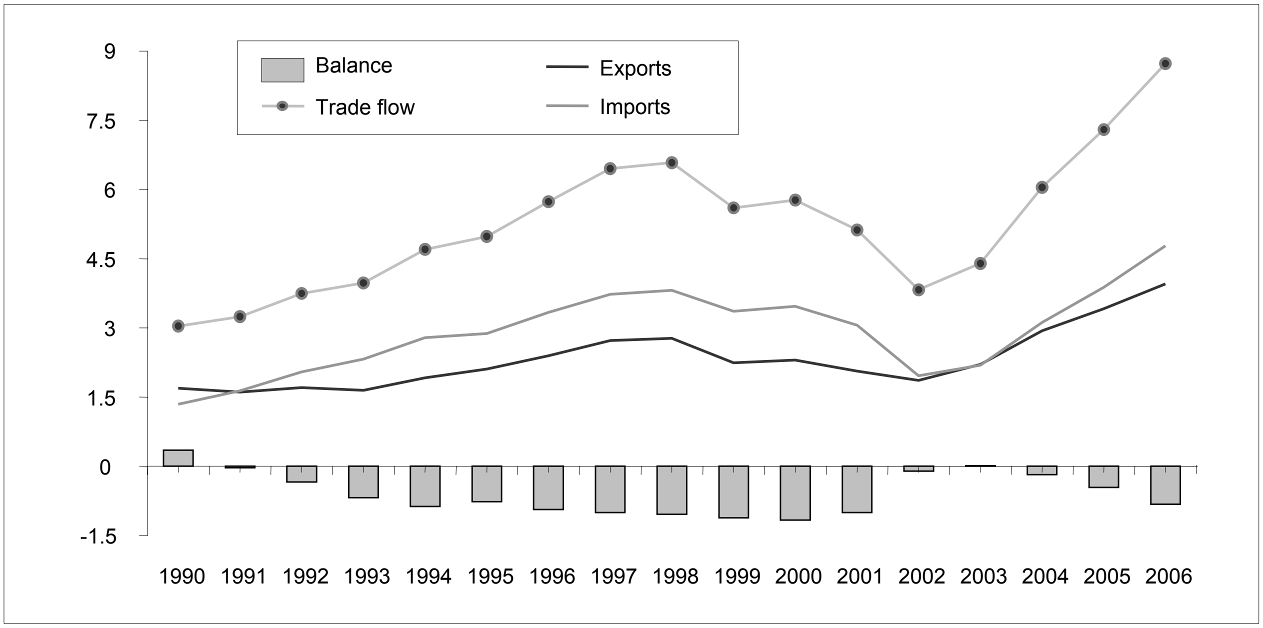
Source: Central Bank of Paraguay.

Uruguay

Over the last eighteen months, Uruguay continued to record a loss balance in its trade in goods, which in 2006 were over US$800m (Figure 14). In the twelve months to June 2007, external sales totaled US$4.1b, while purchases stood at US$4.9b.

[31] See Table AII.3, Annex II.

FIGURE 14
URUGUAY: TRADE FLOWS OF GOODS
1990-2006 - US$ Billions



Source: Central Bank of Uruguay.

Exports expanded 15.7% in 2006 and slowed during the first half of 2007, when they rose 8.1% YOY. This lower rate of growth reflects a drop in external sales of traditional products, which had been performing better in recent years.

Imports behaved in a similar fashion to exports, with the pace of expansion falling from 23.1% in 2006 to 6.2% over the first half of 2007. This slowdown reflects a drop in oil purchases and a lower increase in imports of remaining products.

In the case of both exports and imports, the evolution of the value is explained mainly by growth in quantities. On the other hand, both flows expanded faster in trade with MERCOSUR than with extrazone countries. Uruguay showed loss balances with the countries of the South American bloc as a whole and with LAIA and Asian countries, while recording a surplus in trade with NAFTA countries, the EU, and the rest of the world.[32]

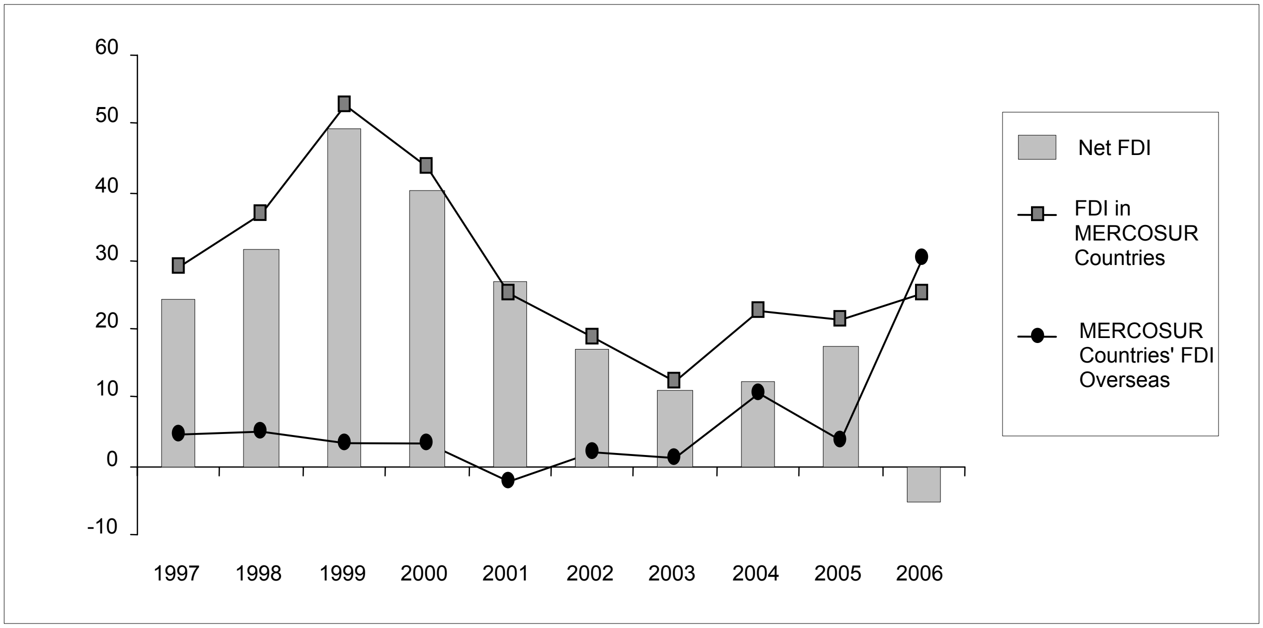
C. Foreign direct investment in MERCOSUR

In 2006, for the first time in MERCOSUR history, net FDI was negative (US$5.2b) as a consequence of the bloc's growing overseas investment (in particular Brazil's), as influxes of FDI to the subregion continued their upward trend. Preliminary figures for the first half of 2007, however, point to a net inflow of FDI.[33]

32 See Table AII.4, Annex II.

33 See Table AII.5, Annex II.

FIGURE 15
FOREIGN DIRECT INVESTMENT IN MERCOSUR[a/]
1997-2006 - US$ Billions



Note: [a/] Total FDI in the four countries, including intra-MERCOSUR investment accordingly.

Sources: ECLAC, BCB, DNCI, and BCU.

Non-residential direct investment in MERCOSUR

US$25.1b in FDI came into MERCOSUR countries during 2006, 18.1% up on the previous year. Although these flows continue to recover when compared to the minima of the crisis, they are still well below the maxima of the late 1990s and are less dynamic than investments in other destinations. Indeed, the bloc's share of world FDI is 1.9%, while it absorbs 6.6% of direct investments to developing countries, in both cases slightly down on the previous year's levels (UNCTAD [2007]).

FDI inflows rose in all countries except Argentina, where they fell 8.1% and the performance of the smaller economies was notable. In Uruguay, FDI grew 55.7%, a record for the second year running. This dynamic is mainly due to the construction of a cellulose factory, a major investment project for the Uruguayan economy. FDI in Paraguay represented 1.8% of GDP, doubling both level and share in GDP against the previous year, although it remains below the levels reached at the end of last decade.

Over the first half of 2007, non-residential direct investments continued to expand in Brazil, while, in Argentina and Uruguay, they were 50% down on the same period the previous year.[34]

MERCOSUR direct investment overseas and the transnationalization of Brazilian companies

Undoubtedly one of the most interesting phenomena in recent years is the growing internationalization of companies from developing countries. Prominent among the so-called "trans-Latins" (a term coined by ECLAC) are Brazilian firms, which explains the growing dynamism of MERCOSUR investment

[34] No information is available for Paraguay for 2007.

overseas, in particular through mergers and acquisitions of foreign companies. Among the main causes behind this process are the attempt to increase their share in world markets, the diversification of risks, the formation of economies of scale, the need to seek more dynamic markets than Brazil's or to negotiate tariff and non-tariff barriers in other destinations, and so on.

The transnationalization of Brazilian firms in recent years has been helped a great deal by high global liquidity, the securing of soft loans by the BNDES, and the appreciation of the real which considerably reduced the cost of external assets. However, some analysts point out that overseas investment stimulated by a drop in the exchange rate would also lead to job losses linked to the decline in competitiveness.[35]

During 2006, MERCOSUR FDI overseas totaled US$30.3b, 93% of which originated in Brazil. This sharp rise is explained largely by the purchase of 75.7% of the Canadian mining company, Inco, by the *Compañía Vale do Rio Doce* (CVRD), an operation that reached US$13.3b. Argentina, for its part, contributed with overseas investments of US$2.1b. During the first half of 2007 however, Brazilian investment overseas was negative by almost US$3.5b, while Argentina's investment in the rest of the world totaled US$580m, less than half that in the same period the previous year.

Although there is no up-to-date information, the data for 2001-2005 indicate that MERCOSUR countries are among the major destinations in Brazil's direct investment overseas, after the EU and the United States. Excluding investments in tax havens, Uruguay and Argentina absorbed a respective 15% and 9.5% of the total (Porta [2007]).

According to unofficial estimates, Brazilian investments in Uruguay went from US$12m in 2004 to US$320m in 2006. Among the most important were Petrobrás (currently the owner of 85 service stations and responsible for the distribution of gas in that country), some in cement production, and others in the financial sector, particularly after the Bank of Brazil reopened in Montevideo and the purchase of Bank Boston by the Itaú Bank.

On the other hand, a growing contingent of Brazilian companies is beginning to be seen in sectors with less tradition of internationalization. Thus, in addition to the settlements of the Gerdau Group in the late 1990s or Ambev in 2003, there are in recent years companies such as the meat processing plant, Marfrig e Bertin, which already controls a third of Uruguayan beef production. Likewise, in 2007, the Brazilian rice producer, Camil, bought Saman, the largest rice processing industry in the country, responsible for 45% of rice production and export.

In Argentina, from exiting the "convertibility" model to mid-2006, Brazilian economic groups invested over US$7b in acquisitions of manufacturing companies, almost four times the value of direct investments originating in Brazil over the whole of the 1990s.[36]

[35] In certain traditionally competitive sectors of Brazilian industry (footwear and footwear parts, or white goods), a process of delocalization of investment in favor of markets such as Argentina has started to be seen, and in the case of certain Brazilian exporters already operating on a global scale, China or India. Furthermore, several automotive terminals with operations in both Southern Cone countries have recently announced that they will not only use their installed production capacity in Argentina before making any further investments in Brazil, but will in some cases make medium-sized investments (linked to the launch of new models) in Argentina instead of Brazil.

[36] During the 1990s, Brazilian investments in Argentina mainly involved companies taking their first steps at international level, their main strategy being to sell in regional markets. While some of these investments were medium-sized (such as those by the auto parts manufacturers, Copaf and Sogefi, the Dixie Toga packaging company in American Plast, and the prepaid medical care company, Amil), there were also larger-scale operations, such as the purchase of the Buen Ayre Bank by the Itaú Bank, the construction of the Brahma brewery plant at Luján, the acquisition of Grafa by Textil Santista, and the participation of the Gerdau steel plant in Sipar.

TABLE 12
BRAZILIAN INVESTMENTS IN ARGENTINA
Main projects announced in 2005-2007 - US$ Billions

Company	Amount	Company	Amount
Ambev	1.31	Coteminas	0.052
Petrobras	1.279	Sipar Gerdau	0.041
Camargo Correa	1.160	Santista Têxtil	0.032
Friboi	0.306	Borrachas Vipal	0.016
Quilmes	0.158	Vale do Rio Doce	0.014
Acindar	0.140	Marfrig	0.010
Lupatech	0.056	Paquetá	0.009
		Total	*4.583*

Source: Author's own compilation based on press information.

Brazilian FDI in Argentina was linked mainly to purchases of existing production companies (55%). To a lesser extent, were expansions (25%) and, lastly, greenfield investment (20%) (Porta [2007]). As part of this process, traditional companies or brands long-established in the Argentine market (the brewers Quilmes, the cement manufacturers Black Hill, the greenfield investment steel company Acindar, the oil company Pérez Companc, or the textile manufacturers Grafa, etc.) changed hands over the last five years from families or local economic groups to large Brazilian-based (or Brazilian-owned) corporations like the Camargo Correa Group, AmBev, Coteminas, Arcelor, Friboi, Belgo Mineira, and the state-owned Petrobrás.[37]

Transport has been another of the most dynamic sectors for Brazilian investment in Argentina. *América Latina Logística* controls the freight branchlines of the San Martin and General Urquiza Railroad (*Mesopotamia*). The arrival of *Vale Do Rio Doce*, with its local subsidiary DoceNave, monopolizes 22% of sea trade between the two countries. The Odebrecht group, specializing in construction and engineering, holds the tender for tolls in the freeway company, Autopistas del Oeste, and has plans to increase its presence in Argentina.

Brazilian direct investment in Paraguay is limited compared to flows to the other MERCOSUR countries. However, in May 2007, President Lula da Silva announced a set of measures designed to increase investment flows to Paraguay. These include the opening of BNDES credit lines so that Brazilian businessmen can finance projects in Paraguay and Paraguayan companies can acquire Brazilian machinery and equipment under advantageous conditions.

This phenomenon of the expansion of Brazilian firms in MERCOSUR countries has, logically enough, had no counterpart in Argentine, Uruguayan or Paraguayan capital flows to the largest MERCOSUR partner. Although several Argentine companies did make some investments in the regional environment in the 1990s (e.g. Techint, Arcor, Pérez Companc, etc.), this process began to peter out after the financial crisis at the turn of the century. While some of these groups were sold to foreign companies, others cut their levels of overseas investment.

[37] Although this company initially geared its activities in Argentina to oil activity, it also currently owns most of the shares in the electrical energy transport companies, Transener, Transba, Distrilec, Citelec, and Enecor, and the distributor, Edesur. Near the completion of this report, this Brazilian government enterprise announced its new international investment plan for 2008-2012, in which Argentina will be second to the United States on the firm's foreign investment agenda, with a sum of around US$2.8b.

D. Conclusions

In a favorable international climate, MERCOSUR trade continues to expand sustainably, both at the intrazone level and with the rest of the world. At the prospect of the probable deterioration of the external climate, the bloc's trade performance could end up being hit.

Prominent in intra-MERCOSUR trade is the extremely dynamic momentum of Brazilian imports from the other countries in the bloc. However, the persistence of bilateral trade deficit results with the largest economy -deepening in the cases of Paraguay and Uruguay- continues to be a source of debate between members over asymmetries.

On the other hand, although Venezuela's full incorporation in the bloc is not yet complete, trade with the Caribbean country is growing sustainedly and Venezuela is gaining in importance as a destination for exports and as a strategic energy supplier.

In 2006, after several years of surplus with all its main trading partners, MERCOSUR began to record a loss balance with Asia, linked to trade with China. Although this country continues to be an important destination for MERCOSUR's exports of raw materials, the steep rise in imports of labor-intensive Chinese manufactured goods has begun to create calls for trade administration, which could become more marked in the future.

In FDI, the growing dynamism of Brazilian investments overseas is conspicuous, with Argentina and Uruguay among the most important recipients of these flows. This led the four MERCOSUR countries' aggregate net FDI into negative territory for the first time in its history. Although, FDI inflows continue to increase, the bloc has not been able to consolidate its relative position as an attractive destination. Indeed, this income is well below 1990s levels (when the process of privatizations generated record FDI inflows), and MERCOSUR is losing share in both world FDI and in flows to developing countries.

Contents

ANNEX II

TABLE AII.1
ARGENTINA: TRADE FLOWS OF GOODS BY COUNTRY AND SELECTED ECONOMIC BLOC
US$ Billions and %

	2005	2006	% Variation	% Share 2006	1st ½ 2006	1st ½ 2007	% Variation
Exports	**40.387**	**46.083**	**14.1**	**100**	**21.849**	**24.546**	**12.3**
MERCOSUR	*7.709*	*9.949*	*29.1*	*21.6*	*4.433*	*5.49*	*23.8*
Brazil	6.335	8.132	28.4	17.6	3.567	4.598	28.9
Paraguay	0.509	0.621	22	1.3	0.337	0.321	-4.7
Uruguay	0.864	1.196	38.4	2.6	0.475	0.554	16.6
Extrabloc	*32.678*	*36.133*	*10.6*	*78.4*	*17.416*	*19.056*	*9.4*
NAFTA	6.034	6.071	0.6	13.2	3.019	2.628	-13
EU	6.846	8.002	16.9	17.4	3.904	4.252	8.9
LAIA[a/]	6.716	7.267	8.2	15.8	3.478	3.633	4.5
Asia	6.715	7.345	9.4	15.9	3.495	4.268	22.1
Rest of the World	6.367	7.448	17	16.2	3.52	4.275	21.4
Imports	**28.662**	**34.126**	**19.1**	**100**	**15.600**	**19.420**	**24.5**
MERCOSUR	*11.020*	*12.686*	*15.1*	*37.2*	*5.887*	*7.213*	*22.5*
Brazil	10.293	11.871	15.3	34.8	5.431	6.458	18.9
Paraguay	0.453	0.505	11.5	1.5	0.241	0.522	116.6
Uruguay	0.274	0.309	13.1	0.9	0.147	0.185	26
Extrabloc	*17.642*	*21.439*	*21.5*	*62.8*	*9.713*	*12.207*	*25.7*
NAFTA	5	5.590	11.8	16.4	2.533	3.108	22.7
EU	4.832	5.813	20.3	17	2.637	3.319	25.9
LAIA[a/]	1.011	1.129	11.7	3.3	0.567	0.574	1.2
Asia	3.866	5.138	32.9	15.1	2.102	3.054	45.3
Rest of the world	2.933	3.770	28.5	11	1.874	2.152	14.8
Balance	**11.725**	**11.957**	**2**	**100**	**6.249**	**5.126**	**-18**
MERCOSUR	*-3.311*	*-2.737*	*-17.3*	*-22.9*	*-1.454*	*-1.723*	*18.5*
Brazil	-3.958	-3.74	-5.5	-31.3	-1.864	-1.86	-0.2
Paraguay	0.056	0.116	106.8	1	0.096	-0.201	-309.3
Uruguay	0.591	0.887	50.1	7.4	0.328	0.369	12.4
Extrabloc	*15.036*	*14.694*	*-2.3*	*122.9*	*7.703*	*6.849*	*-11.1*
NAFTA	1.034	0.481	-53.5	4	0.486	-0.48	-198.8
EU	2.014	2.189	8.7	18.3	1.267	0.933	-26.4
LAIA[a/]	5.705	6.139	7.6	51.3	2.911	3.059	5.1
Asia	2.849	2.208	-22.5	18.5	1.393	1.214	-12.8
Rest of the World	3.434	3.678	7.1	30.8	1.646	2.123	29

Note: [a/] Except MERCOSUR and Mexico.

Source: INDEC.

TABLE AII.2
BRAZIL: TRADE FLOWS OF GOODS BY COUNTRY AND SELECTED ECONOMIC BLOC
US$ Billions and %

	2005	2006	% Variation	% Share 2006	1st ½ 2006	1st ½ 2007	% Variation
Exports	**118.308**	**137.47**	**16.2**	**100**	**61.057**	**73.214**	**19.9**
MERCOSUR	*11.746*	*13.986*	*19.1*	*10.2*	*6.267*	*7.596*	*21.2*
Argentina	9.93	11.74	18.2	8.5	5.319	6.311	18.6
Paraguay	0.963	1.234	28.1	0.9	0.51	0.699	37.2
Uruguay	0.853	1.013	18.7	0.7	0.438	0.587	33.9
Extrabloc	*106.563*	*123.484*	*15.9*	*89.8*	*54.790*	*65.617*	*19.8*
NAFTA	28.831	31.512	9.3	22.9	14.515	15.074	3.8
EU	27.04	31.045	14.8	22.6	13.754	18.178	32.2
LAIA[a/]	9.678	13.051	34.9	9.5	5.631	6.734	19.6
Asia[b/]	18.566	20.816	12.1	15.1	9.254	11.46	23.8
Rest of the world	22.449	27.059	20.5	19.7	11.635	14.172	21.8
Imports	**73.606**	**91.396**	**24.2**	**100**	**41.524**	**52.620**	**26.7**
MERCOSUR	*7.054*	*8.967*	*27.1*	*9.8*	*3.867*	*4.904*	*26.8*
Argentina	6.241	8.053	29	8.8	3.489	4.394	25.9
Paraguay	0.319	0.296	-7.2	0.3	0.119	0.162	36.2
Uruguay	0.494	0.618	25.2	0.7	0.258	0.348	34.5
Extrabloc	*66.552*	*82.428*	*23.9*	*90.2*	*37.657*	*47.716*	*26.7*
NAFTA	14.716	17.321	17.7	19	7.847	10.25	30.6
EU	18.236	20.203	10.8	22.1	9.452	11.884	25.7
LAIA[a/]	3.719	6.004	61.5	6.6	2.61	3.175	21.7
Asia[b/]	16.87	22.888	35.7	25	10.573	13.04	23.3
Rest of the world	13.012	16.013	23.1	17.5	7.176	9.366	30.5
Balance	**44.703**	**46.074**	**3.1**	**100**	**19.533**	**20.594**	**5.4**
MERCOSUR	*4.692*	*5.019*	*7*	*10.9*	*2.4*	*2.693*	*12.2*
Argentina	3.689	3.686	-0.1	8	1.83	1.917	4.7
Paraguay	0.644	0.938	45.7	2	0.39	0.537	37.5
Uruguay	0.359	0.394	9.7	0.9	0.18	0.239	33.1
Extrabloc	*40.011*	*41.056*	*2.6*	*89.1*	*17.133*	*17.901*	*4.5*
NAFTA	14.115	14.191	0.5	30.8	6.669	4.824	-27.7
EU	8.804	10.843	23.2	23.5	4.302	6.294	46.3
LAIA[a/]	5.959	7.047	18.3	15.3	3.021	3.559	17.8
Asia[b/]	1.696	-2.072	-222.2	-4.5	-1.319	-1.581	19.9
Rest of the world	9.437	11.047	17.1	24	4.459	4.805	7.8

Notes: [a/] Except MERCOSUR and Mexico.
[b/] Excluding Middle East.

Source: SECEX.

TABLE AII.3
PARAGUAY: TRADE FLOWS OF GOODS BY COUNTRY AND SELECTED ECONOMIC BLOC
US$ Billions and %

	2005	2006	% Variation	% Share 2006	1st ½ 2006	1st ½ 2007	% Variation
Exports	**1.688**	**1.906**	**12.9**	**100**	**0.927**	**1.508**	**62.7**
MERCOSUR	*0.912*	*0.917*	*0.5*	*48.1*	*0.424*	*0.889*	*109.8*
Argentina	0.326	0.328	0.8	17.2	0.119	0.188	57.4
Brazil	0.107	0.168	57	8.8	0.064	0.606	854.3
Uruguay	0.479	0.42	-12.3	22	0.241	0.095	-60.4
Extrabloc	*0.776*	*0.99*	*27.6*	*51.9*	*0.503*	*0.619*	*23*
NAFTA	0.06	0.074	23.8	3.9	0.029	0.035	21.3
EU	0.181	0.114	-37.2	6	0.067	0.132	96.3
LAIA[a/]	0.128	0.153	19.5	8	0.073	0.167	128.5
Asia	0.124	0.078	-37.3	4.1	0.04	0.042	3.1
Rest of the world	0.282	0.571	102.4	29.9	0.293	0.243	-17.1
Imports	**3.251**	**5.254**	**61.6**	**100**	**2.37**	**3.02**	**27.4**
MERCOSUR	*1.576*	*1.827*	*15.9*	*34.8*	*0.829*	*1.072*	*29.3*
Argentina	0.884	1.053	19.1	20	0.442	0.686	55.2
Brazil	0.639	0.716	12	13.6	0.359	0.357	-0.6
Uruguay	0.053	0.059	11.5	1.1	0.028	0.029	3.5
Extrabloc	*1.675*	*3.427*	*104.5*	*65.2*	*1.541*	*1.948*	*26.4*
NAFTA	0.202	0.375	85.5	7.1	0.204	0.175	-14.5
EU	0.205	0.303	47.8	5.8	0.114	0.145	26.9
LAIA[a/]	0.06	0.243	306.2	4.6	0.054	0.172	218.4
Asia	0.957	2.196	129.4	41.8	0.969	1.398	44.2
Rest of the world	0.251	0.309	23.2	5.9	0.199	0.059	-70.5
Balance	**-1.564**	**-3.348**	**114.1**	**100**	**-1.443**	**-1.512**	**4.8**
MERCOSUR	*-0.664*	*-0.911*	*37.2*	*-17.3*	*-0.405*	*-0.183*	*-54.9*
Argentina	-0.558	-0.725	29.8	-13.8	-0.323	-0.498	54.4
Brazil	-0.532	-0.547	2.9	-10.4	-0.296	0.249	-184.2
Uruguay	0.426	0.361	-15.3	6.9	0.213	0.066	-68.8
Extrabloc	*-0.9*	*-2.437*	*170.9*	*-46.4*	*-1.038*	*-1.329*	*28.1*
NAFTA	-0.142	-0.301	111.5	-5.7	-0.176	-0.14	-20.3
EU	-0.024	-0.189	696.3	-3.6	-0.047	-0.012	-73.2
LAIA[a/]	0.068	-0.091	-234.2	-1.7	0.019	-0.006	-130.1
Asia	-0.833	-2.118	154.3	-40.3	-0.929	-1.356	46
Rest of the world	0.031	0.262	732.2	5	0.094	0.185	95.6

Note: [a/] Except MERCOSUR and Mexico.

Source: Central Bank of Paraguay.

TABLE AII.4
URUGUAY: TRADE FLOWS OF GOODS BY COUNTRY AND SELECTED ECONOMIC BLOC
US$ Billions and %

	2005	2006	% Variation	% Share 2006	1st ½ 2006	1st ½ 2007	% Variation
Exports	**3.417**	**3.952**	**15.7**	**100**	**1.884**	**2.036**	**8.1**
MERCOSUR	*0.783*	*0.942*	*20.3*	*23.8*	*0.435*	*0.514*	*18.2*
Brazil	0.46	0.583	26.5	14.7	0.257	0.304	18.3
Argentina	0.267	0.302	13	7.6	0.149	0.177	18.7
Paraguay	0.056	0.058	3.8	1.5	0.029	0.033	14.3
Extrabloc	*2.634*	*3.01*	*14.3*	*76.2*	*1.449*	*1.522*	*5.1*
NAFTA	0.989	0.699	-29.3	17.7	0.362	0.379	4.7
EU	0.59	0.659	11.7	16.7	0.297	0.393	32.3
LAIA[a/]	0.183	0.293	60.4	7.4	0.222	0.173	-21.8
Asia	0.278	0.352	26.9	8.9	0.157	0.192	22.7
Rest of the world	0.594	1.007	69.6	25.5	0.411	0.385	-6.5
Imports	**3.879**	**4.775**	**23.1**	**100**	**2.267**	**2.408**	**6.2**
MERCOSUR	*1.631*	*2.182*	*33.8*	*45.7*	*1.028*	*1.167*	*13.5*
Brazil	0.825	1.078	30.7	22.6	0.524	0.598	14.2
Argentina	0.786	1.079	37.3	22.6	0.493	0.555	12.6
Paraguay	0.02	0.026	28.9	0.5	0.012	0.015	28.2
Extrabloc	*2.248*	*2.593*	*15.3*	*54.3*	*1.239*	*1.241*	*0.2*
NAFTA	0.332	0.405	22.1	8.5	0.21	0.189	-10
EU	0.407	0.469	15.2	9.8	0.212	0.219	3.2
LAIA[a/]	0.326	0.686	110.5	14.4	0.412	0.378	-8.2
Asia	0.471	0.603	28	12.6	0.257	0.326	47.2
Rest of the world	0.713	0.43	-39.7	9	0.148	0.129	-12.9
Balance	**-0.462**	**-0.823**	**78.1**	**100**	**-0.383**	**-0.372**	**-2.9**
MERCOSUR	*-0.847*	*-1.240*	*46.4*	*150.8*	*-0.593*	*-0.653*	*10.1*
Brazil	-0.364	-0.495	35.9	60.2	-0.266	-0.294	10.2
Argentina	-0.519	-0.777	49.8	94.5	-0.344	-0.378	9.9
Paraguay	0.036	0.032	-10.3	-3.9	0.017	0.018	4.7
Extrabloc	*0.385*	*0.418*	*8.4*	*-50.8*	*0.21*	*0.281*	*34.2*
NAFTA	0.658	0.294	-55.3	-35.7	0.152	0.19	25.2
EU	0.183	0.19	3.9	-23.1	0.085	0.175	104.8
LAIA[a/]	-0.143	-0.393	174.5	47.7	-0.19	-0.205	7.7
Asia	-0.193	-0.251	29.7	30.5	-0.065	-0.134	106.6
Rest of the world	-0.119	0.577	-584.3	-70.1	0.263	0.255	-2.8

Note: [a/] Except MERCOSUR and Mexico.

Source: Central Bank of Uruguay.

TABLE AII.5
FOREIGN DIRECT INVESTMENT IN MERCOSUR[a/]
US$ Billions and % variation

Heading/Country	2005	2006	% Variation	1st ½ 2006	1st ½ 2007	% Variation
FDI Inflows						
Argentina	5.265	4.84	-8.1	2.944	1.453	-50.6
Brazil	15.066	18.782	24.7	7.385	20.864	182.5
Paraguay	0.074	0.165	123.2	n.a.	n.a.	n.a.
Uruguay	0.847	1.319	55.7	0.616	0.293	-52.3
MERCOSUR[a/]	21.253	25.107	18.1	n.a.	n.a.	n.a.
FDI Outflows						
Argentina	1.311	2.119	61.6	1.308	0.584	-55.4
Brazil	2.517	28.202	1,020.6	4.502	-3.462	-176.9
Paraguay	0.006	0.004	-37.5	n.a.	n.a.	n.a.
Uruguay	0.036	-0.002	-106.7	-3	0.001	-140.5
MERCOSUR[a/]	3.870	30.323	683.4	n.a.	n.a.	n.a.
Net FDI						
Argentina	3.954	2.721	-31.2	1.636	0.869	-46.9
Brazil	12.55	-9.42	-175.1	2.883	24.326	743.8
Paraguay	0.068	0.161	138.4	n.a.	n.a.	n.a.
Uruguay	0.811	1.322	62.9	619	0.292	-52.8
MERCOSUR[a/]	17.383	-5.216	-130	n.a.	n.a.	n.a.

Note: [a/] Total FDI in the four countries, including intra-MERCOSUR investment accordingly.

Sources: ECLAC, BCB, DNCI, and BCU.

CHAPTER III. DEVELOPMENTS IN THE INTERNAL AGENDA[38]

This chapter looks at the main issues on the MERCOSUR internal agenda between July 2006 and June 2007. This period was particularly prolific in terms of the number of meetings held by the supreme organ of MERCOSUR. There were four CMC meetings namely: the 31st Ordinary Meeting in Brasilia on December 15, 2006, the 32nd Ordinary Meeting in Rio de Janeiro on January 18, 2007, the 5th Extraordinary Meeting in Asunción on May 22, 2007, and the 33rd Ordinary Meeting in Asunción on June 27 and 28, 2007).

The common denominator of all these meetings was the question of asymmetries and its impact on the evolution of the integration process. Other important issues included the implementation of the FOCEM, the elimination of double CET levying, the possible creation of a development bank for the region (*"Banco del Sur"*), institutional matters, and the establishment of a mechanism to carry out trade transactions in local currency. Also important were the establishment of the MERCOSUR Parliament and the proceedings of the Permanent Review Tribunal created by the Protocol of Olivos for Dispute Settlement between Member Countries.

A. The treatment of asymmetries

As has been pointed out in previous reports,[39] the treatment of asymmetries in the area of MERCOSUR reached a turning point in 2003 after a series of proposals submitted by Paraguay. On that occasion, they resulted in the approval of various rules establishing special treatment for the bloc's smaller economies, including: (i) the granting of differentiated treatment for Paraguay in negotiations with third countries (CMC Decision 28/03), (ii) the establishment of differentiated regional content in the MERCOSUR Origin Regime in favor of Paraguay (CMC Decision 29/03), (iii) the authorization of Paraguay and Uruguay to submit additional CET exceptions lists, as well as lower aliquots on capital goods imports from the rest of the world, information processing and telecommunications, and certain raw materials and agricultural inputs (CMC Decision 31/03 and 32/03), and (iv) the commencement of studies for the formation of structural funds in MERCOSUR.

Since then, the subsequent creation of the FOCEM has been one of the most tangible achievements, but not the only one worthy of recognition in this field.

Indeed, the question of asymmetries has obliquely permeated all issues on the bloc's agenda to become one of the central aspects of the period, as described in this report, especially in the first half of 2007, when Paraguay held the *Pro Tempore* Presidency of MERCOSUR.

In the wide-ranging debates set in motion by Paraguay and Uruguay, difficulties were encountered in the common identification of the source of these asymmetries and the submittal of concrete proposals to make MERCOSUR an instrument to help overcome them or, at least, not to make them any worse.

At the Córdoba Summit in July 2006, the Member Countries adopted the commitment stating that "*the countries with relatively smaller economies shall submit (…) their needs and proposals to overcome asymmetries and facilitate market access*".[40]

---

38 The location and definition of the various different entities forming the institutional framework of MERCOSUR (mentioned constantly throughout this chapter) are presented in the glossary.

39 For a detailed analysis of the background to this subject, see MERCOSUR Reports 10 and 11.

40 Minutes of the 30th Ordinary Meeting of the CMC.

Under this framework, Paraguay submitted a preliminary document in September 2006 entitled "Document on the asymmetries in MERCOSUR from the Paraguayan perspective".[41] It opened with an acknowledgment of the country's endogenous problems as a "Mediterranean" and less economically developed country and outlined a series of "*aggressive, sustained community policies*" for MERCOSUR to help overcome these asymmetries.

It proposed four main courses of action: (1) community policies to promote development; (2) competitiveness support programs; (3) access to regional markets and markets in the rest of the world, and (4) institutional design.

In the main, these proposals were of a general nature, without any specifications to speak of that would make them operative.

Uruguay gave its first written reaction to the question of asymmetries in the bloc in parallel to the formal MERCOSUR channels via an open letter to MERCOSUR Heads of State dated September 8, 2006, from Tabaré Vázquez to Lula da Silva in his capacity as the bloc's *Pro Tempore* President.

After reaffirming that MERCOSUR was a strategic priority for Uruguay, the letter examined in detail the list of issues pending in the integration process, including the costs borne by Uruguay and the scant benefits it had received. The letter ended with a series of proposals to unblock the points standing in the way of progress and, specifically, demanding the option for Uruguay and Paraguay to go ahead with bilateral trade negotiations with third countries "(...) *provided the courses and achievements of proposals obtained do not strike at the heart of MERCOSUR or conspire to undermine our regional integration process and upon this point we are all agreed*".[42]

Vázquez's letter submitted its proposals as "*alternatives and flexibilities necessary to offset the asymmetries damaging Uruguay and Paraguay in turn*" and outlined specific measures that would lead to other general benefits linked to the expansion of MERCOSUR and the formation of the South American Community of Nations (SACN).

Among these measures, the Uruguayan government referred to the need to:

a) "Move forward in the objective of the free circulation of goods and the establishment of the customs union, endeavoring to conclude the negotiations of the items in Decision 54/04".
b) "Focus the objectives of the Customs Union (CU) not on CET compliance but on these breakthroughs on the road to free circulation and on the removal of technical and bureaucratic obstacles to trade, and boosting efforts toward greater macroeconomic coordination".
c) "Recognize that the CET levels are not appropriate and should be revised (...)".
d) "Breathe new life into the external negotiation, making it more flexible by introducing bilateralities, either in the framework of joint negotiations or by permitting individual negotiations. To provide flexibilities, within this framework, so that Uruguay and Paraguay can explore and move forward with third countries, taking care to preserve the interests of the other MERCOSUR partners and its spirit".

In any event, the bilateral negotiation with the United States toward signing a Trade and Investment Framework Agreement finally got back on the rails and does not in principle affect Uruguayan commitments in terms of tariffs in the framework of MERCOSUR.

41 Minutes of the 65th Ordinary Meeting of the GMC, Annex V.

42 See http://www.presidencia.gub.uy/_web/noticias/2006/09/2006091103.htm.

Reasoning along the same lines, a month and a half later, Uruguay submitted the document "Uruguay and MERCOSUR" to the National Coordinators of the GMC.[43] In it, the country expressed a "highly critical approach focusing on certain key components of the outstanding integration process agenda", and incidentally admitted to having a single source of asymmetries: the limited size of its domestic market. The proposals basically referred to the need to move forward effectively in the outstanding agenda in setting up a truly expanded market and opening up other markets through "*simultaneous progress*" in several areas. It also reiterated Uruguay's call to reformulate the bloc's external negotiations, granting the Member Countries flexibility in their negotiations with third parties (in domestic and MERCOSUR processes), as a safety valve enabling the smaller partners to cut the costs of stagnation and thus reverse non-compliance on other commitments.

The partners continued negotiations taking the two documents submitted by Paraguay and Uruguay to the CMC Coordinators into account, but it proved impossible to reach a common, clear diagnosis of the issue.

This was the backdrop to the 31st Ordinary Meeting of the Common Market Council in December 2006, at which Brazil tabled two proposals which, in its opinion, would help to overcome asymmetries: one granting Paraguay and Uruguay more flexible treatment in terms of origin and another anticipating the elimination of double CET levying for the two partners.[44] Although these issues had been informally discussed with Argentina on various occasions, the submittal to the Ministers and the Brazilian statement of its intention to apply them unilaterally was not welcomed by the partner.

On the other hand, the partners with smaller economies reacted positively to the Brazilian initiatives, notwithstanding certain reservations over their viability.

Thus, the CMC was only able to adopt programmatic decisions (very much in line with the Paraguayan document) and instructed directives to be drafted for a plan to overcome asymmetries in MERCOSUR (CMC Decision 34/06). These were to contain:

a) Short-, medium-, and long-term objectives.
b) Community policy instruments for achieving these objectives.
c) A schedule for implementation of the instruments.
d) Criteria to evaluate results.

The CMC also stipulated that identification of objectives be based on the following principles:

a) Action for the development and integration of landlocked economies.
b) Action to support competitiveness in of the smaller economies.
c) Action to facilitate effective market access, including third countries.
d) An institutional framework.

The rule restated the need for the bloc's smaller economies to play a positive role. Subsequently, at its 32nd Ordinary Meeting of January 2007, the CMC passed CMC Decision 6/07, "Overcoming asymmetries in MERCOSUR", entrusting the implementation of this process to an *Ad Hoc* Working Group (WG) at vice-ministerial level, which was also to consider a revised version of the two Brazilian proposals.[45]

43 Minutes of the 65th Ordinary Meeting of the GMC, Annex IV.

44 Minutes of the 31st Ordinary Meeting of the CMC, Annex V.

45 Both proposals were annexed to CMC Decision 6/07, as were the documents previously presented by Paraguay and Uruguay.

In proposing relaxation in matters of origin, Brazil hoped to reduce the requirement for regional value content from current levels of 60%[46] to 25% for Paraguay and 30% for Uruguay. The partners were to draw up national lists of quotas of goods to benefit from this proposal.

The proposal to eliminate double levying consisted of authorizing Member Countries capable of doing so to bring forward the benefits of eliminating double CET levying provided in CMC Decision 54/04 on Paraguayan and Uruguayan products whose imported inputs have complied with the Common Tariff Policy.[47] Thus, it was intended to remove the requirements contained again in CMC Decision 54/04 for these products in terms of the previous effectiveness of the MERCOSUR Customs Code, online interconnection of the customs administration computer systems, and the implementation of a mechanism defining modalities and procedures for the distribution of customs revenue.[48]

The different stances over the treatment of asymmetries were again discussed by Ministers at the 5th Extraordinary Meeting of the CMC in May 2007, at which Paraguay and Uruguay submitted new documents under CMC Decision 34/06.

The Paraguayan document[49] continued along the lines of analysis of its 2006 submittal, stating that, for the country to reach average MERCOSUR *per capita* income levels, additional investments of over US$22b in ten years were required. To this effect, it spelled out a set of measures to be implemented in this period, maintaining that in the short-term, the expansion and capitalization of the FOCEM was the most practical tool for implementing such actions until regional financing institutions were designed.

The Uruguayan document[50] identified more clearly the small size of its domestic market as the main source of structural asymmetry preventing it from embarking upon a process of sustained growth, an objective it felt it could achieve through better access to the regional and extraregional markets.

Uruguay proposed three concrete measures to overcome asymmetries: disciplining incentives, harmonizing indirect taxes, and removing non-tariff restrictions. It also reiterated its request for 'flexibilities' that curbed the negative impact of imperfect CU and distortive public policies on the smaller economies. Unlike Paraguay, Uruguay claimed no Special Differentiated Treatment for itself, but improved intrazone and extrazone markets access.

It was only toward end of the first half of 2007 that Argentina, which had not to date had a particularly active role to play in the submittal of concrete proposals on this issue, related the overcoming of asymmetries to production integration in its document "Production integration as a necessary tool in overcome asymmetries in MERCOSUR".[51]

The document pointed out that "*the evolution of economic integration across the Member Countries centered mainly on tariff levels*" and went on to add that "*in the coordination of regional policy, a central axiom in the foundation of MERCOSUR, progress was minor*". This was a major limitation for the

46 It should be pointed out that there exist at present certain differential treatments via CMC Decisions 29/03 and 41/03.

47 Ditto previous note.

48 For further details on the subject, see MERCOSUR Reports 10 and 11.

49 "Document of Asunción -Guidelines for overcoming asymmetries in MERCOSUR- CMC Decision 34/06", Annex III, Minutes of the 5th Extraordinary Meeting of the CMC.

50 "Measures to overcome asymmetries in MERCOSUR", Annex IV, Minutes of the 5th Extraordinary Meeting of the CMC.

51 Minutes of the 68th Ordinary Meeting of the GMC, Annex XXI.

development of regional production chains, and "*This circumstance prevented imbalances existing at the time MERCOSUR was formed from being overcome"*.

It also added that "*all the flexibilities thus far introduced in favor of the smaller economies and all measures to be decided in the future should be geared to increasing MERCOSUR's global production, gearing new investments to the smaller partners, and incorporating greater added value"*. And, alluding indirectly to the Brazil's proposal to relax the origin regime, it suggested that "*the proposals to create trade in volume, thus inducing higher levels of extrazone import, do not meet the stated objective. Higher levels of trade should be a consequence of higher levels of imports by the larger partners from the smaller partners enabling the substitution of extrazone imports, or else a consequence of higher levels of economic activity, sectoral integration, and intraindustrial specialization"*. For Argentina then, "*complementarity should be encouraged between the various different links of the regional value chains, securing the effective incorporation of the smaller economies' production in the production processes of all the partners"*.

In terms of its working proposals to boost production integration, the Argentine government proposed moving forward with certain concrete measures such as:

- Expanding the scope of the FOCEM for the financing of production projects.
- Organizing joint trade missions, anticipating subsidies for the expenditure of partners with smaller economies.
- Designing technical training programs regarding improvements in production processes, foreign trade, logistics, and so on.
- Cooperating over the development and incorporation of new technologies.
- Development programs for regional suppliers (liaison of big companies and SMEs).
- Cooperating to improve national quality and certification systems of the smaller economies. Training in international quality standards.

Against this background, the CMC meeting that closed Paraguay's *Pro Tempore* Presidency agreed the adoption of three new rules with effective, programmatic commitments, on the issue of asymmetries.

In this sense, CMC Decision 16/07 (MERCOSUR Origin Regime) which, on the basis of the Brazilian proposal, adopted a *de minimis* criterion of 10% in the bloc's origin regime,[52] a criterion that will not be applied to tariff items subject to specific origin requirements. It was also ruled that, when a Member Country detects the negative effect of certain goods on its national production due to the influx of imports under this rule, it could submit the case to the MERCOSUR Trade Commission (CCM) in order to settle the problem identified on the basis of appropriate corrective measures and, in the event of a solution not being reached, the Member Country affected could exclude the respective tariff item from the scope of the *de minimis*.

This Decision also extends the 40% regional value content for Paraguay to 2022 and establishes a mechanism geared to guaranteeing the principle of Most Favored Nation (MFN) in terms of intrazone origin and similar to the one in CMC Decision 41/03.

As regards programmatic commitments in non-tariff restrictions, CMC Decision 27/07 was approved on the basis of the Uruguayan proposal, instructing the Common Market Group (GMC) to define treatment for any non-tariff restrictions and measures identified under the mechanism anticipated in the Decision before December 31, 2008. The maximum term for implementation of any solutions agreed will be December 31, 2010, for any measures applied by Argentina and Brazil, and December 31, 2012, for any applied by Paraguay and Uruguay.

[52] This means that a good maintains its regional origin, even though products of different origins or non-original products are incorporated, provided they do not exceed 10% of the value of the end good.

B. The MERCOSUR Structural Convergence Fund

The MERCOSUR Structural Convergence Fund (FOCEM) effectively began to operate when CMC Decision 18/05 came into force on December 30, 2006, and its Regulations in August 2007.

This delay did not prevent the partners working on the various different aspects of the issue so as to make the instrument operational in the shortest possible space of time.

The work by the FOCEM *Ad Hoc* Group of Experts (set up by CMC Decision 18/05), together with the MERCOSUR Secretariat (SM) and the CRPM and its Presidency, demonstrate the multiple difficulties that have arisen over the Fund's implementation, probably explained by its own inexperience in the joint handling of financial instruments. This resulted in significant delays over the submittal of pilot projects, their assessment, and approval, and even their implementation once projects were approved by the CMC.

However, the flexibility and pragmatism in approaching the issue created a favorable climate for the adoption of various rules throughout the second half of 2006 and the first half of 2007.

In that order, the partners took the necessary precautions to ensure that, if CMC Decision 18/05 came into force before the end of 2006, this would be considered the FOCEM's "first year" and all annual contributions for that year, which had already been anticipated by the partners in their respective national budgets, should be integrated. Measures were also adopted to start drawing up the first budget before the above Decision and its Regulation came into force, with a view to avoid postponement of the Fund's operationality (CMC Decision 17/06).

These commitments enabled a first FOCEM budget to be approved on December 15, 2006, when CMC Decision 18/05 had been incorporated in the relevant national legislation, but had yet to come into force (a term of 30 days stipulated in the Protocol of Ouro Preto was specially extended for this purpose).

This first budget (CMC Decision 28/06) comprised a total of US$125m for the contributions of the instrument's first and second year. It was a schematic budget featuring the relative expenditure on the installation and operation of a FOCEM Technical Unit in the SM (a body charged with evaluating and monitoring project compliance), a general heading of "project allocation" with no meaningful specifications, and a reserve for contingencies. An attempt had at first been made to include each of the projects to be financed. However, delays in their submittal by the partners interested and the complexities of their evaluation meant that the budget approval date was reached without a complete opinion of the projects submitted, with this alternative being adopted as a result.

Similarly, it was ruled that, over the course of 2007, Member Countries could submit pilot projects that would be allocated to the first budget in order to ensure that the final distribution of the budget's funds respected the percentages of 10/10/48/32 for Argentina/Brasil/Paraguay/Uruguay respectively, regardless of when such projects are submitted.[53]

A similar precaution had already been taken for 2008, when CMC Decision 21/07 of June 2007 established that the resources budgeted for each Member Country in CMC Decision 28/06 and not allocated during 2007 would, exceptionally, be placed at the disposal of each Member Country for allocation to new projects in 2008.

[53] It is interesting to remember here that under FOCEM Regulations, resources not allocated during each budget year should be distributed in the next budget with a 10/10/48/32 distribution for Argentina/Brazil/Paraguay/Uruguay.

The process to set up the FOCEM/MERCOSUR Secretariat Technical Unit was embarked upon, after the selection of four senior advisors, with the selection of a further four technical assistants ongoing.

To June 2007, the funding of a total of fifteen pilot projects had been approved,[54] although all countries show underuse of the amounts allocated to them:

- Six projects correspond to Paraguay (two for the 1st Infrastructure Program, two for the 2nd Competitiveness Program, and two for the 2nd Social Cohesion Program), involving a total of US$53.9m to be financed by the FOCEM over the course of their execution.
- Six projects correspond to Uruguay (two for the 1st Infrastructure Program, one for the 2nd Competitiveness Program, and three for the 2nd Social Cohesion Program), for a total of US$13.4m to be financed by the FOCEM.
- A regional project relating to the MERCOSUR Foot-and-Mouth-Free Action Program (PAMA) for US$13.8m.
- Two projects submitted by the SM for US$0.1m.

C. The Common External Tariff

The road to eliminating double CET levying

CMC Decision was approved 54/04 in 2004, establishing the principle that imported goods from the rest of the world complying with common tariff policies would receive treatment as goods originating in MERCOSUR, in terms of both circulation within the Member Countries' territory and their incorporation in production processes.

A year later, in December 2005, CMC Decision 37/05 was approved, including the first stage for the implementation of Decision 54/04.[55]

CMC Decision 37/05 defined the regulations for the circulation of a group of goods that would eventually receive treatment as original MERCOSUR goods as of January 2006. The goods contemplated fell into two categories: those whose CET was zero in all partners and those which all partners granted 100% tariff preference in favor of third countries.

By 2006, studies were anticipated to define the implementation of the second stage foreseen in CMC Decision 54/04 covering all the other marketed goods. Three requirements were established for compliance with this second stage: the entry into force of the MERCOSUR Customs Code (CAM), the online interconnection of the computer systems of the four partners' customs administration, and the adoption of a customs revenue distribution mechanism.

The objective defined is that there be free circulation for the sample of goods by 2008 at the latest. At the close of this report, the impression was that this deadline is rather unlikely to be met, given both the existing technical difficulties in implementing such a rule and the legal implications it would require in each of the countries involved, which in some cases would even require *a priori* certain constitutional amendments.

In terms of work on the Customs Code, although a text had been approved in 1994, it was never incorporated in the Member Countries' legislation. In July 2006, an *Ad Hoc* Group was set up with the

[54] CMC Decisions 8/07, 11/07, and 23/07.

[55] For further details of this Decision, see MERCOSUR Report 11.

brief to submit a proposal for a new text to the GMC for discussion at the first meeting in the first half of 2007, the idea being to have it approved by mid-2007 so that subsequent legislative treatment of the Code would not put back the 2008 deadline for free circulation.

In the period covered by this report, the Ad Hoc Group met five times, but reached the end of the first half of 2007 without completing the work. In June 2007, the Council therefore approved CMC Decision 15/07, extending the deadline for the Ad Hoc Group to submit the CAM project to the first GMC meeting in the second half of 2007 with a view to submitting it for consideration by the CMC in its last meeting of 2007.

Notwithstanding the progress made, consensus has still not been reached over several articles in the CAM' Project, including those corresponding to the area of application and the definition of "customs territory".

Work on the online interconnection of customs houses was completed, as were the tasks for implementation of the first stage contemplated in CMC Decision 54/04. These tasks may be subject to alterations depending on what kind of revenue distribution mechanism is agreed.

The definition of the customs revenue distribution mechanism is the most sensitive issue. A special group, reporting to the CCM was formed to carry out technical analysis in this area.

This group reached consensus over national customs houses being responsible for carrying out collections and threw out the alternative proposed by Paraguay geared toward creating a supranational institution. It was also agreed that the amount of customs revenue to be distributed will be taken from collections under the heading of import duties levied on extrazone goods complying with the common tariff policy.

Among the issues under discussion was the modality of distribution (the allocation of revenue to the country of end consumption or incorporation of the good in a production process, allocation via a predetermined formula, allocation proportional to the average collection for 2000-2004), as did the destination of funds (fiscal neutrality, net transfer via a mechanism similar to the FOCEM's, distribution, the share destined for countries with smaller economies).

Capital goods

As indicated in MERCOSUR Reports 10 and 11, CMC Decision 34/03 on "Capital goods" established a Common Regime for Non-Produced Capital Goods, which should come into force on January 1, 2006. This regime anticipated the establishment of a common list for capital goods not produced in MERCOSUR and subject to the application of a 0% common tariff and the keeping of national lists for two years up to January 1, 2008, with a 2% tariff in the event of consensus over the inclusion of the good on the common list not being reached.

The rule also extended the capital goods import regimes effective in the Member Countries to December 31, 2005, including the unilateral measures authorized by CMC Decision 2/03, "Exceptional measures in the area of tariffs", thus enabling a lower CET to applied to extrazone capital goods imported by Argentina, Paraguay and Uruguay (waiver).

It also authorized Paraguay and Uruguay to apply a 2% tariff up to December 31, 2010, on imports of extrazone capital goods with the exception of those included in the common regime upon its entry into force, which would have a 0% tariff, and established the continued commitment to examining the situation of capital goods in order to maintain the competitiveness of the Member Countries' economies.

CMC Decision 40/05 further extended the effectiveness of the waiver to December 31, 2008, and the coming into force of the common regime to January 1, 2009. It also postponed the initial date of January 2008 to January 1, 2011, after which imports of new capital goods, and their parts, pieces and components, classified as "BK" under the NCM, non-produced, that feature on the Common List (it should clarified that there are still no details for the products making up the common list). Finally, this rule instructed the High Level Group to Examine the Consistency and Dispersion of the Current Structure of the Common External Tariff (GANAEC) to draw up a CET revision proposal for capital goods before December 31, 2006, a process later extended by CMC Decision 37/06 until before the last meeting of the GMC 2007.

Information processing and telecommunications goods

MERCOSUR 10 and 11 Reports pointed out that CMC Decision 33/03 "Information Processing and Telecommunications Goods" (BIT) approved the continued examination of the situation of the BIT in order to maintain the competitiveness of the Member Countries' economies and to negotiate a Common Regime for Information Processing and Telecommunications Goods to be approved by the GMC before December 31, 2005. In turn, Paraguay and Uruguay were authorized to apply a 2% tariff to December 31, 2010, on extrazone BIT imports and the definition of a BIT list was ordered before March 31, 2004, to which the Member Countries could apply a 0% tariff up to December 31, 2005.

Via CMC Decision 39/05 of December 2005, the deadline to negotiate the common BIT regime was put back to December 31, 2006, and the GANAEC was instructed to draw up a CET BIT proposal before June 30, 2006, effective as of January 1, 2009. CMC Decision 13/06 extended the deadlines to draw up the proposal to December 31, 2006, and set a new date for the start of convergence on July 1, 2007. It also extended Paraguay and Uruguay's license to import BIT with a 2% tariff to December 31, 2011.

Lastly, in December 2006, CMC Decision 27/06 extended the term to submit a review proposal of the BIT CET until the last meeting of the GMC in the second half of 2007. This is to be applied as of January 1, 2010, and Paraguay and Uruguay's license to import BIT with a 2% tariff to December 31, 2007.

Special import regimes

The MERCOSUR regulatory framework (CMC Decision 69/00 and its amended version, CMC Decision 33/05) established the Member Countries' obligation to completely eliminate all unilaterally adopted special customs import regimes on January 1, 2008. In June 2007, by CMC Decision 14/07, this deadline was extended to December 31, 2008.

In relation to the Special Common Import Regimes, the list of sectors of interest for which the CCM should negotiate any relevant common regimes had been defined by CMC Decision 2/06. These were goods forming part of projects relating to investment, science, and technology, cross-border land trade, education, the aeronautical industry, the naval industry, and health. This task was to be completed by the first half of 2007. However, in June 2007, CMC Decision 14/07 was approved, extending this term to the end of the first half of 2008.

Brazil's application to raise the CET in the footwear, textile, and clothing sectors

In February 2007, Brazil began to internally analyze a possible increase in the CET on the fabrics, clothing, and footwear sectors, while holding parallel informal talks with its MERCOSUR partners.

The Brazilian idea, submitted at the last GMC in the first half of 2007, consisted of raising the CET from 20% to 35% for a list of fabrics and clothing (some items from chapters 57 and 58, chapters 61, 62 and 63) and for footwear (chapter 64). Although the (MNF) measure would be universally applied, the fundamental objective seemed to be to halt the strong advance of imports from China.

The rule to be approved would thus establish a differentiation between fabrics, for which the CET would be set at 26%, and clothing and footwear that would be protected with rates of 35%.

Even if the temporary nature of this rise were not fully defined, the CCM would be called upon to analyze the evolution of trade flows and assess the impact of the raise in order for the CMC to decide the treatment for these products in its last Ordinary Meeting of 2010. In the interim, Paraguay and Uruguay could maintain current levels of national tariffs for products in the fabrics and clothing sectors.

D. Local currency transactions

The objective of creating a mechanism to carry out foreign trade operations in local currency began to be drawn up on the occasion of the Córdoba Summit of Heads of State in July 2006.

From that point on, officials from Argentina and Brazil worked on designing a bilateral system to enable commercial transactions to be made in *pesos* and reals without needing to resort to the foreign exchange market or foreign currency operations. Toward the end of the same year, both countries' Economy and Treasury Ministries and Central Banks signed a Letter of Intent to define the limits of a pilot project.

The 31st Common Market Council recognized these bilateral negotiations through CMC Decision 38/06, in which, besides supporting the Letter of Intent, it resolved to stimulate studies of the conditions necessary for it to be extended to any other countries that so desired in the event the new system of payments should develop satisfactorily on a bilateral scale.

CMC Decision 25/07 was subsequently adopted in the framework of the Summit of Asunción, through which the system of payments in local currency for trade between the Member Countries of MERCOSUR was set up. In this framework, the operating conditions of this optional system are to be defined by means of voluntarily signed bilateral agreements between the respective countries' Central Banks.

This rule will be registered with the LAIA in the framework of the Economic Complementation Agreement (ECA) 18. The Argentine/Brazilian bilateral system stated that export and import operations be performed in *pesos* or reals as appropriate, anticipating daily clearance in dollars between monetary entities.

According to statements by officials involved in this issue, the implementation of this system will mean the increased integration of markets, the hierarchical ordering of domestic currencies, the establishment of a valid precedent for the creation of a common currency, improved competitiveness in the bloc's exporters, and boosting SME access to the export business by reducing the costs of commissions and arbitrations.[56]

The scheme does not involve adopting credit risk, as this would in fact exist in smaller quantities (estimated at around US$10m), or risk of exposure in local currencies, as compensation would be daily and in dollars. Nor does it anticipate granting subsidies to those making use it or the option of currency arbitration.

According to what was agreed by the parties, it is anticipated this system will begin operating as of 2008.

[56] According to data from the Central Banks, between 40% and 45% of exchange bilateral trade operations between Argentina and Brazil are below US$15,000 and the system could guarantee small operators a rate of exchange similar to market wholesalers'.

E. Trade in services

The entry into effect of the Protocol of Montevideo on trade in services in December 2005 ushered in the countdown of the ten years anticipated for liberalization of this area of trade at the level of the regional bloc.

The instrument's lack of force did not prevent the holding of annual negotiating rounds over commitments in this area, which required the Protocol's entry into effect in order to become effective. Indeed, at the 2006 Córdoba Summit, the 6th Round was approved, consolidating the results of the five previous rounds and incorporating new commitments.

Although, over the course of these six rounds, most service sectors and subsectors were incorporated in the lists of commitments, with progress being made in the consolidation of the regulatory *status quo* and in clarification of the regulatory situation of sectors without commitments, the commitments to liberalization effectively adopted were few and far between.[57]

In the second half of 2006, the Services Group carried out an evaluation of the outlook for the sector's trade liberalization for the next ten years and identified a series of factors that directly influenced the chances of concluding the liberalizing process in the timeframe specified by the Protocol:

a) Developing or completing regulatory regimes in certain sectors at national level.
b) Stepping up efforts toward regulatory harmonization in the bloc so as to contribute to regulatory improvement in the region.
c) Stepping up participation of each partner's internal sectoral organs in the negotiating process.
d) Reinforcing the notion of the compatibility of liberalization commitments with the preservation of their regulatory prerogatives before national organs.
e) Securing a high-level policy directive that will contribute to increased internal mobility in order to step up liberalization of trade in services.

In this framework, the Services Group drew up a series of proposals for courses of action, including:

- Efforts, even before the Legislative Power, to ensure any future regulations establishing limitations on trade in services grant preferential treatment to the MERCOSUR Member Countries.
- Developing or complementing internal regulatory regimes in certain sectors.
- Concluding the process of consolidation of the regulatory *status quo*.
- Making progress in the harmonization agenda for the regulation of services.
- Stepping up work related to CMC Decision 25/03 (Mechanism for Temporary Professional Practice in MERCOSUR) with a view to increasing the movement of professionals in the region.
- Taking into account the specific interests of the partners in defining restrictions that should receive special attention.
- Considering any domestic regulation measures that might represent a bureaucratic obstacle to intrazone trade in services.
- Considering tightening MERCOSUR disciplines on national regulation.
- Stepping up efforts for the internalization of MERCOSUR rules.

Lastly, the Services Group emphasized the need for a high-level mandate, both in MERCOSUR authorities and in each Member Country with a view to bringing the launch of the 7th Round of Negotiations on Services into line with the Protocol of Montevideo. In particular, the Group pointed out

[57] Other regulatory instruments for services, it should be remembered, were also approved, including the MERCOSUR Visa Creation Agreement (CMC Decision 16/03), the Temporary Professional Practice Mechanism (CMC Decision 25/03), and the Business Activity Facilitation Agreement (CMC Decision 32/04), along with other instruments issued by various MERCOSUR forums.

the need for the higher authorities of the governments of the Member Countries and MERCOSUR to devote special attention to the treatment to be given to origin restrictions on laws and/or on the respective Constitutions, as well as to sectors with scant or non-existent regulation.

F. Initiatives to strengthen regional production integration

MERCOSUR has, over recent years, been demonstrating the limits of linear, automatic, and general integration in which the market is the only regulatory body of costs and benefits for the different partners. Indeed, the slender production coordination seen at regional level, despite the logic of certain transnationals, the long history of Argentina-Brazil bilateral sectoral conflicts, and the escalation of statements by the smaller partners (Uruguay and Paraguay) about the meager results of regional integration for their economies are some of the symptoms resulting from the particular MERCOSUR mode of integration.

The inadequacies of the regulatory frameworks and measures of the integrative process in relation to the coordination of microeconomic policies and the search for integral, systemic, balanced development in the participating economies tended to perpetuate the imbalances and production gaps existing at the formation of MERCOSUR.

Production integration is therefore currently encountering obstacles due to differences in scale, asymmetries in technology and management development, national schemes not yet harmonized, market failures, access to funding, border difficulties, and so on. Production integration therefore requires the removal of these obstacles,[58] the positive "administration" of differences between the partners, as well as the incorporation of specific promotion incentives.

In light of these objectives, after surmounting the serious regional economic and financial crisis of 1999-2002, the bloc's countries began to include the issue of production integration on their agenda of priorities. In this way and on different occasions, questions as far-reaching and complex as the coordination of scientific and technological policy, stimuli to form regional production chains, the drafting of instruments to promote joint ventures between SMEs, cooperatives, and production units in the region, the creation of regional funds to finance the production sector, and the consolidation of the regional infrastructure network.

As a consequence, various initiatives related to this issue can be identified in the course of the past year, although in most cases these are in an incipient state.

Thus, at the 20th Meeting of the CMC in mid-2006, Dr. Reginaldo Arcuri (a former MERCOSUR Technical Secretary) was appointed to spearhead the design of concrete production coordination measures with the Member Countries' public and private sectors, including a supplier development program at regional level by Petrobras, a program to strengthen the automotive chain, the creation of a business forum to discuss the issues, and so on.

The Official Joint Statement by Heads of State in July 2006 confirmed that these initiatives had strong political backing at the highest level in order to "(...) *move toward regional production integration with social development and with an emphasis on the promotion of regional production enterprises that include integrated networks, especially for SMEs and Cooperatives (...)*".

[58] Extract from the 68th Ordinary Meeting of the GMC, "Proposal for Guidelines for the Production Integration of the MERCOSUR" (DI 13/07).

Therefore the Heads of State instructed Ministers in areas associated with production to define the guidelines that would make up the Regional Production Integration and Development Plan whose progress was to be reported on at the MERCOSUR Summit at the end of 2006.

At the end of November last year in the framework of Working Subgroup 7 (Manufacturing Policies), Brazil submitted a Guideline Proposal for the MERCOSUR Production Integration and Development Plan, including six types of measures:

- A regional human resources training program in production integration: the formation of a network of post-graduate courses in production integration, specialist exchanges, support for training personnel from business entities, government entities, and union organizations, the promotion of research into the issue, etc.
- National and regional financial support for production integration: a survey of existing instruments, the creation of funding lines for intraregional investment, orchestrating a supplier and/or client development program for large, small, and medium enterprises of less developed countries, supporting the Competitiveness Forum in timber/furniture, etc.
- Coordinating trade facilitation measures: the development of service infrastructure, the harmonization of technical requirements, making viable the setting-up of MERCOSUR companies, the identification of energy bottlenecks at regional level, etc.
- Coordinating the various MERCOSUR Working Groups and committees: defining priority production chains in conjunction with private sectors, creating joint projects with the various different negotiating organs, promoting dialogue and cooperation between national technological institutes, research centers, and development agencies, etc.
- Coordinating national policies for SME development: intensifying regional cooperation in the area of design, quality, and productivity, the formation of cooperatives and consortia, facilitating the circulation in MERCOSUR of the services of the national institutions linked to these questions, etc.
- Monitoring regional production integration: moving toward homogeneous statistics enabling the evaluation of the performance of production chains in the region, and developing monitoring indicators, both for the process of production integration and any concrete actions at regional level.

On the occasion of the 66th Meeting of the GMC in December 2006, a WG was set up consisting of officials from the Member Countries to work on the location of the headquarters for the SM in order to monitor the production initiatives identified in the framework of the work done by Dr. Arcuri and to design the basic guidelines for further action. Though these guidelines were to be submitted at the last Ordinary Meeting of the GMC in the first half of 2007, the Group has not met.

In 2007, at the 68th Meeting of the GMC, were added the Timber and Furniture Competitiveness Forum (whose work has had little impact in recent years) and the creation of the MERCOSUR Film and Audiovisual Sector Competitiveness Forum (GMC Resolution 14/07). The objective of this new forum is related to the coordination of public and private policies to increase the number of regional coproductions and the intra- and extrazone circulation of the Member Countries' national audiovisual products.

Box 3
WORKING TOWARD GREATER PRODUCTION INTEGRATION IN MERCOSUR

The objectives of the Supplier Development Program for the oil and gas sector are: (a) for more companies associated with this activity in MERCOSUR countries to be accredited as Petrobras suppliers, both in terms of goods and services; (b) to promote better, broader coordination of the company with existing or new regional suppliers; (c) to facilitate improvements in the quality, innovation, and price of different SMEs in the sector in order for them to qualify as Petrobras suppliers; (d) to generate systemic competitiveness profit throughout the supplier chain.

The Automotive Production Chain Complementation Program aims to develop bigger and better linkage between terminal companies and the group of SMEs supplying the region. To achieve this, an attempt is being made to work in conjunction with terminal companies to support supplier firms in areas as wide-ranging and varied as investment, technological development, international economic integration, innovation, and funding.

In both cases, the objectives would be achieved through a variety activities including various training seminars and workshops, business rounds linking producers with buyers, business facilitation on a global scale, etc.

Lastly, the program, "Production chains associated with tourism in MERCOSUR", aims to create a "tourist route" crossing all four partners, for which would be needed the training of the workforce associated with the sector and a MERCOSUR business coordination program for production integration through the promotion of meetings between the specialist agents of the partner countries, at which opportunities and obstacles for the integration of this chain would be identified.

At the meeting, Argentina stated its position over the importance of promoting greater production coordination at regional level, stating that "*there is a danger of manufacturing production tending to be concentrated in countries with larger-scale, more mature production apparatuses, even in the absence of special incentive policies"*.[59]

At the 33rd Meeting of the CMC, it was resolved to commission the GMC to propose alternatives for the constitution of a MERCOSUR Support Fund for SMEs involved in production integration initiatives. This Fund would complement any initiatives funded by the FOCEM (within the Competitiveness Development Programs). This work was to be submitted at the Ordinary Meeting of the CMC in December 2007.

Lastly, it should be pointed out that the CRPM has recently adopted a different kind of specific initiatives in the area of production integration. In July 2007, it organized a "Seminar on Production Integration in MERCOSUR" with the participation of the Uruguayan Foreign Minister, Reinaldo Gargano, the President of the MERCOSUR Parliament (PARLASUR), Roberto Conde, authorities from the areas of Industry, Labor, SMEs, and Social Development, and representatives of business groups, at which proposals were discussed on the problem of SME funding, strengthening regional production chains, and the possibility of making improvements in MERCOSUR institutionality.

Essentially, the institutional framework for channeling the various different initiatives is being analyzing in the area of the CRPM. Among other alternatives, the option to set up a Regional Production Integration Observatory is being studied in order to undertake a systematic survey of the issues in the most dynamic sectors in the bloc and so generate inputs that help strengthen regional production chains and the coordination of SMEs, both with each other and in their relations with big companies operating in the region, especially in Paraguay and Uruguay.

On the other hand, different types of funding options are being evaluated for the MERCOSUR SME Support Fund, the submittal of a project in the FOCEM in the framework of the 2nd Competitiveness Development Program, and the possibility of regionalizing successful national instruments in production integration. It is a

[59] "Production integration as a necessary tool in overcoming the asymmetries in MERCOSUR", Minutes of the 68th Ordinary Meeting of the GMC, Annex XXI. For further details of this document, see Point A on asymmetries, earlier in this chapter.

new development -and an extremely positive one- that regional financial organizations like the IDB, CAF, or FONPLATA are participating in some of the workshops organized by this Commission.

G. Entry of new members

A review of the Protocol of Adherence of Venezuela to MERCOSUR[60]

The purpose of the WG created by Article 11 of the Protocol of Adherence of Venezuela to MERCOSUR (PAV) is to reach agreement with Venezuela over how it intends to:

i) Adopt the regulatory legacy of MERCOSUR.
ii) Define its schedule for adopting the MERCOSUR tariff nomenclature.
iii) Agree with MERCOSUR members the format for tariff convergence with the CET and the Intrabloc Trade Liberalization Program.
iv) Establish guidelines for incorporating Venezuela in MERCOSUR agreements with third parties.

The WG met twice during the course of 2006. Significant breakthroughs were reached in key areas.

In nomenclatures, it was decided that Venezuela would gradually adopt the MERCOSUR Common Nomenclature (NCM) within a maximum of four years and the CET according to the following schedule: 3% of tariff lines in 60 days (September 2007), at least 20% of the current nomenclature's lines as from the second year, and the remaining tariff lines as from the fourth year.

In terms of regulatory legacy, progress was made in the classification of rules, for which five phases of incorporation were tabled in order to adopt the legacy gradually in a maximum of four years from the date of the Protocol's entry into effect.[61]

Lastly, the WG defined the conditions and courses of action to be negotiated with third countries or groups of countries for Venezuela entering agreements already negotiated or under negotiation. To this effect, it was agreed that, upon the Protocol coming into force, Venezuela would embark upon analyzing each of the agreements and at the same time dialogue would be reopened with countries with which MERCOSUR agreements already exist in order to negotiate the new partner's incorporation in the agreed instrument.

In Trade Liberalization Programs (PLCs), the negotiation was defined bilaterally and Paraguay and Uruguay's agreements with Venezuela were concluded, there remaining aspects of the schedule for Venezuela/Argentina and Venezuela/Brazil to be defined, work on which was foreseen for March-September 2007.

The tasks of the WG formally concluded on March 2, 2007, upon conclusion of the 180 day period laid down in the above regulatory frameworks. However, despite efforts by the partner countries to comply with the terms specified by the Protocol of Adherence, it proved impossible to comply with the objectives originally anticipated.

In this framework, the WG drafted a final report detailing the agreements reached, together with the tasks pending in order to close those aspects that would require more extensive negotiation.

---

60 For information on the background to Venezuela's entry, see MERCOSUR Report 11, p. 104.

61 On this point, 783 rules were identified that Venezuela could join in three phases of between six months and four years. However, the deadlines for a further 169 rules, among which are the elimination of double CET levying, adaptation to the automotive regime, financial matters, and rules of product origin, have still not been set.

In the final report, the WG established:

1) Calling on the CMC to determine the areas where the Group's remaining tasks will be continued.
2) Calling on the CMC to determine the legal instruments through which the agreements reached will be formalized in the framework of the WG or any others adopted in compliance with the provisions of the Protocol of Adherence.

Thus, after the WG submitted its final report to the CMC, the CMC set up an *Ad Hoc* Working Group through CMC Decision 12/07 to arrive at all the pending definitions that will conclude Venezuelan membership of the bloc. The Decision also extended Venezuela's schedule for adaptation to MERCOSUR rules by six months, with the option of extending the deadline for a further six-month period. However, it stated that negotiations relating to the PLC should be bilateral.

Bolivian membership

In December 2006, Bolivian President, Evo Morales, stated his country's intention to join MERCOSUR as a full member[62] and, in contrast to Venezuelan proposals, without "*Bolivia's withdrawal from of the Andean Community"*.

Below are some preliminary considerations regarding the implications of the application (in the above terms) by Bolivia.

The legal framework

The terms and conditions to be negotiated with Bolivia are anticipated in Decision 28/05 regulating Article 20 of the Treaty of Asunción and should include:

- Membership of the Treaty of Asunción, the Protocol of Ouro Preto, and the Protocol of Olivos.
- Adoption of the CET through implementing a convergence schedule.
- Membership of ECA 18 and its additional protocols through adopting a trade liberalization program.
- Adoption of the regulatory legacy of MERCOSUR, including rules in the process of incorporation.
- Adoption of the international instruments signed in the framework of the Treaty of Asunción.
- The modality of incorporation in the agreements and negotiations signed by MERCOSUR with third parties.

In this sense, Bolivia's intention to enter MERCOSUR without relinquishing its membership of the Andean Community of Nations (CAN) raises additional queries:

- The Common External Tariff -

There is a question mark over whether the obligation of applying the MERCOSUR CET is compatible with Bolivia's continuance in a customs union such as the CAN, quite apart from whether Bolivia currently applies a different CET to the other CAN countries'.

[62] This had already been anticipated by Argentina's high officials taking part in the 2nd South American Summit of Nations in Cochabamba, in December 2006 (La Nación, 12/10/2006).

However, this does not mean that Bolivia has authorization in the CAN to unilaterally modify its CET, for which it would need special permission from its partners if it was willing to adopt MERCOSUR's CET, implying in some cases an increase in the levels of tariff protection.

According to statements by Bolivian officials on various occasions, the country does not feel that the formal existence of an Andean CET (unapplied in practice) should be an obstacle to entry to MERCOSUR. However, Bolivia will probably be required to maintain a lower CET than the other MERCOSUR countries considering its "Mediterranean" nature and being a small economy.

- Regulatory issues -

Bolivia's dual membership may present difficulties, since as a member of the CAN, it is bound by that community's regulatory legacy. Thus, incompatibilities may arise in various areas such as rules of origin, phyto- and zoosanitary rules, technical rules, or trade defense. These aspects require detailed technical analysis and, in areas that prove impossible to harmonize, the possible evaluation of the alternative of granting Bolivia a waiver for the application of any such non-harmonized regulations.

- MERCOSUR's external relations in light of the Bolivian agenda -

One aspect to be underlined is that, as part of the CAN, Bolivia is currently authorized to negotiate agreements with third countries (LAIA or otherwise). This freedom is not granted to MERCOSUR Member Countries as expressly anticipated in Decision 32/00.

Thus, in the event that Bolivia were to apply to keep this authority within MERCOSUR, it would prove complicated to grant it given the position adopted toward Uruguay's expressions of interest regarding more freedom to negotiate individually with third countries.

Bolivia has acknowledged that this is the most sensitive and difficult issue to resolve. It has indicated that the mandate of the European Commission would be to negotiate with the CAN of four. It should be pointed out here that, in March 2007, the European Parliament approved a recommendation for the Council on the negotiation mandate of an Association Agreement between the EU and the four-member CAN.

- Intrazone trade liberalization -

There would be no major difficulties a priori, since, according to the Trade Liberation Program set up by ECA 36, the level of current liberalization is over 90% of the tariff universe. There remain only 148 articles listed by MERCOSUR (to be eliminated in 2011) in order to attain the 100% tariff preference and around 600 by Bolivia most of which will complete the elimination schedule in 2011 and a minority of which (contemplated in Annex VI of ECA 36) in 2014. In any event, the products not yet eliminated have no relevance in commercial trade.

- Special differentiated treatment -

The letter from President Evo Morales expressly mentions maintaining "*special differentiated treatment recognized in the CAN and the LAIA for Bolivia, not only due to its level of special differentiated development, but also to its condition as a cloistered country"*. This treatment is expressly recognized in the Andean regulatory framework.

In MERCOSUR, aside from specific benefits granted to Paraguay and Uruguay, the Treaty of Asunción does not contemplate special differentiated treatment in a generic way. This classification could not thus be recognized for Bolivia unless Uruguay and Paraguay call for similar duties. However, Bolivia's application could be contemplated through concrete benefits and specific actions, say, in the framework of the FOCEM and the measures adopted as a consequence of the debate on asymmetries in MERCOSUR.

Looking ahead: Bolivia's entry to MERCOSUR

By seeking simultaneously to remain a member of the CAN, Bolivia seems to have interpreted its membership of MERCOSUR as a process of harmonization of the regulatory frameworks of both regional blocs. In this context, the negotiation to complete its membership would consist in defining which of the requirements stated in Article 3 of CMC Decision 28/05 Bolivia would be in a position to fulfill to prevent them clashing with the Andean regulatory framework or with its national legislation and/or policies. This interpretation aroused concern in the five MERCOSUR delegations (including Venezuela).

The membership process has (at the time of writing this report at least) reached technical deadlock and fresh high-level political momentum is necessary to find "creative" solutions to some of the legal-technical issues outlined above. Similarly, the solution of difficulties linked to Venezuela's membership of the bloc could also contribute to facilitating and/or accelerating the Bolivian process.

There is, nevertheless, a hard core of issues (Bolivia's application of the MERCOSUR CET and NCM, Bolivia's participation in the CAN/EU negotiations) regarding which negotiators drew attention to their concern over how they might be reasonably resolved without impinging upon fundamental MERCOSUR principles.

H. Other relevant issues for the internal agenda

Toward the Bank of the South[63]

At the July 2006 Summit, Economy Ministers discussed various alternatives in moving toward greater financial integration between MERCOSUR countries. A working group was set up in this area to step up the various initiatives, such as capital market integration, the creation of a MERCOSUR development bank (the Bank of the South), the possibility of performing operations in local currencies, and the joint issuing of bonds.

The issue of setting up a regional development bank has been the subject of analysis at the level of both MERCOSUR and the SACN, as well as its successor, the Union of South American Nations (UNASUR), in which Argentina and Venezuela were the main instigators.

The initiative aims to take advantage of existing international liquidity to secure long-term funding for infrastructure and energy projects in the region, funding not easily accessed due essentially to the scant development of financial and capital markets in Latin America.

Toward February 2007, Argentina and Venezuela signed a Memorandum of Understanding designed to promote the bank's creation in the framework of economic and financial cooperation by the two countries, undertaking to take the necessary steps to set up a Bank of the South within 120 days from the signing of the Constitutive Agreement. It was stated at the time that the new bank's objectives would be to support

[63] See Founding Charter of the Bank of the South at *http://www.fazenda.gov.br/portugues/releases/2007/outubro/081007.doc.*

the integration process in the financial and social spheres, to finance economic development, commercial trade, and trade in services, to promote the formation of multinational companies with regional capital, and to foster technological development.

The bilateral text was open to membership for any South American state and Bolivia duly joined in March 2007.

Although, at first, some countries (Brazil, Chile, and Uruguay) openly expressed their reservations regarding the project's opportunity and suitability (advocating, however, the strengthening of existing institutions), the truth is that this initiative gradually won the support of an increasing number of countries in the region, including Brazil, which announced its full participation in the project in early May 2007 on the understanding that the new institution will solely be used to fund infrastructure and energy projects.

By June, work was developing apace at multilateral meetings at ministerial level for the countries interested in participating in order to define the Bank of the South's Charter and Statute, following proposals by the May meeting of the CMC in Asunción. In other words, it was attempted to orchestrate Heads of State from the countries interested to sign documents that month containing explicit policy commitments regarding the creation of the bank and incorporating the consensus achieved in terms of objectives and functions.[64]

Technical discussions were delayed, however, and reached deadlock. Specifically, the main points apparently delaying an agreement are the bank's purpose and functions, the total amount of each member's capital and contribution, the location of the new institution's headquarters, its geographical priorities, risk criteria, each country's importance in the composition and powers of the Bank's technical body, and the voting system.

At the time of writing this report, all South American countries were participating in talks on this initiative, except Colombia and Chile, which were attending the meetings as observers.

Biofuels and the MERCOSUR internal agenda

At the 65th Ordinary Meeting of the GMC (November 2006) and in the framework of the SACN, the Brazilian government submitted various projects seeking to set up cooperation programs to promote the production, use, and marketing of biofuels (bioethanol and biodiesel).

While the agreement submitted in MERCOSUR promoted parity cooperation, the text introduced by Brazil in the SACN leaned more toward vertical cooperation between it and the other SACN members. Thus, on the strength of the Brazilian project, the MERCOSUR Member Countries and Venezuela signed a "Memorandum of understanding to establish a special Biofuels Working Group" in December 2006.[65]

Through this instrument a special Working Group was set up to draft a cooperation program in the area of biofuels and biofuel technologies at regional level, keeping in mind the strategic importance of energy cooperation across MERCOSUR countries and the common interests in relation to the development of secure, renewable, and environmentally sustainable energy sources.

---

64 Minutes 07/01 of the 5th Extraordinary Meeting of the CMC.

65 Minutes of the 31st Ordinary Meeting of the CMC, Annex XXI.

The Group was to submit its initial conclusions to the CMC in six months and to complete its work one year after signing the Memorandum.

In terms of working areas, the Group was to propose measures to:

- Stimulate the production and consumption of biofuels, in particular ethanol and biodiesel.
- Draft a comparative report on the regulatory frameworks for biofuels in MERCOSUR.
- Stimulate the formation of integrated production chains in the area of biofuels in MERCOSUR.
- Stimulate technical cooperation between the partners' public and private entities regarding biofuels, particularly where ethanol and biodiesel are concerned.
- Stimulate joint research programs into the production and use of biofuels, keeping in mind existing programs, projects, mechanisms, and bilateral and regional cooperation instruments.
- Facilitate information exchange on technical and technological aspects linked to the production and use of biofuels, including those relating to any modifications necessary to adapt vehicles to the different mixtures of bio- and fossil fuels.
- Promote training in the sustainable production of biofuels, including evaluation of environmental impact, land use, waste use, waste disposal and recycling, distribution infrastructure, logistics, etc.

Since the signing of the Memorandum, the issue of biofuels has undergone major new developments on a global scale, particularly after the decision by the EU and the United States to promote their use. The issue was high on the agenda both on the occasion of George W. Bush's recent South American tour of Brazil and Uruguay and of President Lula da Silva trip to Lisbon, in both talks and the respective documents and agreements duly signed by MERCOSUR's largest partner and the two leading powers in the world economy.

Initiatives of the Commission of Permanent Representatives of MERCOSUR (CRPM)

Among the tasks performed by the CRPM in the period covered by this report were those relating to the MERCOSUR Social Institute (ISM), the MERCOSUR Democracy Observatory (ODM), and the MERCOSUR Training Institute (IMEF).

- The MERCOSUR Social Institute -

On the basis of CMC Decision 19/06 approved in July 2006 in the city of Córdoba, Argentina, through which the CRPM was commissioned to draw up a proposal for the creation of the MERCOSUR Social Institute (ISM), the CMC approved CMC Decision 3/07 at its 5th Extraordinary Meeting in January 2007, provisionally setting up the Institute in the Assembly of MERCSUR Social Development Ministers and Authorities, based permanently in Asunción.

The ISM's objectives included contributing to the consolidation of the social dimension as a fundamental axiom in developing MERCOSUR, contributing to overcoming asymmetries, collaborating technically over the design of regional social policies, systematizing and updating regional social indicators, compiling and exchanging good practices in social matters, promoting horizontal cooperation mechanisms and identifying sources of funding.

Its functions included providing technical collaboration on the design and planning of social projects, researching and submitting available lines and modalities of funding for the execution of projects to the Meeting of Ministers, promoting research into the design and implementation of social policies and programs, promoting the realization of international, regional, and national meetings on social issues, systematizing and disseminating experiences and practices in the area, compiling information on the region's social position, submitting annual reports of its activities, consulting the Consultative, Economic, and Social Forum over aspects of competence, and receiving any projects this forum might submit.

On the other hand, this Decision commissioned the Group created in CMC Decision 19/06 to draw up a first budget proposal based on contributions by the partners to make the ISM operational.

CMC Decision 28/07 was approved at the 33rd Meeting of the CMC in July 2007. This was the "Base Agreement between the Republic of Paraguay and MERCOSUR for the operation of the MERCOSUR Social Institute". The Council also noted the project, "A Minimal Budget for the MERCOSUR Social Institute for the 2008 financial year", approved and submitted by the Meeting of MERCOSUR Social Development Ministers and Authorities, and commissioned a report from the SM on the potential operational modalities for its execution.

In addition, the CRPM has carried out different types of negotiations with international organizations, specifically the UNDP, to conclude technical cooperation agreements to help fund projects in the framework of the ISM.

- MERCOSUR Training Institute (IMEF) -

CMC Decision 08/06 of July 2006 created a High Level Group coordinated by the CRPM to draw up a proposal for the creation of the MERCOSUR Training Institute for Officials of Public Administrations.

CMC Decision 4/07 was approved at the 32nd Common Market Council in January 2007 creating the IMEF and ruling that the lines of work and contents of the activities and programs to be developed by the Institute would be the responsibility of a Steering Committee made up of two representatives from each Member Country, one of them being the incumbent head of the National Institute or School for Public Administration Training or its equivalent.

The rule also established that the CRPM would sit on this Committee in developing its activities and lend support to the IMEF in the performance of its functions.

The IMEF would be based in Montevideo, and its Committee, jointly with the Technical Cooperation Committee, was to identify and negotiate the sources of funding for its development in order to commence its relevant activities in the second half of 2007.

Against this background, the Steering Committee of the IMEF was formally formed in May 2007 and resolved at its first meeting to:

a) Draft a report on training needs in the Member Countries;
b) Hold a workshop to develop elements for use in designing the Strategic Plan for the IMEF;
c) Drawing up the program for the Basic MERCOSUR Integration Course;
d) Improving the program for the MERCOSUR Specialization Diploma, keeping in mind developments in the regional integration process;
e) Move forward in identifying possible sources of funding for activities to be implemented within the framework of the IMEF, and
f) Preparing a communication strategy for the dissemination of IMEF activities.

The Study Program for the Basic Course and the plan for its implementation were approved in June 2007 (CMC Decision 35/07).

As regards funding for IMEF courses, preliminary contacts have been made with the Japanese International Cooperation Agency (JICA), the Institute for the Integration of Latin America and the Caribbean (IDB/INTAL), and organizations associated with cooperation provided by the Italian Republic and the Kingdom of Spain.

- The MERCOSUR Democracy Observatory -

In July 2006, CMC Decision 24/06 commissioned the CRPM to draw up the MERCOSUR Democracy Observatory (ODM) Project.

In January 2007, the CMC approved CMC Decision 5/07, creating the ODM, associated to the MERCOSUR Center for Promotion of Democracy (CEMPED). The rule provided that the ODM was jointly coordinated by the CEMPED and the CRPM.

The Observatory's objectives were to contribute to strengthening the objectives of the Protocol of Ushuaia on Democratic Commitment in MERCOSUR, the Republic of Bolivia, and the Republic of Chile, to monitor electoral processes in MERCOSUR Member Countries, to coordinate the activities of the MERCOSUR Electoral Observers Body at the request of the Member Country where the electoral process is to be held and draw up the regulatory framework for the performance of its functions, and to perform activities and studies linked to the consolidation of democracy in the region.

The following functions were included: (a) establishing the criteria to monitor electoral processes and to outline the observation tasks of the MERCOSUR Electoral Observers Body. The ODM is to work in coordination with the tribunals or electoral organs of the Member Countries in developing this function; (b) to draw up and evaluate the indicators and statistics necessary to carry out its studies and activities; (c) to perform any activities and provide any reports commissioned via the CMC; and (d) to submit an annual report of its activities to the CMC through the CRPM.

The ODM would have an integrated Steering Committee made up of a representative from each Member Country, coordinated by the representative of the Member Country in the exercise of the *Pro Tempore* Presidency. The ODM would be supported in its activities by the CRPM Presidency and will hold its meetings at the CRPM's headquarters.

It was also ruled that the Steering Committee would draw up proposals for a work plan, a plan for funding any activities required, and a plan for regulation of the ODM, keeping in mind its objectives and functions.

The 1st Meeting of the Steering Committee took place in May 2007. Its first activities centered on the preparation of the Work Plan that would include ODM Regulation, the criteria for monitoring electoral processes and for the observation tasks of the Body of Electoral Observers of MERCOSUR, Electoral Cooperation in MERCOSUR, the modalities for carrying out activities and studies on the consolidation of the democracy in the region, and the identification of sources of funding for the ODM and its activities.

Regional directives for employment growth strategy in MERCOSUR

In 2004, the CMC created a High Level Group to draw up a "MERCOSUR strategy for employment growth" (CMC Decision 46/04).

In this framework, CMC Decision 19/07 establishing these guidelines was approved at the Asunción summit in June 2007 with a view to drawing up National Employment Plans to make progress in the creation of decent work.

These consisted of promoting the development of Micro, Small, and Medium Enterprises (MSMEs), cooperatives, family-owned farms, and the integration of production networks, encouraging production complementarity in the context of the regional economy and in gearing public and private investment to labor-intensive and strategic sectors of the economy like infrastructure and new technologies.

Effectiveness and internalization of MERCOSUR rules

Earlier Reports have provided detailed explanations of the mechanism for the effectiveness of the rules issued by MERCOSUR organs in light of the provisions of the Protocol of Ouro Preto and the associated regulatory framework. There follows a description of the current state of incorporation and effectiveness of the MERCOSUR regulatory framework.

According to the SM, 1,850 rules had been approved in MERCOSUR between 1991 and May 2007. Of these, 1,130 require incorporation to come into effect, which has only occurred in 47% of cases.

Differentiating this information in accordance with the issuing organ, it emerges that a total of 473 decisions were approved by the CMC, 210 of which require incorporation. 70% are effective, that is, incorporated by the Member Countries in their respective legal classifications.

Of a total of 1,206 GMC Resolutions, 798 require incorporation, a process completed in 41% of cases.

171 CCM directives have been approved, incorporation being necessary in 122 cases. The directives are effective in 61% of cases.

I. Final considerations regarding the MERCOSUR internal agenda

Between July 2006 and June 2007, the bloc's internal agenda was characterized by the (political and technical) treatment of the suggestions mooted by the two smaller partners in relation to asymmetries both at the level of the MERCOSUR space itself and within the economies of individual countries. The sectoral conflicts, political disputes, and bilateral issues (which characterized previous years and are reflected in previous MERCOSUR Reports) gave way to much deeper and more complex discussions on the possibility of moving toward building a more solid, homogeneous, sustainable regional space.

Thus, as part of the positive agenda and looking to the future, there are certain good omens: the implementation of the FOCEM, the recent decision by the partner countries to set up a Fund for the development of SMEs, the work done in a technical committee reporting to the CCM with a view to eliminating double CET levying, and the programs and projects geared to achieving greater integration in the region's main production chains, can be numbered as some of the recent breakthroughs on this long road, though the list is an incomplete one. Although concrete progress has been made in some of these issues, in others their full implementation still depends on programmatic commitments, and on administrative and technical decisions whose effectiveness has yet to be evaluated.

The questions relating to the bloc's institutional framework deserve special consideration. MERCOSUR has, in recent years made significant progress toward strengthening the process in this area. The creation of a technical consultation sector in the sphere of the SM and the creation of the TRP were the steps that created greatest expectation at the time. Although these organs have not yet produced all the results expected, it is no less true that the creation of know-how, effective administrative routines, and "hands-on learning" are inevitable steps in any process of generating homegrown institutional capabilities.

Lastly, it should be pointed out that the expansion of MERCOSUR through the membership of new full partners has not yet lived up to the original expectations that this would bring a new dynamism to the integration process. Although the countries' willingness to incorporate Venezuela and Bolivia has been repeatedly expressed in various different understandings and policy statements, the technical job of completing of incorporation these countries has advanced more slowly than originally anticipated.

Reasonably complying with the commitments adopted by the various different parties and identifying concrete, creative, and realistic solutions to the technical and policy obstacles inevitably emerging from this kind of process are the major challenges faced by "old" and "new" partners in the months ahead.

CHAPTER IV. A REVIEW OF THE MAIN SECTORAL NEGOTIATIONS AND TRADE CONFLICTS IN THE REGION

A. Overview

As expressed in previous reports,[66] in the context of the continuity and intensification of the growth process that has been in evidence in the region over the last year, it is no surprise that the sectoral controversies, disputes, and/or trade "incidents" that characterized the bloc during times of crisis (particularly at the end of the 1990s and in the first three years of the current decade) have taken up little space on the bloc's internal agenda during our period.

As will be seen during this chapter, many of the controversies between countries over questions of market access can generically be qualified as quantitatively and qualitatively "low intensity", with weak media and political repercussions. The flip side of this, however, is that many of them have no immediate resolution, past or present, and in many cases have tended to become chronic, keeping to the framework of technical discussions, information exchange between the respective competent areas, and the search for precise, specific solutions.

In addition to this, the existence of certain institutional channels (such as the bilateral trade monitoring commissions, certain bilateral sectoral agreements with private sector participation, or the dynamic of the CCM itself) have been shown to be reasonably efficient instruments, at least in terms of channeling claims, facilitating greater knowledge between the respective public and private actors, and promoting the identification of valid alternatives to overcome such difficulties. So it is no coincidence that many of the bilateral sectoral agreements duly signed during 2003-2005 between the respective private sectors and/or governments have functioned without no great difficulty or that many of them have been renewed and/or extended.

Two further parallel elements have also contributed to improved trade climate in the region. On the one hand, the growing appreciation of the Brazil real, which has been largely responsible for facilitating the global rise in intrazone trade in the tow of the major partners' imports. This situation has been particularly important for Argentina, which thus recouped, in late 2006 and early 2007, the absolute levels of exports to its big neighbor after the sharp contraction they had suffered as a result of the 1999 crisis and the devaluation of the real.

On the other hand, the incorporation on the bloc's internal agenda of the issue of asymmetries by the smaller countries as being one of particular relevance has also contributed to bring some order to the negotiating table, particularly where the real possibilities of access to the Brazilian market for certain production sectors in these countries is concerned.

However, on the Brazilian side, in particular in activities linked to temperate agriculture, a sector in which many subsectors and/or producers continue to operate at very low productivity levels, there are also recurrent (generally regional) claims and pressures concerning damage caused to them as a result of the entry of production from Argentina and Uruguay.

66 See MERCOSUR Reports 10 and 11.

B. Difficulties faced by Argentine tires entering the Brazilian market

Since late July 2006, some Brazilian customs houses have not been allowing the entry of products exported by Argentine tire manufacturer, FATE S.A, claiming they were for the spare parts market (and not for new unit production), and that, as the firm is not a vehicle manufacturer, it should not be benefit from the 100% tariff preference anticipated in the 35th Additional Protocol to ECA 14 regulating trade in vehicles and auto parts between Argentina and Brazil.

The measure was based on a particular interpretation of the agreement, issued by the Regional Superintendence of the *Receita Federal* of the First Fiscal Region of Brazil, on the basis of which Brazilian importers were required to pay the CET as if the goods were from extrazone.

During the consultations with Brasilia, Argentina argued that the above Protocol, signed in June 2006, did not modify the rules governing intra-MERCOSUR trade in original auto parts, including tires, marketing of which, within the rank of the current coefficient of trade deviation (flex), is free.

Both governments (and their customs houses) traditionally interpreted the bilateral automotive agreements following this model and therefore the "new-fangled" reasoning of the Regional Superintendence jeopardized normal trade not just in tires, but in other goods under the automotive heading protected by the agreement, with consequent damage to industry and the auto parts distribution chain.

Thus it was that after the consultations and intense negotiations with the Brazilian government, the *Receita Federal* corrected the situation through a report in October 2006, stressing that the preference is applicable to automotive companies, resellers, or retailers, there being no need for any special qualification. The Brazilian customs authority thus swiftly authorized the regularization of FATE's shipments to the Brazilian market (an export flow of around US$50m p.a.).

C. Between MERCOSUR and the WTO: Brazilian anti-dumping measures on (PET) resin imports from Argentina

In August 2005, after two years of investigations and at the request of M&G Fibras e Resinas, a subsidiary of an Italian company controlling over 50% of the Brazilian market of the product in question, Brazil imposed an anti-dumping duty, via CAMEX Resolution 29, on polyethylene terephthalate (PET) resin imports from Argentina of between US$345 and US$641 per tonne.[67] Thus, Eastman Argentina, a chemical company with US capital exporting around 80% of its production, was pushed out of this market.[68]

The measure implied an extremely sharp downturn in Argentina's share of Brazilian PET resin imports, which went from over 50% of the country's external purchases to 0% in 2006. This market share was not covered by local Brazilian production, but by imports from East Asia, which soon came to represent almost the entire Brazilian import market.

Furthermore, the conflict seriously jeopardized the continuity of Eastman's activity in Argentina, bearing in mind the firm's heavy dependence on scale production in relation to the Brazilian market.[69] Other

[67] Anti-dumping duties of between US$314 to US$889 were imposed on imports from the United States.

[68] This sum involves a tariff of around 35% on the operations of Eastman (Voridian) Argentina SRL, the largest local producer, and of 67% for other Argentine PET manufacturers.

[69] Eastman (Voridian) called on the Argentine government to investigate the existence of dumping. The investigation concluded in June 2006 (nine months after Brazil's, which applied countervailing duties on the entry of local products) with the application of countervailing duties of 3.17% on the operations of M&G Fibras e Resinas, Brazil's main exporter, and 18.9% on other PET imports from this country. Brazil's exports to Argentina are estimated to have dropped nearly 50%.

countries like Peru, Chile, and Uruguay are the main destinations of Argentine exports, though of course with far less significant shares.

Throughout 2006 and also in 2007, numerous bilateral meetings were held in both Brazil and Argentina, at which various options were considered, yet it proved impossible to reach a solution to the controversy. Thus, in the absence of any substantive breakthroughs in the settlement of the conflict, in December 2006, Argentina requested consultations to be held with Brazil before the WTO's Dispute Settlement Body.

In its submittal, Argentina claimed that the investigation carried out, the decision formulated, and the duties levied failed to comply with Brazil's obligations under the provisions of the 1994 General Agreement on Tariffs and Trade (GATT) and the Antidumping Agreement. Argentina argued that the measures applied were incompatible with WTO provisions, as Brazil had not informed the Argentine exporter about the faults perceived in the responses to the Brazilian authorities' questionnaire. It had not been given the opportunity to submit further explanations within a reasonable time period. Nor had it been given the opportunity to submit in writing all the proof it deemed relevant to the anti-dumping investigation.

The Argentine side also claimed that Brazil had not demonstrated that imports supposedly forming the target of dumping had damaged its local industry. It had not based its determination of the existence of a causal relationship between imports supposedly the target of dumping and damage to the sector of national production on positive proof. It had not examined other factors it had knowledge of, apart from the imports supposedly the target of dumping, which were, at the same time, damaging the sector of national production.

Lastly, it pointed out that Brazil had rejected a price commitment proposal drawn up by the Argentine exporter, without revealing the reasons that led the investigating authorities to deem acceptance of such a commitment unsuitable or giving the exporter the opportunity to formulate any observations in this regard.

The consultations between the two parties were eventually held in Brasilia in February 2007, but reached no satisfactory settlement. In parallel to this, the Argentine company applied to the Brazilian authority responsible for the dumping investigation for an administrative review of the duty levied at the time.

After no significant progress was made during the first half of 2007, Argentina made its first request in June that year for a special group to be set up under the framework of the WTO. The application was blocked by Brazil, which exercised the right granted to it by the Dispute Settlement Understanding.

After this, when Argentina made a second application in July to for a panel to be formed, the said panel was formally set up. Taiwan, Japan, the United States, and the European Community reserved their rights as Third Parties in this issue.

D. Entry restrictions in Uruguay on Argentine products from provinces with industrial promotion regimes and on goods incorporating inputs with export withholdings over 10%

Trade relations between Argentina and Uruguay were expected to take a more favorable turn after Tabaré Vázquez came to power in March 2005 than under the previous government. However, they were soon rattled by the "escalation" of the conflict sparked between the two countries over the installation of pulp mills on the Uruguayan side of the River Uruguay.

In November 2006, the Uruguayan government announced it would apply tariffs on the influx of products from four Argentine provinces as if they were from extrazone. The argument on which Decrees 473/06 and 643/06 were based was that, being areas that benefited from industrial promotion, they were subsidized items, thus constituting unfair competition.

The measure not only affected goods manufactured in the Argentine provinces of La Rioja, San Luis, San Juan, and Catamarca, but also included products manufactured by economic groups with plants installed in these areas. The measure was not actually a new issue on the bilateral agenda: it was in fact confirmation of a settlement devised by President Jorge Battle in April 2002, through which additional duties had been imposed on products from these provinces due to alleged "unfair competition".

Also involved were products on which Argentina imposes export withholdings. Having a stepped structure (the greater the value added, the lower the withholding), such duties favor the export of more elaborate goods, which affects Uruguayan manufacturers, who, if they wished to use Argentine raw materials, would have to do so at a cost higher than that paid by the Argentine exporter. The Uruguayan measure then sought to offset the effect of depreciation caused by these Argentine exports in the Uruguayan market for these goods.[70]

The measure was welcomed by Uruguayan manufacturers, who expressed their "satisfaction at the government deciding to strengthen the measure, which in turn strengthens national production" (La Nación [29-11-2006]). This was precisely the logic behind the decree pushed through by Vázquez, who pointed out in its recitals that "although free trade has been established in MERCOSUR, there are other commitments adopted in this area which have seen no significant breakthroughs".

The Decree established that, when a product is included in both groups (provinces promoted or the existence of withholdings on exports of their inputs), its import would be taxed at the highest of the set Global Tariff Rates. Nevertheless, it was decided that exporters of products from Argentine provinces with industrial promotion could process the tariff exception before Uruguay's National Directorate of Industries in the case of companies with depleted benefit programs or with benefits on products not classified under the same tariff heading.[71]

Furthermore, the Decree also left open the option to incorporate on the list new products subject to higher withholdings of 10% or above in Argentina, or else products whose main inputs are levied with export duties of 10% or above, in which case no exceptions may be processed. The option of incorporating new products on the list at the request of the Uruguayan private sector affected was also anticipated.

Argentina quickly retorted that the above decrees violated the Treaty of Asunción. To make matters worse, import duties are only applied in a discriminatory manner (against Argentina). This situation was brought up by Argentina on the occasion of the GMC Meeting of December 2006 and at the CMC Meetings of December 2006 and January 2007.

Several applications submitted by importers in Uruguay to exempt products of Argentine origin from the regime established by Decree 473/06 were welcomed by Argentina's application authority, at which the "trade tension" created by the above regulatory framework thus tended to dissipate. Indeed, Argentine officials of government areas linked to the administration of foreign trade have stated they have no business claims connected with this issue under consideration. Nevertheless, there have been several applications by the Uruguayan private sector in recent months calling for the inclusion of certain Argentine products in the tariff exception regime.

[70] Affected products include dairy and dairy-based products, oils and fats, cereals, pasta, baked products, chocolates, candies, fresh grape wines and other fermented drinks, napkins, diapers, soaps, detergents, furniture, crockery, clothing and footwear, animal feed, and paints.

[71] Unlike the 2002 regime, the *ad valorem* tariff on products affected by withholdings would henceforth be applied to all Argentine exports of such products, not just those from industrial promotion zones, as was formerly the case.

E. Application of anti-dumping duties for edible oils by Uruguay against Argentina

In November 2002, the Uruguayan government set anti-dumping duties on Argentine exports of edible vegetable oils composed of mixtures of refined, pure, and bottled oils. This measure sought to counter relative price distortion due to the devaluation of the Argentine peso in early 2002 and to bolster the Uruguayan food oil industry, which was being damaged by differential withholdings (around 20%) applied to grains and oils in Argentina.

Thus, Uruguay's National Directorate of Industries decided, in late 2004, to begin the procedure to authorize the extension of the anti-dumping duties applied to Argentine oils. A hearing was held in June 2005, after which it was decided to extend the duties and, in October that year, the measure was duly extended for another three years.

The anti-dumping duties that have been applied to Argentine products (as well as import licenses and specific duties) have, according to Argentine businessmen in the sector, provoked heavy trade deviation in favor of Brazil.

F. Claims for non-automatic import licenses imposed on Argentina for textile products from Uruguay

In the framework of the policies implemented by the Argentine government to protect national production of various different manufactured goods, the Ministry of Economy and Production's Resolution 343/07 of May 2007 set the requirement of certificates for Textile Product Imports (of any origin) at nine NCM tariff items, four of which were jersey sweaters. The rule is applied exclusively to imports ultimately destined for consumption and sets out the formal application procedure for the certificate. Imports for the items included in the above Resolution totaled US$13.9m in 2006.

The procedure, which the Uruguayan government was quick to question, requires the submittal of a application form for each tariff item, and a form has to be submitted for each country of origin even when the goods are the same. The rule also stipulates that the amounts and/or FOB value in dollars declared in import applications may only be 5% higher or 10% lower than those recorded on the import certificates.

In connection with this issue, Uruguay submitted a consultation against Argentina at the CCM. Its concern centered on possible delays caused by the procedure, discretionality for the authorization of the entry permit, the deadline for the authority responsible for processing import certificates, and, ultimately, the possible closure of this export trend. They also pointed out that the measure constituted a system of non-automatic import licenses incompatible with MERCOSUR rules.

The Argentine reaction was that the measure forms part of its government's more general policies geared to promoting the recovery of certain local manufacturing sectors affected by the crisis of the past decade and highly employment-sensitive. However, the measure emerged as an administrative requirement in order to keep abreast of trends in the various different sectors of import trade, particularly those most exposed to competition from East Asian countries. The measure is not therefore geared to blocking or otherwise obstructing the sales of MERCOSUR partner countries.

G. Paraguayan claims on Argentina for withholdings on deodorized gas and Liquefied Petroleum Gas (LPG) exports

In September 2006, the Paraguayan government submitted a claim against Argentina over the existence in that country of export duties of 20% on NCM product 2711.29.90 "*other petroleum gases and gaseous hydrocarbons, in a gaseous state*".

In its submittal, Paraguay claimed that the duty affected the costs structure of its local aerosol industries, which use these inputs in their production process. In Paraguay's opinion, the application of the duty would give Argentine aerosols exported to Paraguay a competitive edge over Paraguayan production, as the Argentine producer has access to the input at a price that does not include the tax paid by this good when exported to Paraguay.

Argentina argued that such duties had been set in the context of the Emergency Law after the 2001/2002 crisis and that, as such, they are of temporary. It also pointed out that these duties are applied to the entirety of the tariff universe without discriminating between destinations.

Paraguay, on the other hand, stated that, according to the principles of international trade, non-discrimination and national treatment criteria should be applied. To this Argentina replied that such duties are levied solely and exclusively on national production and that, furthermore, Argentine exports to Paraguay of the most important items in aerosols exhibit behavior similar to that seen for the country's overall exports to Paraguay.

Asunción subsequently submitted another consultation over the 20% export duties applied by Argentina on foreign sales of LPG. Originally 5%, this duty rose to 20% in mid-2006 in line with rising international oil prices. Paraguay also argued that the measure constitutes a policy that distorts competitiveness and conditions of competition between economic factors in MERCOSUR. This should not occur between full members of the bloc and its elimination or substantial reduction was therefore requested.

H. The Argentina/Brazil bilateral agenda: wheat and wheat flour

Globally speaking, wheat flour is one of the most highly protected sectors in external competition, with import tariffs that, in the case of European countries, are virtually prohibitive. In the United States, although import tariffs are not so high in nominal terms, phytosanitary standards are so high that they seriously limit the chances of products' entry.

Both the EU and the United States are self-sufficient in wheat production, and are also the international market's main exporters. Brazil, on the other hand, is the world's second largest importer of wheat, with a volume of around 5m tonnes, Argentina being its foremost supplier. However, Argentina's wheat flour exports are marginal in comparison to its total production volume and the size of its domestic market, with exports accounting for around 10% of activity in the sector.

Wheat and wheat flours have been paying a 20% export duty in the framework of Argentina's current economic policy since exiting convertibility. Nevertheless, Brazilian millers have argued that, by making small alterations in the composition of the products, their Argentine counterparts export wheat flour to Brazil "disguised" as premixes, which only pay 5%. Thus, from the Brazilian viewpoint, they are not only able reduce the impact of this duty, but also practice "crippling competition", considering that Argentines have internal access to the raw material 15% cheaper than they do.

With things being as they are, Brazilian millers have complained to their government about what they see as an invasion of their domestic market by Argentine wheat in the form of premixes, arguing that the country buys this commodity from Argentina due to a State policy in the framework of MERCOSUR, despite the fact that they could obtain a cheaper, better quality product from the United States.

Thus, in May 2006, through COANA Executive Declaratory Act 2 of COANA Execution Rule 3 in order to avoid what they saw as Argentine exporters' maneuvering,[72] the Brazilian government ruled that purchases of wheat and wheat-based products from Argentina were subject to two kinds of restrictions:

a) the submittal of a declaration of the composition of merchandise, stating any added products and describing their physical and chemical features and
b) a compulsory test at the port of Santos for technical verification of their features (to determine whether they are flours or premixes). In the event of this analysis differing from the information submitted to customs, a fine equivalent to the current CET would be applied.

Under the above rule, the cost of this procedure would be met by the importer. Until the test result is out, the *Receita Federal* will not allow shipment of the goods to proceed.

Thus, Argentine operations for around 12,000 tonnes (US$2.6m) were immediately held up at the ports of Rio de Janeiro (125 containers), Sepetiba (155 containers), Foz do Iguaçu (87 trucks with 2,455 tons), Recife (70 containers), Uruguayana (977 tons), and Dionisio Cerqueira (11 trucks).

Therefore, the detained shipments were released onto the market when Argentine exporters paid the tariff for third countries (ignoring preferential treatment) and the fines imposed in the rules for infractions under the tariff classification. In other cases, the goods entered Brazilian territory as a consequence of preventive measures adopted by the country's legal authorities.

Brazil argued that these rules were due to the need to combat irregular imports of wheat flour originating in Argentina, pointing out that 100% of samples tested demonstrated incorrect classification and therefore the existence of fraud. It was reported that it would be impossible to suspend the measure, although the option of authorizing other laboratories would be looked at. It was also reported that testing takes a maximum of 5 days. This is at odds with the information provided by the Argentine private sector, which reported delays of up to two weeks.

In August 2006, in the framework of the CCM, the Argentine government submitted a consultation request to Brazil concerning what it saw as a clear restriction to free trade. The request called for a technical analysis to be authorized on products in laboratories near the goods' points of entry in Brazil in order to avoid transport costs to and from the port of Santos. A request was also for force of the above rule to be suspended until such time as the matter was settled.

Similarly, the Argentina side called on the Brazilian authorities to repeal the COANA Rules leading to the imposition of bilateral trade para tariff barriers in wheat premixes, while demanding a solution for the goods being held at the border and even those released for sale with precautionary measures.

In various different negotiating arenas, the Argentine side had explained in detail the process carried out to determine whether the product in question was in fact a premix, placing emphasis on the consultation duly formulated to the World Customs Organization (WCO), who ruled that the product was a premix, and on

[72] It should be remembered that Brazil had, on various occasions, called on Argentina to eliminate the distortion caused by applying differential export duties to wheat, wheat flour, and premixes, enabling Argentine mills to export flour as premixes (with a 5% duty) to which they only added salt.

AFIP Resolution 1598/2003 (drafted on the basis of the WCO response), which clearly determines the features of the products included under headings 11.01 and 19.01.

However, the Brazilians claimed that, as they saw it, the product in question did not meet the conditions of for a premix, being composed of wheat flour and salt without the presence of an emulsifier and, therefore, was "plain" wheat flour.

In addition to this, the Argentine millers’ business union argued that purchases of Argentine wheat flour represented just 2.7% of the Brazilian market and that damage to Brazilian industry was negligible.

However, in October 2006, as an expression of goodwill to the Brazilian government, the Ministry of Economy and Production decided, via Resolution 768/2006, to put the export duties applied to wheat flour and premixes on an equal footing. Thus, withholdings on premixes rose from 5% to 10%, while duties on flour exports fell from 20% to 10%. According to allegations by the main buyer of the local products and destination of 60% of Argentine exports, Brazil, the measure aimed to eliminate distortions in export duties, while seeking to discourage trade maneuvers in the sector (such as sending premixes instead of flour in order to pay the lower tariff).

Subsequently, toward the end of October 2006, the Argentine government passed Resolution 803/2006, through which a quota of 1.5m tonnes of flour was exempted from paying export duties on the part corresponding to the value added of the industrialization. Although the reason given by the Ministry of Economy was that it was seeking to encourage wheat exporters to send flour abroad instead of cereal grains, this meant in practice a reduction of withholdings on flours of around 7.5%.

Brazilian millers, especially in the south, protested about this measure, which in practice increased the export tariff differential between wheat and flour, arguing that the wheat flour would, for that reason, be up to 50% cheaper than Brazilian wheat flour produced with Argentine wheat.

Argentina subsequently issued Resolution 22/2007 in January 2007, modifying export duties on pasta disks and other similar solid forms and preparations for cakes, sponges, and similar wheat flour-based confectionery in containers with net contents of or less than 1kg. The new rule set export duties of 5% for these products. Its operation created additional confusion among Brazilian producers, as they initially understood it would mean a general reduction in export tariffs on premixes (returning to the situation prior to Resolution 768/2006), with the measure only being applied in the case of the above products.

As this report was nearing completion, journalistic channels revealed the decision by Brazil’s milling business union to call on its government to investigate Argentina over subsidies.

I. Brazilian restrictions on Argentine textured polyester exports

The Argentine company, MAFISA S.A., complained to its government that it could not obtain the import licenses required by Brazil for textured polyester, having no certificate of origin or equivalent document to certify national production. The problem arose through the application of SECEX Implementation Laws 14/04 and 10/06, establishing a general import regime that enabled non-automatic licenses to be applied.

In the case of fabrics, textile, and clothing imports, these rules stipulate that products originating in other countries, except East Asia, have to submit a certificate of origin issued by a government organ or a document issued by a high-ranking entity from the country of origin and certifying production from that country.

The difficulty arose when the company applied for the import license, as the certificate of origin was required at the time, as stated in the regulations. However, the MERCOSUR Certificate of Origin can only be issued against a definitive invoice, and this is only issued once the relevant import license has been obtained, thus creating a vicious circle that prevents completion of the operation.

J. Opening of the investigation in Argentina into potential dumping in polystyrene trays for food products originating in Uruguay

Polystyrene trays are used for packing fresh foods: red meat, poultry and fish, fruit and vegetables, fresh pasta, etc. Its users are supermarkets, meat packing plants, poultry producers, fruit and vegetables packers, and so on. The application for information was first submitted at the end of 2005.

The Argentine side argues that, between 2002 and 2005, imports from the origin under investigation more than doubled from 52.8m to 124.5m units and that imports from Uruguay forced down the local price and made the transfer to the price of the growth in domestic costs impossible.

The additional threat of damage was mentioned, given the excess of Uruguay's production capacity over its absorption capacity (a surplus of 460m units). Thus, in September 2006, Argentina's National Foreign Trade Commission (NFTC) concluded that there was enough proof to support allegations of damage and causation, thus opening the way for a formal investigation.

Among the arguments put forward, it was claimed that the price of the nationalized product was somewhere between 19% and 27% lower than the domestic product and that a decline was being seen in the price/cost ratio for national industry. This established a possible dumping margin of 27% and heralded the opening of the investigation.

K. The imposition of floor prices on Argentine wines entering Brazil

Argentine wine exports to Brazil have grown considerably since 2005, mainly in the lower price niche. Brazil's production sector then required its authorities to find a solution to the problem created by far more efficient competition with improved scales, thus leaving local production out of the market.

On the basis of such claims, the Argentine private sector expressed its willingness to discuss the issue and move forward in a possible agreement on the problem submitted by its Brazilian counterpart. The Brazilian authorities delayed the granting of import licenses as leverage, but the negotiations with Brazil's Foreign Trade Department (DECEX) secured their release in a relatively short period.

At successive meetings held first with the private sector, then jointly with both countries' official sectors, they made it possible for an agreement to be reached on the basis of an export price from Argentina to Brazil of 8 dollars per crate and of evaluations of the market situation. At the close of the negotiation, no effective term had been agreed.

As Brazilian customs and trade authorities were informed of the agreement, these control its compliance and imports of other origins by non-automatic import licenses. Although the situation is still rather precarious, the Argentine companies have recently reported no major conflicts or problems of access.

L. Difficulties in registering Argentine foot-and-mouth vaccines in the Brazilian market

Several Argentine companies in this sector have been lodging claims with their government for years regarding the difficulties they encounter when registering their foot-and-mouth vaccines with the relevant Brazilian health authorities. Biogénesis, for example, presented the government with the requirements for the registration of its vaccines and which it had not so far been able to meet.

Under Brazilian legislation, to gain access to this registration, it is obligatory to carry out power trials in the place where the vaccines are to be marketed. A purpose-built high-security laboratory is needed to carry out these tests. This demand cannot be met, Argentine exporters argue, as Brazil does not have the kind of active laboratory demanded by its own regulations.

Such a laboratory was in fact built some months ago, but is not yet in operation, as it still requires certain modifications and also the release of the necessary funds. On the basis of this, the Brazilian Ministry of Agriculture, Cattle, and Supply (MAPA) recommended that the company requests that power trials be carried out in Argentina under the supervision of the SENASA and the MAPA itself.

M. The activities of the Argentina/Brazil Bilateral Trade Monitoring Commission

Background

In late 2003 and early 2004, when the Argentine economy was leaving behind the serious recessive crisis it had been undergoing since the end of last century, various different production manufacturing sectors began to express concern that imports of many goods were growing at a rate which, in its judgment, was higher than what they deemed acceptable or reasonable.

In this respect, Argentine businessmen understood that the Argentine market's recovery was largely due to products imported from Brazil. They accordingly decided to formally urge the authorities to seek solutions to a problem they viewed as "*risking a repeat performance of the history of 1990s trade liberalization*".

Among sectors deemed "sensitive" were such headings as textiles, televisions, footwear, and white goods (Table 13). The Argentine government took due note of the private sector's concern and, on the basis of that, decided to begin to formally tackle such questions with their Brazilian counterparts in the framework of the so-called Brazil/Argentina Trade Monitoring Commission[73] to find reasonable, feasible solutions that would try to avoid the political, trade, and legal failures of previous sectoral understandings.

Thus, in mid-2004, the Argentine government raised the need to create public-private working commissions by sector in order to work on the design of "voluntary-type" agreements that would aim to establish rules, trade quotas, complementation agreements, and so on, some of which (depending on the features of the sectors and the relationship between the two countries' private sectors) were made explicit and ended up being monitored more or less on a permanent basis by governments and private sectors themselves.

---

[73] The Commission was formally created through a bilateral Memorandum of Understanding signed in Buenos Aires in October 2003. The Commission, which meets upon application by one of the countries, is coordinated by the Executive Secretary of the Brazilian Development, Industry and Foreign Trade Ministry and by Argentina's Industry, Trade, and SME Minister, although it can also "invite other parties with an interest in the issues to be examined by the Commission to participate in its meetings". Its main objectives include looking at specific "cases of sudden import disturbance with a view to comprehensively evaluating the state of specific products". For this purpose, the option is explicitly established to promote meetings geared to "stimulating understanding between representatives of private sector entities and/or companies from both countries, with a view to overcoming the causes that led to the case being presented". It is the Commission's job to monitor "compliance with the understandings reached and the decisions adopted".

Indeed, of the approximately 25 products and sectors over which there was originally some kind of conflict, nearly 20 reached solutions or agreements based on quotas, floor price, or voluntary restriction agreements. In parallel, the growth of Argentine imports from Brazil in some of these sectors slowed, enabling Argentine companies, in the context of the marked recovery of internal activity and investment in machinery and equipment, to recover a share of their own market.

TABLE 13
ARGENTINA: STATE AND EVOLUTION OF TRADE IN MAIN MONITORED IMPORTS FROM BRAZIL

Product	Total Argentine imports in millions of US$					Market share of Brazil in Argentine imports (%)				
	2003	2004	2005	2006	2007*	2003	2004	2005	2006	2007*
Footwear	73.4	106.6	119.1	138.6	85.9	82.6	77.9	68.8	60.6	63.1
Refrigerators	45.2	54.3	74.8	87.4	52.7	93.5	84.4	86.8	86.4	80.8
Gas stoves	8.6	10.5	13.2	18.4	10.1	94.7	93.6	92.9	86	81.9
Washing machines	16.3	24.3	26.8	33.4	22.5	74.8	70.2	71.9	64.5	57.8
Televisions*	7.7	24.3	16	29.7	12.2	87.6	81.1	41.5	35.2	30.8
Denim fabric	37	30.1	35.9	38.6	21.1	99.7	99.1	99.6	98.2	95.6
Corduroy cloth	6.3	7.5	8.7	7.9	2.1	68.8	58.2	46.7	45.1	29.9
Lead automobile batteries	14.5	26.4	29.9	36.9	31.3	89.6	92.6	93.1	93.8	92.4
Cotton fabric	73.9	88.5	110.5	131	76.3	92.1	86.5	85.7	82.9	75.1
Paper	34.1	43.9	64.4	69.8	43.1	57.6	51.7	64.5	57.2	58.4
Manufactured fibers and yarns	49.2	52	56.6	64.4	37.8	45.7	39.4	39.1	40.3	39.7
Wooden closets	7.5	15.1	18.9	23.5	18.4	90.2	90.7	86.7	83.5	86.3

Notes: Including inflows from Manaus free trade zone.
* January through July inclusive.

Source: INDEC and COMTRADE.

The operation of agreements in 2006-2007

In general terms, all bilateral agreements of trade quotification between the two countries duly signed over the last two years were satisfactorily complied with during the year under analysis. Indeed, unlike previous years, no serious claims have been made publicly by the business entities representing the sectors in question regarding their operation and observance. The same cannot be said, however, of imports from extrazone in certain specific sectors, especially the Far East.

White goods

The original agreements for refrigerators and stoves expired in December 2005 (an extension for January 2006 was later negotiated) and the agreement for washing machines expired in March 2006. Brazil's private sector declared that it felt the agreements had achieved the objective of improving conditions for

Argentine companies and that its continued effectiveness was not justified.[74] Brazilian business recommended that Argentine producers therefore look to apply the Competitive Adaptation Mechanism (MAC) or other intrazone trade defense measures in the event of any imbalances or crises.

As an alternative solution, the Brazilian side suggested monitoring trade through bimonthly private sector meetings. It also undertook to make known to its associates the proposals (conditions of new agreements) submitted by its Argentine counterparts and to formulate a response in October 2006.

Argentine imports from Brazil during 2006 reached 40% of internal demand, as against 62% in 2003. This result was related to the improvement and recovery of Argentine production, which came to represent 54% of apparent consumption in 2006, as against 37% in 2003. Nevertheless, and in the context of strong growth in Argentina's consumption of durables, the value of Brazilian settlements in the Argentine market continued to rise steeply.

Despite some contraction in the first months of 2007, Brazil remained Argentina's main foreign supplier, with around 66% of total imports.

Subsequently, in mid-2007, representatives of the Brazilian sector's National Association of Electric & Electronic Products Manufacturers (ELETROS) held a meeting with the then Argentine Industry Secretary, Miguel Peirano, and his Brazilian counterpart, Ivan Ramalho, at which they discussed the state of import licenses issued by Argentina. They concluded that, although there had at first been a delay typical of the implementation of any new mechanism, the situation had then been normalized. Argentina, for its part, stressed that the use of licenses essentially allowed greater control over products from Asia, particularly China.

-Refrigerators-

Business entities from both countries felt the 2005 agreement had run its course. The Argentine side intended to re-extend the agreement for a further three years, with a share of 240,000 units for the first year and 25% of the apparent market for subsequent periods. However, and despite the growth of purchases from countries like Turkey, Italy, and Mexico, Brazil remains Argentina's foremost foreign supplier with a share of around 80% in the country's growing import market.

-Stoves-

In December 2005, the Brazilian private sector agreed to extend the agreement covering stoves to January 31, 2006, setting a quota of 8,334 units for that month. Taking the quota agreed during 2005 (100,000 units) as a reference, it was observed that imports originating in Brazil for the first two months of 2007 had only covered 25% of the quota set. Compared to 2006, the imported units exceeded the quota allocated to this market by 10%. Brazil is currently (far and away) Argentina's main supplier of this type of product.

ELETROS did not accept the proposal by the Argentine Chamber of Gas Appliance Manufacturers (CAFAGAS) to extend the agreement for 2006, insisting instead on the need to apply the MAC, thus inducing the Argentine government to set up new instruments for the competitive adaptation of this branch

---

[74] On this subject, María Teresa Bustamante, the foreign trade coordinator of ELETROS, a chamber that brings together Brazilian white goods manufacturers, stated at the meeting of the Bilateral Trade Commission in July 2007 that "*Argentine industry had enough time to grow, recover, and invest in equipment*". She emphasized the sector's forward-looking vision by saying that "*we are not willing to go on being subjected to import restrictions. If they do not exclude our products from the non-automatic import license regime, Brazil will have no option but to make a claim against Argentina before the MERCOSUR court*" (Valor Económico [07/31/2007]).

of national production. ELETROS did nevertheless undertake to analyze some kind of agreement, provided it limited the participation of third country origins.

-Washing machines-

The two countries' entities -the Argentine Chamber of Electrical and Mechanical Household Appliances (CAFAEMEH) for Argentina and ELETROS for Brazil- agreed to comply over the quotas in the Agreement's three closed quarters (04/01/2005 to 12/31/2005). CAFAEMEH proposed continuing with the agreement on the following conditions:

- Effective term: over two years.
- Quota: 28% of the apparent market for Brazil and 9% of the apparent market for third country origins, with a commitment from the Argentine government to study a mechanism for efficiently administering the extrazone quota.
- Incorporating in the agreement household washing machines of over 10kg.
- ELETROS undertook to submit the proposal to Brazilian washing machine manufacturers and to reply by the last week of October 2006.

Although the quotas were adequately complied with in the framework of bilateral trade, the same was not true of purchases from countries like Italy, Spain, or Chile. However, Brazil remains Argentina's main supplier of this type of product, with a market share that remains at around 60% (despite a slight decline in recent years) and significant increases in terms of absolute values.

Plasma TVs

Point 6 of the agreement signed in February 2005 by the private sector color TV manufacturers, the Association of Argentine Electronics Terminals Manufacturer (AFARTE) for Argentina and ELETROS for Brazil, anticipated the possibility of including LCD and/or plasma TVs in its product sample, provided evidence of their production is submitted in the Special Customs Area of Tierra del Fuego.

After confirming that production had started in April this year at the Río Grande and Ushuaia plants, the representatives of the above Chambers reached consensus in August 2006 over the outline of a new understanding that would be effective until 06/30/2007 for LCD and/or plasma TV sets.

The salient aspects of this agreement are:

- The quota for imports originating in Manaus was set at 3,000 units for August-December 2006.
- For the first half of 2007, exports from Manaus would not exceed 4,000 units and 5,000 units for the second half of the year.
- AFARTE undertook to negotiate the inclusion of the NCM's tariff item on plasma and/or LCD TV sets with the Argentine government under the Previous Non-Automatic Import Licenses (LNAP) regime.
- ELETROS undertook to negotiate the issuing of Export Registers with the Brazilian government for exports affected by the quotas for 2006 and 2007.

This is the first case of an agreement in which there has been no trade growth, but a clear case of market distribution agreed with the partner to the detriment of extrazone.

Aerosols

The Argentine Chamber of Aerosol (CADEA) notified the Argentine government about the demand by Brazilian authorities for previous licenses for the import of Argentine aerosol products, which would be authorized through technical certificates issued in the future by the National Institute of Metrology, Standardization and Industrial Quality (INMETRO). Called upon for information, the Brazilian government explained that this is an Automatic License whose processing required nothing more than the submittal of information by the importer on regarding whether products come in aerosol containers or not; in terms of deadlines for their authorization, nothing had changed with respect to previous practices (48 hours according to MERCOSUR rules).

In parallel to this, the Brazilian government applied for this product's inclusion in the Brazil/Argentina Trade Monitoring Commission on the understanding that the substantial increase in Argentine exports of various preparations (perfumes, toiletries, cosmetics, and insecticides) in aerosol form impact negatively on this country's local production.

Argentina's response was that, from an analysis of the evolution of trade for the products submitted by Brazil for incorporation in the Commission, it could be concluded that, only in the case of "*other liquid deodorants and antiperspirants, Argentine exports rose substantially after exiting convertibility"*.

Nevertheless, there were three other products that, despite showing growth in exported volumes in recent years, should be looked at in more detail. Accordingly and in line with the application by the Brazilian authorities at the bilateral meeting of November 2006, the two countries' private sectors were urged meet in order to tackle the problems faced by Brazilian industry as a consequence of growing aerosol imports from Argentina. The two countries' private sectors held an initial meeting in March 2007.

The Argentine sector highlighted the complementation existing between certain Brazilian and Argentine companies, as for products in aluminum containers marketed by a well-known multinational, for which it imports aluminum "currency" from Brazil and then exports the end product (deodorant) to that market. It also mentioned that, as of September 2007, another big multinational in the sector will be moving to Manaus, upon which it would begin to obtain Brazilian tin.

The Brazilian sector called for immediate restrictions on the particular products supplied by this company from Argentina, rather than awaiting the installation of the plant. The request brought an emphatic response from Argentina, which underscored the share of extrazone purchases by Brazil.

Brazilian denim fabrics (jeans) entering Argentina

In 2006, 20m meters of denim entered Argentina from Brazil. This was 1.7m in excess of the quantity agreed, a surplus of 9% on the quota agreed for the period. This result was felt to be highly satisfactory by the Argentine authorities, bearing in mind that, in the first two quarters, the quota had been exceeded by 30% and 38% respectively. In 2006, Brazil was Argentina's main supplier of denim with a 98% share of the total volume imported.

It should be stressed that, in order to avoid extrazone trade deviation, the Argentine Chamber in the sector urged the establishment of denim criteria. The note establishing the preventive criteria was published in the Argentine Official Bulletin on April 2007 to tackle tax evasion and combat underinvoicing in goods imports.

During the first quarter of this year, imports originating in Brazil totaled 5.6m meters, representing 81% of the quota set. On the other hand, purchases from extrazone used 1,013% of the quota, boosted mainly by imports originating in China and North Korea. In this framework, Brazil had expressed its concern at the bilateral meeting in March 2007 over the growth of Argentine imports at very low prices from China, Korea, and other Asian countries.

In this framework, at the bilateral commission's meeting in mid-2007, it was agreed to defer the agreement between the sector's private entities (CADECO and ABIT) for the rest of 2007, contemplating a quota of 22m meters on imports from Brazil (12m for the first half and 10m for the second).

Differentiated Argentine fuel prices at border service stations

Through Resolution 938/2006, Argentina's Energy Secretariat set up an optional differential price scheme for fuel-dispensing service stations located in border zones or areas. The mechanism applies to fuel purchases by vehicles with foreign plates. The Resolution sets out the obligatory nature of implementing the scheme in all service stations located in border zones or areas for the sale of diesel and gasoline.

The argument behind these rules, as stated in their recitals, is the National State's obligation to guarantee the regular supply of energy needed by the country. To this effect, it rules that "*the differential price to be charged shall tend to reach values which, in each individual case, render the place where the fuel is bought reasonably insignificant to the private consumer or haulage contractor resident in the limitrophe country*".

Despite three federal judges from the Argentine provinces of Misiones, Corrientes, and Entre Ríos ordering the suspension of the measure, it has remained effective in recent months. The judges' argument is based on the idea that setting a differential price mainly affects trade in border areas because, aside from buying fuel, foreign customers demanded other goods, as, for example, in food outlets at such places. Should this measure remain in place, the economies involved would be seriously affected.

A sector with chronic difficulties: the footwear industry

Since the very beginnings of MERCOSUR, this sector has been one of the most controversial headings in bilateral trade. The major differences in size,[75] technological capacity, and competitive legacy between the positioned companies of both countries, coupled with the strong tradability of products and the atomization characterizing the sector (particularly in Argentina) have meant that successive government attempts to promote "voluntary" understandings between the two countries' private sectors (geared to facilitating production complementation, developing extrazone exports, or coordinating cooperation strategies) ended in emphatic failures of both form and content.

After being one of the sectors worst hit by the liberalization of the 1990s and the recessive crisis of 2001-2002, the Argentine footwear sector recovered strongly under the new post-convertibility macroeconomic and exchange conditions. Nevertheless, in parallel to the sharp rise in internal demand, the fears of manufacturers over the pace of import growth soon made themselves felt in Argentine political and business spheres.

Thus, despite the difficulties of reaching explicit agreements between the representatives of Argentina and Brazil's private sectors, Argentine footwear production, in deed, came under the protection of a voluntary restraint commitment on Brazilian exports. Even when the two countries' private sectors could reach no formal understanding and did not meet with the same regularity as they did over other sensitive sectors, the "agreement" set a benchmark for sales to the Argentine market of around 12m to 13m pairs a year.

---

75 Whereas Brazil produces about 700m pairs of shoes a year, Argentine production fluctuates between 70m and 90m.

Subsequently, in the framework of the claim by Argentine business over a supposed case of non-compliance with the commitments by their Brazilian counterparts[76] and the failure of successive attempts to reach an agreement at the private sector level,[77] Argentina's Economy Ministry ruled in mid-2005 that the sector be included in a system of non-automatic import licenses to monitor and regulate the entry of "sensitive" products. After implementation of this mechanism, in the framework of the operation of the remaining micro- and macroeconomic variables, Argentine footwear purchases from Brazil fell from 15.7m pairs in 2004 to 13.6m in 2005, only to grow to almost 16m in 2006.

The voluntary restraint "agreement" expired by mid-2006, when the highest echelons of the Brazilian Industry Ministry openly expressed their intention not to defer it in order to move on "*as fast as humanly possible*" to systems of free trade, with the argument that "*Brazil's contribution for the recovery and development of the Argentine industry has already been great enough*" (official statement from Brazil's Ministry of Development, Industry and Foreign Trade, August 2006).

Nevertheless, both the Argentine public and private sectors strongly urged the need for the agreements for these sectors to remain in effect, given the need to grant the private sector a longer period in which to achieve the technological, competitive, and scale improvements necessary to offset the sharp asymmetries between the two countries' companies, which were not "solely" the result of the crisis at the end of the past decade, but had much longer-standing, structural roots involving other kinds of incentives and asymmetries.

Thus, in February 2007, the parties "renegotiated" an export guideline for Brazil of around 13.5m pairs of shoes per annum, plus the equivalent rise in GDP and Argentine sectoral production (pushing up the volume to around 15m pairs, against total Argentine production of around 80m). Thus, the license system aimed to keep the share of sales of these products from Brazil at around 70% of total imports, and total imports at between 20-25% of total domestic consumption. External purchases at the end of the past decade stood at 35-40%.

In this context, whereas the Argentine government stated in various different forums that "*we are working to protect the national sector*" and that Argentina had instruments to prevent higher than usual influx of the main MERCOSUR partner's products, Brazilian footwear manufacturers began, in July 2007, to call on their government to remove restrictions on intrazone trade in the sector. Although Argentina's response was that it was not feasible to make any progress in analyzing these kinds of issues until after the presidential race at the end of 2007, certain Brazilian business leaders from the sector hinted that, if Argentina did not exclude its products from the non-automatic import license regime, they would call on Brasilia to lodge a complaint with the MERCOSUR court.

The Executive Director of the Brazilian Footwear Industry Association (ABICALÇADOS), Heitor Klein, stated his concern in mid-2007 about the real effect of Argentine licenses and quotas on the sector. He

---

[76] Compared to 2004 results, Argentine businessmen suggested that, given the informal agreement of a benchmark of 12m pairs established for that year, real inflows had risen to 15m. For a more detailed analysis of the legal difficulties of States Parties in guaranteeing effective compliance with this type of agreement under the framework of the institutional instruments effective in MERCOSUR, see MERCOSUR Reports 6 and 8.

[77] In late June 2005, at a seminar held in Buenos Aires to look at issues linked with Argentine/Brazilian production integration, the then Argentine Industry Minister, Miguel Peirano, had stated that "*strengthening MERCOSUR does not mean setting our country up as a mere exporter of raw materials*". And in relation to the unsettled footwear disputes, he stated publicly that Argentina would apply unilateral measures to restrict footwear imports from Brazil if in two weeks' time the manufacturers of both countries did not agree a quota that limited or at least set a benchmark for the entry of these goods. These statements were made in the framework of a claim by Brazilian footwear manufacturers for a quota of around 15m pairs per year, and an Argentine proposal of 10m (La Nación [06-24-2005]).

took as a reference point the loss of competitiveness of Brazilian supply due to the steep appreciation of the real and Brazil's loss of market share in the Argentine market to East Asian countries.[78]

While Klein pointed out to the Brazilian press that "*this is the third year running of shrinking sales to Argentina. Let's hope it's the last",*[79] the Development Minister, Iván Ramallo, maintained that "*if non-automatic licenses are justified in Argentina as a means of monitoring the growth in Asian product sales, restrictions on Brazilian sales are no longer justified".* The Argentine side then stated that, if it was legally impossible to exclude MERCOSUR countries from a general trade rule such as this one, an informal commitment would be adopted to provide fast treatment for shipments from the region.

A few days later, on the occasion of the opening of the Forum of the Latin American Footwear Industry, Argentine Economy Minister, Miguel Peirano, held that the domestic market would be "*prioritized*" for those wishing to invest in the country. In reference to the footwear sector, he pointed out that businessmen "*will find the Argentine government constantly accompanying industry in general, and the footwear industry in particular".* The President of the Argentine Footwear Chamber said much the same, pointing out that "*we're happy with non-automatic licenses and the sector is investing a great deal as a result"*.[80]

Similarly, a new issue of no small importance to be borne in mind when looking to the years ahead has been the sharp rise in production investments destined for the sector, a phenomenon not seen in Argentina for several decades. This process ranges from Brazilian companies interested in facilitating their access to the River Plate market and escaping problems arising from the appreciation of the real,[81] to medium Argentine companies with good prospects in the domestic and regional markets needing to expand or reequip their plants, or even the reopening or changing of hands of traditional license holders from international companies that have taken up the gauntlet of attempting their repositioning in the local market after several years of contraction in their activity in the country.

Medium-term agreements: the paper sector

A voluntary restraint agreement on Brazilian exports is in force, originally signed during the regional crisis created by the devaluation of the real in 1999 and successively renewed up to 2007 through an understanding between private sectors (the Association of Cellulose and Paper Manufacturers of Argentina and the Brazilian Cellulose and Paper Association). This is based on three -or six- monthly quotas. At the time of writing this report, the parties signed the renewal of their voluntary agreement in Buenos Aires for a further three years.

Brazilian sales of products in this sector defined as "sensitive" by the Argentine side have been rising in recent years, current standing at around US$40m p.a., in line with the steep recovery of Argentine

78 It is interesting to remark here that, while Brazilian footwear accounted for 86% of Argentine purchases of these products in 2003, this share had, by 2006, fallen to 61%. However, the Brazilian authorities also stressed that trade deviation favoring extrazone suppliers (such as Italy or Mexico) was even more marked in sectors like white goods.

79 According to one estimate, Brazilian footwear exports to Argentina went from US$86m in 2003 to US$80m in 2004, US$69m in 2005 and US$62m in 2006.

80 According to data from the Secretariat for Industry, Trade and SMEs of Argentina's Economy Ministry, investments accumulating in the sector during 2003-2006 reached a global total of US$300m, with average annual rises in productivity of around 15%.

81 Throughout 2007, there were repeated claims from different forums about what the Brazilian footwear business association, ABICALÇADOS, interprets as a trend to move factories in the sector from Brazil to China, India, and Argentina as a direct result of the appreciation of the real. An example of this trend is the deal undertaken by the Brazilian company, Vulcabrás, which, in association with Alpargatas Argentina and Paquetá, has set up a US$65m venture geared to producing sports footwear under the license of Adidas and Diadora in the town of Chivilcoy. In September 2007, the Brazilian group, Dass, which already had a production plant in the Argentine province of Misiones operating under license from Nike, also announced the purchase of the Argentine subsidiary of the well-known Italian brand, Fila, as part of an operation through which it takes the regionwide license for this brand.

demand. Nevertheless, Brazil's relative share as an external supplier has remained stable, representing between 50% and 60% of Argentina's total purchases.

N. Bilateral agreements in the automotive sector

The Argentina/Brazil Agreement

The main features of the current Automotive Agreement (36th Additional Protocol to ECA 14) are:

a) The term of the agreement: July 2006 to June 2008.
b) The Agreement is temporary by nature. The negotiation of a definitive agreement was anticipated during its effective term.
c) Free trade: unlike the previous bilateral agreement, the agreement does not mention this issue. Instead, it is stipulated that "before June 30, 2008, the Parties will fully assess the evolution of the industry and commercial trade, both between the Parties and with the rest of the world, in order to make any adjustments necessary in the automotive policy established in the current Agreement so as to achieve wide-ranging facilitation of commercial trade and production integration between the Parties".
d) Trade administration scheme: (symmetrical) global flex by country. Annual measurement, July-June. Including auto parts.
e) Flex level: bilateral trade is governed by an annual deviation coefficient of no more than 1.95 (coefficient: import value vs. export value). The calculation of the coefficient allows the possible absorption of the inertia of the current trade flow, which brings about levels higher than those foreseen. For this purpose, its value will be allowed to reach 2.1 between July 2006 and July 2007, but this will be compensated for during the rest of the period, otherwise, fines will be activated for exceeding the coefficient. (70% of the tariff on vehicles, 75% on auto parts).
f) Tariff treatment for extrazone auto parts: the tariff on auto parts from third markets fluctuates between 8% and 16%. However, both Argentina and Brazil have national import regimes that reduce this amount. There is a commitment in the Agreement to define, before December 31, 2006, a common auto parts policy that will eliminate this asymmetry. However, in spite of certain meetings, the private sectors have not reached consensus and no progress has yet been made in this area.
g) Temporary admission and draw back: for the application of these import tax suspensive regimes in trade between the parties, the reader is referred to the MERCOSUR general regime.

This new configuration of the bilateral agreement between the two main actors, resting as it does on production rather than merely trade understandings, provides, in the view of the competent Argentine authorities in the matter, the conditions for an embryonic common policy.

Although, on the Brazilian side, there were certain initiatives during the first half of 2007 designed to open up the debate over the future regime post-2008,[82] the Argentine government stated the intention to maintain current limits "*until trade reaches more balanced levels*", requesting treatment of the issue to be deferred to no earlier than the first two months of next year.[83]

Thus, whereas Brazil's stance is to make purposeful strides toward free trade for the sector, the Argentine position is that the conditions to do so do not yet exist, as Brazil's larger market would secure most of the investments. In this sense, the announcements of investments and the development of new models in the sector made by several terminals operating in Argentina over recent months (after several years in which injections of new capital into the sector were overly limited due to weak internal demand) have helped create a far more favorable environment for new understandings in the sector throughout the region.

---

82 The current bilateral agreement expires on January 1, 2008.

83 At which time free trade should theoretically come into force between both countries for the sector.

The Brazilian private sector made its concern over the issue known to its government on several occasions regarding what it saw as the impossibility of reaching sustainable and medium-term agreements designed to avoid "*having to discuss the deferral of the automotive agreement every year and to provide security and clear playing rules for investors*". When the latest deferral in the bilateral agreement with Uruguay was agreed, the Brazilian business entity ANFAVEA stated that "*it would accept no further deferrals"*.

Regarding the evolution of the sector in the two largest partners, the available data make for some interesting interpretations. Although the asymmetries in the scale and capacity of production between the two countries are clearly still important, the recovery of the Argentine terminals over the last two years has been little less than remarkable and has opened up the possibility for many of them of significant investment over the next three years.[84]

However, while demand continues to look highly resilient in both markets, Argentine terminals seem to be starting to make up ground both in the domestic and, more tentatively, in the neighboring Brazilian market. In parallel to the appreciation of the real, the Brazilian sector's balance of trade, on the other hand, has tended to worsen. Thus, while internal sales of imported automobiles, mainly from Argentina, are growing vigorously, exports show negative evolution.

TABLE 14
ARGENTINA AND BRAZIL: AUTOMOTIVE SECTOR EVOLUTION
Variations on previous year - % of units

Heading	Argentina		Brazil	
	2006	2007*	2006	2007*
Production	35.1	28	3.2	9.1
External market sales	14.4	22.6	12.9	26.2
National	31.5	26.4	9.5	22.8
Imported	4.9	20.2	82.3	72.6
Exports	30.4	35	-6.1	-7.8
To Brazil	74.6	64.2		
Imports from Brazil	-11.8	n.d.		
Brazilian share in Argentine imports	80.5	n.d.		
Brazilian share in Argentine exports	47.6	56.6		
Argentine share in Brazilian imports**			76.5	73.3

Notes: * January through August. ** estimate.

Sources: ADEFA and ANFAVEA.

The Argentina/Uruguay Agreement

The effectiveness of ECA 1 between Argentina and Uruguay applicable to the automotive sector was limited to 2001 by MERCOSUR commitments (CMC Decision 7/94). Nevertheless, and in light of the difficulties involved in bringing the PAM into force at MERCOSUR level, a bilateral automotive agreement registered in the LAIA as ECA 57 was signed in April 2003.

[84] In mid-2007, the Association of Automotive Manufacturers of Argentina (ADEFA) announced investments in the sector of US$3.5b to 2010, most of which were intended for the respective corporate complementation strategies for its regional production. In parallel to this, considering the differences in costs arising from *peso*-real exchange parity, certain platforms and/or new models for export to third markets are being reassigned by the terminals in favor of their plants in Argentina.

The instrument established quotas on automotive products from Argentina up to 2006 and free trade as of January 2007. In turn, 2006 quotas were maintained for Uruguayan vehicles and auto parts, as no modification was renegotiated before the schedule expired in December 2006.

In the second half of 2006, a claim based on a line-by-line interpretation of Article 15 of the Agreement was lodged in Uruguay, refuting Argentine exporters' right to free trade. Since then, Argentine companies have been exporting to their neighbor without recovering repayments (every shipment has to be accompanied by certification from the terminal, stating that no repayments have been recovered on the merchandise).

In this framework, the Association of Automobile Manufacturers of Argentina (ADEFA) duly called on Uruguay's Industry Secretariat to amend the text of ECA 57. A definitive resolution of the issue would require finding a formula backdated to May 2003, the Agreement's starting date, as of when the repayments now being queried were recovered.

Taking advantage of the need to update the Agreement (the values of new quotas for 2007 for vehicles and auto parts with preferential origin have yet to be defined in favor of Uruguay), this could be the right moment to set about redefining the controversial Article 15. In this sense, the negotiations pending between Argentina and Uruguay are aimed at settling the interpretation of this issue. It should be pointed out here that Argentine vehicle exports currently enjoy such conditions for all destinations, including Brazil.

By contrast, there are two further issues of fundamental importance to Uruguay:

a) Ensuring the scope of the Agreement incorporates trucking rigs, which were not included. This affects access to Argentina of this type of vehicle, currently manufactured in Uruguay.
b) Duly safeguarding the full and free access of vehicles to the Argentine market as a condition for the success of the installation project of the Chinese company Chery's automobile terminal in Uruguay.

The Brazil/Uruguay Agreement

The bilateral negotiations between Uruguay and Brazil culminated at the end of 2005[85] in a temporary agreement, which will hold until the PAM comes into force or, failing that, until July 1, 2008.

The bilateral agreements originally signed by Uruguay with Argentina and Brazil in automotive matters were essentially similar. As Uruguay did not renegotiate its agreement with Argentina in 2003, the products exported by the two countries went on to benefit from free access in both markets, provided they complied with the relevant origin requirements.[86]

Uruguay's desire to establish a compensated trade mechanism (the only way to attract investment) thus forcing Brazil to acquire vehicles and auto parts in Uruguay to sell automobiles with a 100% preference there was not accepted by Brazilian officials. On this issue, Uruguay wanted there to be a commitment at some stage in the future that, for every dollar exported by Brazil to the Uruguayan market, purchases would be from Uruguay for a further 3 dollars in automobiles and 1.5 in buses and trucks.

Finally, in the framework of the visit by the then Brazilian Industry Minister, Luis Furlán, to Uruguay in late March 2007, both countries agreed to maintain part of the automotive agreement as from July 2007

[85] The Brazil/Uruguay agreement is Protocol 62 of CET 2 of December 23, 2005. Paraguay, however, opted, in this sector, not to sign bilateral agreements with its MERCOSUR partners.

[86] Under this scheme, Uruguay also has export quotas to Argentina with preferential origin requirements. Under the agreement, this situation will remain in place until the PAM is brought into effect or both countries agree to modifying the agreement.

and another part up to June 30, 2008, while certain preferential access quotas were added for automobiles manufactured in Uruguay.

The "Bilateral Memorandum of Understanding on the Renewal of the Bilateral Automotive Agreement" laid down that the quotas on access to Uruguayan market for 6,500 automobiles and light commercial vehicles from Brazil be maintained. An annual quota of 20,000 units for access to the Brazilian market of Uruguayan automobiles and light commercial vehicles was also agreed.

On the basis of this, it was stipulated that automobiles entering both quotas should pay no tariffs provided 50% of their components are produced in MERCOSUR. Other automobiles, trucks, and buses pay no tariffs provided 60% of their components are produced in MERCOSUR, as provided under the current agreement. A category of utility vehicles with a loaded capacity of over 1,500kg and a total gross weight of under 3,500kg was also incorporated in the agreement. Quotas were also agreed so that Uruguay can sell 2,500 such utility vehicles and 2,500 trucks to Brazil without paying a tariff provided 50% of their components are from MERCOSUR.

A regime was also put in place for armored vehicles in Uruguay, with an annual quota of 2,000 units with tariff preferences as above. In addition to this, it was ruled that a Bilateral Automotive Committee be set up, issuing a report detailing the results of the agreement every 60 days.

As with the bilateral agreement with Argentina, it is anticipated that free trade will come into force between the two countries by July 1, 2008.[87] To this end, it was agreed to initiate detailed negotiations in the course of that year. In mid-2007, Uruguayan Industry Undersecretary, Martín Ponce de León, claimed that the deadline's advantage is that "*pressure over the need to reach balanced trade is maintained*".

In the event of no agreement being reached over the PAM, it was decided to carry out a revision of the automotive agreement "*based, among other instruments, on a system of trade compensation with flexible bands and a convergence transition period*".

According to statements by Uruguayan authorities to the Uruguayan press, there is a belief in Montevideo that Brazil will make efforts to comply with the PAM, as the agreement it has with Argentina in this sector also expires in June 2008.

Uruguay claimed from the outset that, in its bilateral agreement with the largest partner in the bloc, the entry of vehicles of Brazilian origin should continue to be regulated by a system of quotas, while the assembly plants located mainly in Brazil repeatedly voiced their opposition to this claim. Uruguay based its argument on the fact that the Brazilian automotive sector exports around US$128m p.a. to the Uruguayan market (around 18,000 units p.a., or less than 1% of Brazil's annual production) and imports just 8m, while auto parts sales account for a further US$70m. Although, due to a problem of scale, it would presumably not be very feasible to establish a terminal in the country, this is not the same for the auto parts niche.[88]

But the negotiating landscape altered significantly when, at the start of the current year, it became public knowledge that Chery was to announce a project for the construction of an automobile assembly plant in Montevideo[89] in association with the Argentine group, Macri, making the most, among other things, of the

[87] The Brazilian authorities repeatedly expressed the hope that they will be able to expand to other countries in the bloc and so put the PAM back on the negotiating table.

[88] According to certain press coverage, the Brazilian bus body manufacturers, Marcopolo, are studying the possibility of installing a bus 'finisher' in Montevideo, at which vehicles would be assembled for the local market.

[89] With production estimated at around 20,000 units per year.

benefits deriving from Uruguay’s more lenient origin requirements. However, Uruguay’s Industry Undersecretary, Martín Ponce de León, played down the importance of the effects of this news on the rest of the region, saying that "the day the Chinese want to produce a lot of cars, they won’t come and set up shop in Uruguay, but Brazil".

O. Some conclusions

As the introduction to this chapter pointed out, trade controversies and the imposition of new restrictions on intrazone trade have not -fortunately- been a significant problem for the bloc during the period under analysis, due mainly to economic, trade, financial, and policy factors.

Nevertheless, despite this favorable landscape and the work being done by the bloc’s various authorities (especially the CCM), there are still numerous national non-tariff restrictions, cost asymmetries linked to regimes effective in certain production chains in some countries, short-term ("unmercosurized") bilateral agreements, and a not inconsiderable number of sectors and subsectors subject to different types of systems of administered, restricted or regulated trade.

And in this respect, relatively little progress has been made in this field regardless of the trade dynamism and good macroeconomic "trade winds" of recent years, either in terms of sectors that might strive for greater "standardization" of their trade systems or in those where work on negotiating special regional regimes that promote greater complementation between the companies of the various different partner countries has been going on for years.

CHAPTER V. THE EXTERNAL RELATIONS AGENDA

The twelve-month period analyzed in this Report was not characterized by any major breakthroughs at the level of trade negotiations or understandings with third countries or blocs.

While MERCOSUR negotiators concentrated their activity and energy on drawing up and exchanging lists of products, analyzing proposals for relief and offers for trade discipline harmonization, and on interacting with their respective private sectors to examine the details of the various different agreements, none of the exercises managed to overcome the natural barriers to these kinds of negotiations and thus reach any decisive conclusion.

As an integral part of these processes, while the FTAA negotiations continued to show no sign of revival after the crisis in the wake of the Mar del Plata Summit, and the negotiation with the EU continued to await breakthroughs at the multilateral level that would facilitate discussion of the more complex or sensitive issues on the biregional agenda (essentially, access to agricultural markets and, to a lesser extent, trade services and disciplines), the process of Venezuela's incorporation in the bloc entered an extremely complex phase, both from the technical point of view and at the political level.

In parallel to this, the trade negotiations started years ago with possible extraregional partners (including Israel, the Gulf Cooperation Council, the Southern Africa Customs Union, and Pakistan) ran into difficulties or came to a standstill without so far any clear political signs of a successful conclusion, at least short term.[90]

However, toward the end of the period, certain events in the international policy arena brought about an environment that, *a priori* at least, would be characterized by greater activity in terms of the bloc's negotiating agenda with third parties in the following year.

The failure of the attempt by the two main world trading powers to reactivate multilateral negotiations at the recent G4 Meeting in Potsdam would thus give rise ex ante to a more favorable environment to refloat the negotiation between MERCOSUR and the EU during the second half of 2007. In addition, other events would create a climate in which the bloc's external relations agenda would gain in dynamism. These events included the signing of the Strategic Association Agreement between Brazil and the EU at the start of July, President Kirchner's official visit to Mexico, and the signing of a strategic association agreement between Argentina and Mexico toward ends of that month, and President Lula Da Silva's trip to Mexico and Central American several countries.

A. The global factors conditioning the MERCOSUR external agenda

Although the external agenda of a bloc or trade agreement is, in essence, a strategic and/or long-term matter (in fact, most of the negotiations last several years and usually outlast even the political administrations of the day), it is no less true that the current climate (linked to policies, the economy, and finances) exert a not inconsiderable influence on the dynamics and direction of the negotiating agenda. Under certain conditions, these factors may even steer negotiations in one direction or another.

It is therefore useful to provide a brief outline of the main aspects of the global and regional context of negotiations before going into detail over the main developments in the MERCOSUR external agenda.

[90] It is right to point out here that, to give fresh impetus to the external agenda, the bloc's countries intend to close at least one of the three most advanced negotiations (Israel, CGC, or SACU) during the Uruguayan presidency.

Economic context

- Marked dynamism in world trade, with a pronounced trend toward improvement in TOT in of the countries of the region, making some analysts believe we are in a new phase in the world economy, characterized by better conditions for developing countries.
- Partner countries' rates of GDP growth above the average for recent decades.
- In spite of the recent dynamism of Brazilian imports due to the appreciation of the real, the country continues to maintain a strong surplus in its trade balance against its regional partners. However, the growth of this surplus may recently have been showing signs of slowing. To an extent, the smaller partners' difficulties are to do with a certain structural mismatch between their exportable supply and Brazilian demand, as Brazil has in the last decade been achieving high levels of self-sufficiency in sectors and products in which it has traditionally been an importer from the bloc (e.g. dairy products, rice, etc.).
- Mexico's consolidation as an increasingly important trade and policy partner of the bloc's main countries, albeit still on a relatively insignificant scale.
- The growing presence of companies and large economic groups from Brazil in the rest of the region through the purchase of existing companies, the acquisition of international licenses, and/or the settlement of new production investments.

Political and strategic context

- The emergence of certain queries from various Brazilian internal sectors (business, political, academic, etc.) regarding the lack of concrete results of Brazilian trade policies in terms of obtaining concessions and/or opening up new markets in recent years and, consequently, regarding the real benefits of targeting such negotiations while having to make room for the specific interests (and schedules) of the other partners.
- A clear-cut trend on the part of the Brazilian authorities to adopt a markedly more proactive position over various issues on the foreign policy agenda at regional, hemispheric, and world levels, both from a national point of view and in Brazil's capacity as MERCOSUR's "major partner".[91]
- Strengthening Uruguay's trade links with the United States (and, to a lesser extent, with Chile), whose correlate, in the context of the difficulties existing in MERCOSUR over increasing its placements of goods, is a rise in this country's interest in obtaining broader autonomy in handling its trade policy.
- Hand in hand with strong economic growth, energy issues have become increasingly relevant on both the internal and external agendas of the region.
- Greater underperformance by Latin America in the pyramid of US foreign policy priorities and the absence of signs of reactivation of the hemispheric integration process (FTAA).
- The continued trend toward bilateralization of trade relations between the United States and several Latin American countries (e.g. Peru, Colombia, Central America, etc.). This phenomenon has not just caused a degree of concern in the region's diplomatic sectors (particularly Brazil's), but has also paralyzed initiatives designed to achieve closer relations with CAN countries.
- A strong offensive from the upper echelons of the Brazilian government to introduce the issue of biofuels as one of growing relevance on regional and international strategic agendas.
- The unfulfilled hopes of a possible reactivation of multilateral negotiations at the Doha Round.
- Expectations over a possible breakthrough in the negotiation between the EU and MERCOSUR.
- The strong presence of Venezuelan diplomacy, operating in parallel with the dynamism of Venezuela's imports from most countries in the region.

[91] The numerous trips and missions by the Brazilian President to developed and developing countries over the past year should be understood in this capacity, as should repeated stances taken by the Brazilian government on subjects of extreme international policy importance. Among these are the negotiations at the WTO (agriculture, industrial tariffs, intellectual property, etc.), the question of new energy sources, environmental issues, and regional and international security.

- The emergence or reactivation of new instances of cooperation and diplomatic exchange at intraregional level (the Margarita Energy Summit, Energy Interconnection Projects, the Bank of the South, the Cochabamba Summit, Bilateral Summits of Heads of State, etc.).
- Concern over and implementation of certain defensive measures in most of the region's countries in the face of the growth of imports from China, which threaten the most active manufacturing sectors, while the Asian giant's share as a trading partner of the main MERCOSUR countries is also on the increase.

B. The global framework of international economic negotiations: MERCOSUR in Doha

The possibilities of a common solution at the multilateral level

What is up for discussion for MERCOSUR countries at the Doha Round are concessions that, despite potential positive effects on agricultural trade, will also have a major impact on levels of industrial protection. However, the bloc's bargaining position over such a sensitive issue has been anything but uniform, despite public statements from certain members. Thus, whereas the Brazilian government had been signaling its readiness to start working with import tariff reduction scenarios in the manufacturing sector, the Argentine authorities advertised a rather different stance.[92] It is worth clarifying here that, due to the particular features of the customs union structure and the CET, central questions in the negotiation like the coefficient to be applied in relief for manufacturing products ("non-agricultural market access" or NAMA) or the flexibilities to be obtained in terms of sensitive products of the respective manufacturing sectors, require consensus between the four partners.

In the area of MERCOSUR, there is an *Ad Hoc* Group for Consultation and Coordination for Negotiations in the area of the WTO and the Global System of Trade Preferences (GSTP) among Developing Countries, which met several times during 2005 and 2006. The Group, coordinated by the MERCOSUR *Pro Tempore* Presidency and made up of officials responsible for these negotiations in the Member Countries, was set up "to coordinate positions and define negotiating modalities concerning market access" in those areas.[93] As a global political concept for the *Ad Hoc* Group's actions, Argentina has been suggesting that, since the CET should remain the central element of the Customs Union, it would be vital for its members to apply the same coefficient (25 points above developed countries) and streamline the list of flexibilities to produce a single list of sensitive MERCOSUR products that would allow for individual countries' structural difficulties.

This was on the understanding that if, say, the four countries were to submit a list of flexibilities without prior coordination, there would be disparities between the individual commitments of the Member Countries and the CET. Likewise if one or several members went ahead with sectoral agreements such as those foreseen in NAMA without due coordination or if a Member Country were exempted from the application of the general formula, as is sought by the "Small Vulnerable Economies".

On a more technical level, certain differences between Argentina and Brazil have been noticed over questions of Sensitive and Special Products and the Special Safeguard Mechanism, for example. In fact, within the G20, there are diverging positions between Argentina, Paraguay, Brazil and Uruguay on the one hand, and Group Members that are also G33 Members and take a strongly protectionist stance over market access for agricultural goods (e.g. India, Indonesia and Philippines).

[92] Lula: *"Corte de tarifa é ganho político"* (O Estado de São Paulo [17-07-2006]); *"Lula admite concessões na área de bens industriais"* (Valor Econômico [17-07-2006]); *"Argentina descarta as bases de Doha"* (Valor Econômico [02-02-2007]).

[93] MERCOSUR/GMC/RES. 09/05.

Furthermore, Argentina and Brazil (along with India, South Africa, Venezuela, Egypt, Namibia, the Philippines, Indonesia, Pakistan, and Tunisia) have been working within "NAMA 11"[94] to guarantee that any efforts they have to make in the framework of the negotiation do not end up being greater in that sector than those made by the DDC themselves. This group, which feels the DDC demands in NAMA are disproportionate, has also advocated reasonable flexibilities for DGC: appropriate implementation deadlines for sensitive sectors and an appropriate percentage of tariff lines subject to a lower cut than those of the general formula. Lastly, NAMA 11 has supported compliance with Paragraph 24 of the Hong Kong Ministerial Declaration,[95] urging high levels of ambition in market access, both in Agriculture and in NAMA, while also taking into account Special and Differentiated Treatment for DGC.

C. A review of the main points of the MERCOSUR external agenda

From the SACN to UNASUR

On December 8 and 9, 2006, the SACN held its Second Summit of Heads of State in the city of Cochabamba, attended by 8 of the 12 heads of states of the countries making up the organization. The meeting culminated in a declaration expressing the readiness to move forward in the process of South American integration, although no concrete agreements were reached on how to do so and it was clearly stated that the most appropriate course was to move forward in common public policy areas respecting each country's schedules and sovereignty.

The Cochabamba Declaration outlined a "Strategic Plan to Step Up South American Integration" containing several core approaches. These are to:

a) Strengthen the institutionality of the SACN. A Commission of High Officials will be set up to establish Working Groups in the areas of infrastructure, energy integration and social policy. A Working Group, with CAF backing, will step up studies and proposal development relating to the formation or adaptation of financial and development mechanisms for South America. This Commission will work on such issues as institutional convergence, economic development, and job creation, trade integration, energy integration, infrastructure integration for transport and communications, asymmetries, production integration, innovation, research and development, information and communications technologies, South American funding mechanisms, the South American social agenda, the environment, South American citizenship, cultural identity, and citizen participation in the integration process.
b) Policy Dialogue. Policy consensus-building is to be promoted between countries in the Community, identifying lines of action that enable common interests to be dealt with in a coordinated fashion.
c) External Dialogue. SACN external dialogue and cooperation initiatives with other regions and regional groups are to be stepped up.
d) Coordination of member countries' positions in the WTO and multilateral financial institutions.
e) Parliaments. The Parliaments are invited to consider the design of mechanisms leading to the establishment of a South American Parliament.

As a result of the 1st South American Energy Summit, held in Isla de Margarita, Venezuela, on April 16 and 17, 2007, the 12 neighbors' integration initiative was named the "Union of South American Nations" (UNASUR) and a Permanent Secretariat, based in Quito, was also created. UNASUR's constitutive agreement project will be submitted at the 3rd Summit of Heads of State and Government to be held between January 24 and 28, 2008, in Cartagena de Indias, Colombia.

---

[94] A group of developing countries that has proposed that, in the event of the adoption of a Simple Swiss formula, Developing Countries (DGC) coefficients should be separated by at least 25p.p.

[95] Hong Kong Ministerial Declaration. December 22, 2005. Doha Work Program.

Toward closer relations with Mexico

In August 2006, after two years of arduous negotiations, the Plenipotentiary Representatives of Argentina and Mexico signed the 15th Additional Protocol to ECA 6 before the LAIA, thus formally endorsing the agreements reached by the parties two months earlier, through which over 1,500 new tariff lines were incorporated in the bilateral agreement, which thus covered around 60% of the tariff nomenclature (around 4,500 items).[96]

The new agreement also reordered and consolidated the regulatory framework existing under the current LAIA agreements, defined a new origin regime, and laid down that all products included on the respective lists will enjoy 100% preferences over a maximum of ten years.

However, the cereal complex -of particular interest to Argentina- was not included in the agreement, which basically covers the manufacturing sector (mainly the chemicals, plastics, steel, printing, computer, rubber, and textile sectors). Reciprocal preferences were agreed in the agricultural sector involving total and immediate elimination for certain primary products such as plums, olives, fishing products, beverages, preserves, and "*alfajor*" cookies. Products such as sweet cookies and soup preparations were granted significant preferences, while a quota was also set for canned peaches (the exporting country being responsible for administering it).

Regarding intrazone trade, the agreement establishes three types of baskets of goods (A, B and C), for which different elimination schedules are established, ranging from 0 to 10 years.

Subsequently, toward the end of July 2007, Argentine president, Néstor Kirchner, paid an official visit to Mexico, in the course of which the Strategic Association Agreement between Argentina and Mexico was signed "on matters of policy, economy, and trade, as well as cooperation in the areas of education, culture, science, and technology". Although this agreement has no immediate implications for trade, it nevertheless reflects the improved relations between the two countries, confirming Mexico's desire to reduce trade exposure with the United States and continue to intensify its trade and economic ties with the Latin American region, after they had been sharply curtailed following Mexico's entry to NAFTA in the mid-1990s.

D. New issues on the external agenda: energy diplomacy

George W. Bush's visit to Brazil and the Brazil/United States biofuels agreement

As part of a tour of certain countries in the hemisphere in March 2007, President Bush's visit to Brazil was a sign of Brazil's readiness to strengthen its economic and trade ties with the United States (its main trading partner at the time) and of the US government's readiness to take a more proactive stance in a region that has clearly been a low priority on the current administration's foreign policy agenda. Thus, after a year and half with no personal contact (the last meeting between the two presidents was at the end of 2005, the day after the Hemispheric Summit in Mar del Plata), both leaders resumed direct dialogue.

The issue of main interest for Brazil at this meeting (which just weeks later would have its second chapter on the occasion of the two presidents' meeting at Camp David) dealt specifically with the possibility of reaching some agreement or joint plan to develop biofuels, taking into account that Brazil is not just currently the main world producer and exporter of sugar cane ethanol (with an annual production of over 17b liters) but is also one of the nations with greatest potentiality in this new energy development chapter.

[96] It should be pointed out that, since 2004, Uruguay has had a free trade zone with Mexico under the framework of CET 60, for which it duly obtained a waiver from the bloc. Brazil has its own bilateral fixed preference agreement, the last negotiation of which was held in 2003 (CET 53). There is also a MERCOSUR/Mexico fixed preference agreement (CET 55).

Brazil exported around 2.6b liters of ethanol in 2005, nearly half the total world trade, its main buyers being the United States and Europe.

Brazil has taken a lead as a promoter of these new energy sources to replace fossil fuels, a scenario that, in strategic terms, is seen by this country as being of great benefit to its economy as an efficient producer of raw materials to that end. The Brazilian government has repeatedly weighed up the advantages of this energy alternative in the fight against global warming.

However, there is an important difference between Brazil and the United States in terms of plant-based fuels: while US corn-based ethanol has low productivity and, produced on a large scale, would have a serious impact on food prices, the production of sugar cane ethanol is five times more efficient. In fact, ethanol today represents 40% of the gasoline/ethanol market in Brazil, but just 3% in the United States. Sugar cane productivity is 7,000 liters of ethanol per hectare, more than double the productivity for corn-based ethanol. The production cost is 30% less and the energy balance is extremely favorable: sugar cane generates 8.3 units of renewable energy for each unit of fossil energy used to produce it, 5.5 times higher than the value for corn.

This would make Brazil the world leader in this boom market. Even so, the United States outperformed Brazil in ethanol production in 2005, no doubt confirming in the authorities' minds the need to boost production and improve infrastructure, as well as investing more in innovation.

From President Bush's visit to São Paulo emerged a Memorandum of Understanding between Brazil and the United States to move forward on biofuel cooperation, promotion, and distribution, with a work proposal on three levels: the bilateral level, the level of joint action in third countries, and the global level. In the first case, the stated intention is to move forward in research and development of new generation biofuel technology, developing on the work done in the framework of the various instances of bilateral cooperation. At the second level, the aim is to work together to bring the benefits of biofuels to third countries via viability studies and technical assistance geared to stimulating private sector investment in the new energy source.

The parties also committed to start work in Central America and the Caribbean encouraging local biofuel production and consumption with a view to working together in key areas elsewhere in the world. Lastly, at the global level, a desire was expressed to expand the biofuels market through cooperation in establishing uniform patterns and rules. Cooperation to achieve this objective is being sought in the area of national standardization and quality agencies, as well as coordinating with existing complementary international forums. It was also decided to set up a Working Group to follow up on the agreement.

The question of tariff restrictions on Brazil's ethanol exports to the US market was not included on the agenda, although it was brought up by President Lula da Silva at the joint press conference held at the end of the bilateral meeting in São Paulo.

After signing this Memorandum, the Brazilian President made clear to his visitor the strategic priority for Brazil of MERCOSUR and South American integration. He also emphasized that only a biofuels market free of protectionism could be an effective instigator of sustainable development to benefit poorer countries. The reality is that biofuels in the United States and EU are heavily subsidized through internal aid to farmers via a whole battery of incentives, high import tariffs, and technical standards. For Brazil, the current customs barrier on ethanol is very high: an *ad valorem* tariff of 46%, or 2.5% plus US$0.14 per liter. It is worth remembering that countries with trade preference agreements with the United States (such as the members of the Caribbean Basin Initiative) no longer suffer such a disadvantage.

Box 4
BIOFUELS AND THE GLOBAL ENERGY SCENARIO

From the point of view of the United States, the sudden interest in this issue has as its background both the factor of national security and the strategic vision of the need to reduce the country's dependence on oil suppliers in regions of high political instability. In August 2005, President George W. Bush signed the Energy Policy Act establishing a target of renewable fuel consumption of 28.4b liters by 2012. Then, in his 2006 State of the Union speech, he set a national target to replace 75% of oil imports from the Middle East by 2025.

He then advocated the use of ethanol as one of the keys to achieve this target. Also in 2006, the Governor of the State of Florida, Jeb Bush, together with Brazil, promoted the creation of the Interamerican Ethanol Commission as a forum for cooperation on the subject with a view to developing a hemispheric biofuels market. The Commission has the backing of the Inter-American Development Bank (IDB) whose president, Ambassador Luis Moreno, is a board member in the Commission.

Furthermore, the surprising boost to the development of this clean energy source is being accompanied by copious investment that developing countries with comparative advantages in this industry will try to attract in ever more competitive ways. It is estimated that US$100b will be invested in clean energy by 2010, as against US$38b in 2005 and just over US$5b a decade ago. Of a sample of 50 countries surveyed by a study specially commissioned by the IDB to analyze the current situation and the prospects for biofuels, 27 have already passed or are considering passing rules that stipulate mixing fossil fuels with biofuels, and 40 of these countries already have some type of legislation in place that promotes biofuels.

A conservative estimate of biofuels' share in global energy consumption for transport in 2020 is 5%, from its 1% today. Meeting such growing demand would also entail quintupling world biofuel production and an investment of over US$200b over the next 14 years just to expand installed capacity.

But, these scenarios apart, there is the world energy situation. An increase in energy consumption of around 30% is expected by 2020, in a context of the sustained exhaustion of fossil fuels, geopolitical instability, and uncertainty of supply, as well as pollution and increasingly obvious problems relating to climate change. All these factors point to this being the right moment for the world, having embarked on the search for alternative sources of clean energy, to turn its attention to initiatives such as the one being implemented by Brazil. Especially when studies indicate that fuel consumption in the transport sector contributes most heavily to carbon dioxide emissions and the greenhouse effect, at the precise moment that emerging economic giants like China and India are already witnessing an explosion in vehicular growth.

Broadening the horizons: biofuels on Brazil's bilateral agenda with the European Union

The American President's visit and the agreements signed on that occasion apart, the Brazilian government is placing special emphasis on an issue over which the country is preparing to make one of its main political and economic wagers for the coming decades. Some analysts have already used the metaphor "ethanol diplomacy" to describe this strategy.

Accordingly, President Lula da Silva has been particularly active over the past year, giving the issue of biofuels a privileged place on his bilateral agenda with many countries. This issue not only ties in with strategic and environmental questions, but also with such questions as the promotion of trade interests, the development of direct investments in Brazil and overseas, the establishment of technological cooperation channels, and the creation of binational companies, and even with the search for a more meaningful position in international organizations.

In the case of the EU, in the framework of the strategic association agreement signed at the bilateral summit in early July 2007 in Lisbon and the World Biofuels Forum held subsequently in Brussels, the Brazilian government and the EU committed to strengthening cooperation over renewable energy and to working together to promote the development of biofuels and to create a world market for these products. This issue takes on particular importance if it is remembered that the EU is the largest potential market for this type of product, not only due to its geography and agricultural capacity, but also to its formally stated commitment to replace 10% of gasoline and diesel consumption with biofuels by 2020.

E. Final considerations

For some years, the bloc's external negotiations agenda has been characterized by a relatively high degree of activism in terms of the number of initiatives and negotiations tabled, which is in sharp contrast to the real quality and effectiveness of the agreements finally reached and/or implemented.

In this context, faced with the absence of any significant results, it is logical and reasonable that differences, both between partners and within countries, over the courses of action to be taken in this area have been widening. And in a environment where the claims by the smaller countries in the bloc over the distribution of the benefits of integration have occupied an increasingly important place on the MERCOSUR agenda, it comes as no surprise that talks over the bloc's negotiating strategy and the different partners' room for maneuver in external relations should also be part of these debates. The issues of the bloc's internal and external agendas are thus increasingly tightly intertwined.

These questions take on even greater relevance when linked to the negotiations designed to open the door for new countries to join MERCOSUR, a process that, as mentioned in Chapter III, has encountered technical difficulties over its implementation and requires greater effort in coordinating trade policies with third parties.

Thus, making concrete progress in some external negotiation processes -thus providing effective responses to sectors in different countries that are calling for a more proactive international policy of integration in the world economy- and finding positive outcomes to the challenges raised for the agenda by the entry of the two new partners, Venezuela and Bolivia, are two issues of fundamental importance for the future and the sustainability of MERCOSUR as it looks to the year ahead.

Contents

BIBLIOGRAPHY

BIBLIOGRAPHICAL SOURCES

BOUZAS, ROBERTO. *MERCOSUR: instituciones, asimetrías e integración profunda*. Mimeo. Buenos Aires. 2006.

BRADESCO. *Informe semanal de investimentos setoriais anunciados*. São Paulo: Economic Research and Study Department. 2007. *http://www.bradesco.com.br*.

CENTRAL BANK OF THE ARGENTINE REPUBLIC (BCRA). *Informe de inflación.* Various issues. Buenos Aires: BCRA. 2007. *http://www.bcra.gov.ar.*

CENTRAL BANK OF BRAZIL (BACEN). *Relatório de inflação.* Various issues. Brasilia: BACEN. 2007. *http://www.bacen.gov.br.*

CENTRAL BANK OF PARAGUAY (BCP). *Informe económico.* Various issues. Asunción: BCP. 2007a. *http://www.bcp.gov.py.*

__________. *Informe de inflación.* Various issues. Asunción: BCP. 2007b. *http://www.bcp.gov.py.*

CENTRAL BANK OF URUGUAY (BCU). *Comité de coordinación macroeconómica.* Various issues. Montevideo: BCU. 2007a. *http://www.bcu.gub.uy.*

__________. *Informe de política monetaria.* Various issues. Montevideo: BCU. 2007b. *http://www.bcu.gub.uy.*

COORDINATION OF NATIONAL ACCOUNTS (CONAC). *Apresentação da nova série do sistema de contas nacionais, Referência 2000.* Brasilia: Brazilian Institute of Geography and Statistics (IBGE). 2007. *http://www.ibge.gov.br/home/estatistica/indicadores/pib/pdf/01_apresentacao.pdf.*

ECOLATINA. *Informe económico semanal.* Various issues. Buenos Aires. 2007.

ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN (ECLAC). *Balance preliminar de las economías de América Latina y el Caribe 2006.* Santiago de Chile: CEPAL. 2006. *http://www.cepal.org.*

__________. *Anuario estadístico de América Latina y el Caribe 2006.* Santiago de Chile: CEPAL. 2007a.

__________. *Estudio económico de América Latina y el Caribe 2007.* Santiago de Chile: CEPAL. 2007b.

FEDERATION OF INDUSTRIES OF SÃO PAULO STATE (FIESP). *Revista da industria.* Various issues. São Paulo: FIESP. 2007. *http://www.fiesp.com.br.*

FISCAL POLICY OFFICE. *Informe de coyuntura fiscal.* Various issues. Asunción: Ministerio de Hacienda. 2006 y 2007. *http://www.hacienda.gov.py.*

FOREIGN TRADE STUDY CENTER FOUNDATION (FUNCEX). *Boletim de comércio exterior*. Various issues. Rio de Janeiro: FUNCEX. 2007. *http://www.funcex.com.br.*

GARCÍA, MARCO AURELIO. *La opción de Brasil.* Buenos Aires*:* La Nación. April 13, 2007.

GUADAGNI, ALIETO ALDO. *La triple tenaza energética*. Special Economic Report 377. Buenos Aires: Econométrica. 2007. *http://www.econometrica.com.ar.*

INSTITUTE OF APPLIED ECONOMIC RESEARCH (IPEA). *Boletim de conjuntura.* Various issues. Brazil: 2007. *http://www.ipea.gov.br.*

INSTITUTE FOR THE INTEGRATION OF LATIN AMERICA AND THE CARIBBEAN (INTAL). *MERCOSUR Reports 9, 10 and 11.* Subregional Integration Reports Series. Buenos Aires: IDB-INTAL. 2002, 2005 & 2006. *http://www.iadb.org/intal*.

INSTITUTE FOR INTERNATIONAL TRADE NEGOTIATIONS (ICONE). *EU and US Policies on Biofuels: Potential Impacts on Developing Countries*. 2007. *http://www.iconebrasil.com.br.*

INTER-AMERICAN DEVELOPMENT BANK (IDB). *A Blueprint for Green Energy in the Americas.* Washington DC: IDB. 2007. *http://www.iadb.org/biofuels/.*

INTERNATIONAL COURT OF JUSTICE (ICJ). *Case Concerning Pulp Mills on the River Uruguay (Argentina v. Uruguay). Request for the Indication of Provisional Measures.* ICJ. January 2007. *http://www.icj-cij.org.*

INTERNATIONAL MONETARY FUND (IMF). *World Economic Outlook: Spillovers and Cycles in the Global Economy.* Washington DC: IMF. 2007a. *http://www.imf.org.*

__________. *World Economic Outlook: Globalization and Inequality, October.* Washington DC: IMF. 2007b.

KLEIN, LAWRENCE & WENDY MAK. *Current Quarter Model of the Chinese Economy. Bi-Weekly Update on Chinese Economy.* University of Pennsylvania. September 14, 2007. *http://www.chass.utoronto.ca.*

MERCOSUR ABC. *Economía y comercio exterior.* Various issues. Buenos Aires. 2007.

NATIONAL CONFEDERATION OF INDUSTRY (CNI). *Informe conjuntural. Melhor cénario em 2007 não deve beneficiar toda a indústria.* Year 23, Issue 1 (January-March 2007). Brasilia: CNI. 2007a.

__________. *Superávit na balança comercial e juros altos sustentam valorização do real.* Brasilia: CNI - Unidade de Política Econômica. 2007b.

__________. *Comércio exterior em perspectiva.* Various Issues. Brasilia: CNI. 2007c.

NOGUEIRA, UZIEL. *Crisis financiera, Ronda Doha y MERCOSUR. Escenario hacia 2008.* Buenos Aires: MERCOSURABC. September 20, 2007. *The financial crisis, WTO and MERCOSUR,* in INTAL Monthly Newsletter 133. Buenos Aires: IDB-INTAL. August 2007.

PEÑA, FÉLIX. *Newsletter de negociaciones comerciales internacionales*. Various issues. *http://www.felixpena.com.ar.*

POOLE, PHILIP. *The Impossible Trinity.* HSBC Global Research. June, 2007.

PORTA, FERNANDO. *La internacionalización de las empresas brasileñas en Argentina.* Mimeo. July 2007.

RAMOS, M. ALBERTO. *Latin America: More Than Just a Commodity Play.* Global Economics Paper 157. Goldman Sachs. 2007.

STUDY CENTER OF THE ARGENTINE INDUSTRIAL UNION (CEU-UIA). *Informe de comercio exterior argentino Nº 6.* Buenos Aires: UIA. 2007. *http://www.uia.org.ar.*

TALVI, ERNESTO. *Beyond Perceptions: Macroeconomics in LAC.* Paper presented at the 25th Meeting of the Latin American Network of Central Banks and Economy Ministries. Washington DC: IDB. May 2007.

UNITED NATIONS CONFERENCE ON TRADE & DEVELOPMENT (UNCTAD). *World Investment Report 2007. Transnational Corporations, Extractive Industries and Development.* UNCTAD. 2007.

WEB SITES

• Andean Community of Nations (CAN)	*http://www.comunidadandina.org*
• The Boston Globe	*http://www.boston.com*
• Cairns Group	*http://www.cairnsgroup.org*
• *Clarín* Newspaper, Argentina	*http://www.clarin.com*
• *El Cronista* Newspaper, Argentina	*http://www.cronista.com*
• G8 Summit 2006	*http://en.g8russia.ru*
• *Gazeta Mercantil* Newspaper, Brazil	*http://www.gazetamercantil.com.br*
• *Infobae* newspaper, Argentina	*http://www.infobae.com.ar*
• International Centre for Trade and Sustainable Development	*http://www.ictsd.org*
• International Trade Administration	*http://www.trade.gov*
• MERCOSUR, official site	*http://www.mercosur.int*
• Ministry of External Relations, International Trade, and Worship, Argentine Republic	*http://www.cancilleria.gov.ar*
• Ministry of External Relations, Brazil	*http://www.mre.gov.br*
• Ministry of External Relations, Uruguayan Republic	*http://www.mrree.gub.uy*
• *La Nación* Newspaper, Argentina	*http://www.lanacion.com.ar*

- *El País* Newspaper, Uruguay *http://www.elpais.com.uy*
- *Prensa Económica* Magazine, Argentina *http://www.prensaeconomica.com.ar*
- President's Office of the United States Government *http://www.whitehouse.gov*
- President's Office of the Uruguayan Government *http://www.presidencia.gub.uy*
- *La República* Newspaper, Uruguay *http://www.larepublica.com.uy*
- SICE-Foreign Trade Information System *http://www.sice.oas.org*
- *Valor Económico* Newspaper, Brazil *http://www.valoronline.com.br*
- World Trade Organization (WTO) *http://www.wto.org*

INTAL PUBLICATIONS

Regular Publications

Integration & Trade. Two journal issues (English and Spanish) by subscription or individual issue purchase.

INTAL Monthly Newsletter (English, Portuguese and Spanish - Internet).

Sub-regional Integration Reports

Andean Report. Annual publication (Spanish). English version: Internet.

CARICOM Report. Annual publication (English).

Central American Report. Annual publication (Spanish). English version: Internet.

MERCOSUR Report. Annual publication (English, Portuguese and Spanish).

Special Reports

Desarrollo rural y comercio agropecuario en América Latina y el Caribe (Spanish, only in PDF format). Paolo Giordano, César Falconi and José María Sumpsi (Comp.) INTAL-INT Series. 2007.

Raúl Prebisch: Power, Principle and the Ethics of Development (English and Spanish). Essays in Honor of David Pollock Marking the Centennial Celebrations of the Birth of Raúl Prebisch. INTAL-ITD Serie 2006.

China y América Latina: nuevos enfoques sobre cooperación y desarrollo. ¿Una segunda ruta de la seda? (Spanish). Sergio Cesarin and Carlos Juan Moneta (Comp). Serie INTAL-ITD 2005.

Solución de Controversias Comerciales e Inter-Gubernamentales: Enfoques Regionales y Multilaterales (Spanish). Julio Lacarte and Jaime Granados. INTAL-ITD Serie. 2004.

Tributación en el MERCOSUR: Evolución, comparación y posibilidades de coordinación (Spanish). Alberto Barreix and Luiz Villela. 2003.

MERCOSUR: Impacto Fiscal de la Integración Económica (Spanish and Portuguese). Luiz Villela, Alberto Barreix and Juan José Taccone (eds.). 2003.

Perspectivas y Desafíos del Proceso de Integración Argentino-Chileno a Diez Años del ACE 16 (Spanish). 2002.

América Latina a principios del Siglo XXI: Integración, Identidad y Globalización. Actitudes y expectativas de las elites latinoamericanas (Spanish, only in PDF format).

INTAL: 35 años de Compromiso con la Integración Regional (Spanish).

Impacto del TLCAN en las exportaciones de prendas de vestir de los países de América Central y República Dominicana (Spanish, only in PDF format)

El impacto sectorial de la integración en el MERCOSUR (Spanish and Portuguese). Juan José Taccone and Luis Jorge Garay (Eds.) 1999.

Integración en el Sector Transporte en el Cono Sur (Spanish):

Transporte Terrestre. José Alex Sant'Anna. 1997.

Puertos y vías navegables. Martín Sgut. 1997.

Los ferrocarriles y su contribución al comercio internacional. Ian Thomson. 1997.

Integración energética en el Cono Sur (Spanish). Mario A. Wiegers. 1996.

Working Papers

Las relaciones de comercio e inversión entre Colombia y Venezuela (Spanish). Eglé Iturbe de Blanco. INTAL DT-03. 1997.

MERCOSUL e Comércio Agropecuario (Portuguese). Ives Chaloult and Guillermo Hillcoat. INTAL DT-02. 1997.

The Integration Movement in the Caribbean at Crossroads: Towards a New Approach of Integration (English). Uziel Nogueira. INTAL WP-01. 1997.

Dissemination Papers

El Tratado de Libre Comercio entre el Istmo Centroamericano y los Estados Unidos de América. Oportunidades, desafíos y riesgos (Spanish). Eduardo Lizano and Anabel González. INTAL DD-09. 2003.

Los países pequeños: Su rol en los procesos de integración (Spanish). Lincoln Bizzozero - Sergio Abreu. INTAL DD-08. 2000.

Capital social y cultura. Claves olvidadas del desarrollo (Spanish). Bernardo Kliksberg. INTAL DD-07. 2000.

La dimensión cultural: base para el desarrollo de América Latina y el Caribe: desde la solidaridad hacia la integración (Spanish) Alejandra Radl. INTAL DD-06. 2000.

Cómo expandir las exportaciones de los países dentro de una economía globalizada (Spanish). Rubens Lopes Braga. INTAL DD-05. 1999.

Comercio Electrónico: conceptos y reflexiones básicas (Spanish). Gerardo Gariboldi. INTAL DD-04. 1999.

Evolución institucional y jurídica del MERCOSUR (Spanish). Vicente Garnelo. INTAL DD-03. 1998.

Estado de evolución en la elaboración e implementación de las Normas ISO 14.000 y CODEX Alimentarius (Spanish). Laura Berón. INTAL DD-02. 1997.

Integración y democracia en América Latina y el Caribe (Spanish). Alvaro Tirado Mejía. INTAL DD-01. 1997.

Databases - Software

DATAINTAL (CD-ROM) Sistema de estadísticas de comercio de América.

Base INTAL MERCOSUR (BIM).

Base de datos bibliográficos (INTEG).

Directorio de las Relaciones Económicas de América Latina y el Caribe con Asia-Pacífico (CD-ROM).

Instrumentos básicos de integración económica en América Latina y el Caribe.

Rueda de Negocios.

Red INT SERIES

The Integration Research Centers Network (RedINT)

Second Call:

Visión microeconómica de los impactos de la integración regional en las inversiones inter e intrarregionales: El caso de la CAN (only in Spanish- Short and Full version). 2003.

Integración regional e Inversión Extranjera Directa: El caso del MERCOSUR (only in Spanish- Short and Full version). 2002.

Condiciones y efectos de la IED y del proceso de integración regional en México durante los años noventa: Una perspectiva macroeconómica (only in Spanish) (short version). 2003.

First Call:

El impacto sectorial del proceso de integración subregional en la Comunidad Andina: sector lácteo y sector textil (only in Spanish). 2000.

El impacto sectorial del proceso de integración subregional en Centroamérica: sector lácteo y sector metalmecánico (aparatos eléctricos) (only in Spanish). 2000.

El impacto sectorial del proceso de integración subregional en el MERCOSUR: sector calzado y sector farmacéutico (only in Spanish). 2000.

La industria láctea de México en el contexto del Tratado de Libre Comercio de América del Norte (TLCAN) (only in Spanish). 2000.

Contents

INTAL/INT PUBLICATIONS

Working Papers - Special Initiative on Trade and Integration (SITI)

The FTAA and the Political Economy of Protection in Brazil and the US (English, only in PDF format). Marcelo de Paiva Abreu. INTAL-ITD WP-SITI-12. 2006.

Which "industrial policies" are meaningful for Latin America? (English, only in PDF format). Marcelo de Paiva Abreu. INTAL-ITD WP-SITI-11. 2006.

Building Regional Infrastructure in Latin America (English). Vito Tanzi. INTAL-ITD WP-SITI-10. 2005.

The European Window: Challenges in the Negotiation of Mexico's Free Trade Agreement with the European Union (English and Spanish). Jaime Zabludovsky and Sergio Gómez Lora. INTAL-ITD WP-SITI-09. 2005.

Trade Liberalization and the Political Economy of Protection in Brazil since 1987 (English). Marcelo de Paiva Abreu. INTAL-ITD WP-SITI-08b. 2004.

The Political Economy of High Protection in Brazil before 1987 (English). Marcelo de Paiva Abreu. INTAL-ITD WP-SITI-08a. 2004.

The Food Industry in Brazil and the United States: The Effects of the FTAA on Trade and Investment (English). Paulo F. Azevedo, Fabio R. Chaddad and Elizabeth M.M.Q. Farina. INTAL-ITD WP-SITI-07. 2004.

MERCOSUR: IN SEARCH OF A NEW AGENDA. MERCOSUR´s Institutionalization Agenda: The Challenges of a Project in Crisis (English and Spanish). Pedro da Motta Veiga. INTAL-ITD WP-SITI-06e. 2003.

MERCOSUR: IN SEARCH OF A NEW AGENDA. Exchange Rate Instability in MERCOSUR: Causes, Problems and Possible Solutions (English and Spanish). José Luis Machinea. INTAL-ITD WP-SITI-06d. 2003.

MERCOSUR: IN SEARCH OF A NEW AGENDA. MERCOSUR: Dillemas and Alternatives for the Trade Agenda (English and Spanish). Sandra Polónia Rios. INTAL-ITD WP-SITI-06c. 2003.

MERCOSUR: IN SEARCH OF A NEW AGENDA. MERCOSUR´s Insertion into a Globalized World (English and Spanish). Juan Ignacio García Pelufo. INTAL-ITD WP-SITI-06b. 2003.

MERCOSUR: IN SEARCH OF A NEW AGENDA. Rapporteur's Report (English and Spanish). Andrew Crawley. INTAL-ITD WP-SITI-06a. 2004.

Estudio sobre las condiciones y posibilidades políticas de la integración hemisférica (Spanish). Adalberto Rodríguez Giavarini. INTAL-ITD DT-IECI-05. 2003.

The Impacts of US Agricultural and Trade Policy on Trade Liberalization and Integration via a US-Central American Free Trade Agreement (English). Dale Hathaway. INTAL-ITD WP-SITI-04. 2003.

Agricultural Liberalization in Multilateral and Regional Trade Negotiations (English). Marcos Sawaya Jank, Ian Fuchsloch and Géraldine Kutas. INTAL-ITD-STA WP-SITI-03. 2003.

Reciprocity in the FTAA: The Roles of Market Access, Institutions and Negotiating Capacity (English). Julio J. Nogués. INTAL-ITD-STA WP-SITI-02. 2003.

Free Trade Area of the Americas: The Scope of the Negotiations (English and Spanish). Herminio Blanco M. and Jaime Zabludovsky K. INTAL-ITD-STA WP-SITI-01. 2003.

Working Papers

Integration Options for MERCOSUR: A Quantitative Analysis by the AMIDA Model (English, only in PDF format). *Renato G. Flôres Jr. and Masakazy Watanuki*. INTAL-INT WP-36. 2007.

Nicaragua: inserción internacional en beneficio de la mayoría (Spanish, only in PDF format). *Ziga Vodusek, Erick Zeballos, Jaime Granados and Alberto Barreix*. INTAL-INT DT-35. 2007.

Convergence in the Rules of Origin Spaghetti Bowl: A Methodological Proposal (English and Spanish, only in PDF format). Rafael Cornejo and Jeremy Harris. INTAL-INT WP-34. 2007.

Fiscal Policy and Equity. Estimation of the Progressivity and Redistribute Capacity of Taxes and Social Public Expenditure in the Andean Countries (English, only in PDF format). Alberto Barreix, Jerónimo Roca and Luiz Villela. INTAL-ITD WP-33. 2007.

Costa Rica: ante un Nuevo Escenario en el Comercio Internacional (Spanish, only in PDF format). Jaime Granados, Ziga Voduzek, Alberto Barreix, José Ernesto López Córdova and Christian Volpe. INTAL-ITD DT-32. 2007.

Honduras: Desafíos de la Inserción en la Economía Internacional (Spanish, only in PDF format). Jaime Granados, Paolo Giordano, José Ernesto López Córdova, Ziga Voduzek and Alberto Barreix. INTAL-ITD DT-31. 2007.

Trade Costs and the Economic Fundamentals of the Initiative for Integration of Regional Infrastructure in South America (IIRSA) (English, only in PDF format). Mauricio Mesquita Moreira. INTAL-ITD WP-30. 2007.

Regional Integration. What is in it for CARICOM? (English, only in PDF format). Mauricio Mesquita Moreira and Eduardo Mendoza. INTAL-ITD WP-29. 2007.

Emigration, Remittances and Labor Force Participation in Mexico (English, only in PDF format). Gordon H. Hanson. INTAL-ITD WP-28. 2007.

La Cooperación al Desarrollo como Instrumento de la Política Comercial de la Unión Europea. Aplicaciones al Caso de América Latina (Spanish, only in PDF format). Antonio Bonet Madurga. INTAL-ITD DT-27. 2007.

Mexican Microenterprise Investment and Employment: The Role of Remittances (English, only in PDF format). Christopher Woodruff. INTAL-ITD WP-26. 2007.

Remittances and Healthcare Expenditure Patterns of Populations in Origin Communities: Evidence from Mexico (English, only in PDF format). Catalina Amuedo-Dorantes, Tania Sainz and Susan Pozo. INTAL-ITD WP-25. 2007.

Leveraging Efforts on Remittances and Financial Intermediation (English, only in PDF format). Manuel Orozco and Rachel Fedewa. INTAL-ITD WP-24. 2006.

Migration and Education Inequality in Rural Mexico (English, only in PDF format). David McKenzie and Hillel Rapoport. INTAL-ITD WP-23. 2006.

How Equation Chapter 1 Section 1Do Rules of Origin Affect Investment Flows? Some Hypotheses and the Case of Mexico (English, only in PDF format). Antoni Estevadeordal, José Ernesto López-Córdova and Kati Suominen. INTAL-ITD WP-22. 2006.

Chile's Integration Strategy: Is There Room for Improvement? (English, only in PDF format) Mauricio Mesquita Moreira and Juan Blyde. INTAL-ITD WP-21. 2006.

Globalization, Migration and Development: The Role of Mexican Migrant Remittances (English, only in PDF format) Ernesto López-Córdova. INTAL-ITD WP-20. 2006.

El desafío fiscal del MERCOSUR (Spanish). Luiz Villela, Jerónimo Roca and Alberto Barreix. INTAL-ITD DT-19. 2005.

Improving the Access of MERCOSUR´s Agriculture Exports to US: Lessons from NAFTA (English). Pablo Sanguinetti and Eduardo Bianchi. INTAL-ITD WP-18. 2004.

Premio INTAL - Segundo Concurso de Ensayos. La coordinación macroeconómica y la cooperación monetaria, sus costos, beneficios y aplicabilidad en acuerdos regionales de integración (Spanish, English and Portuguese). Mauricio de la Cuba; Diego Winkelried; Igor Barenboim; Louis Bertone; Alejandro Jacobo and James Loveday Laghi. INTAL-ITD DT-17. 2004.

Agricultural Exporters in a Protectionist World: Review and Policy Implications of Barriers Against Mercosur (English and Spanish). Julio J. Nogués. INTAL-ITD WP-16. 2004.

Rules of Origin in FTAs in Europe and in the Americas: Issues and Implications for the EU-Mercosur Inter-Regional Association Agreement (English). Antoni Estevadeordal and Kati Suominen. INTAL-ITD WP-15. 2004.

Regional Integration and Productivity: The Experiences of Brazil and Mexico (English). Ernesto López-Córdova and Mauricio Mesquita Moreira. INTAL-ITD-STA WP-14. 2003.

Regional Banks and Regionalism: A New Frontier for Development Financing (English). Robert Devlin and Lucio Castro. INTAL-ITD-STA WP-13. 2002.

Métodos casuísticos de evaluación de impacto para negociaciones comerciales internacionales (Spanish). Antonio Bonet Madurga. INTAL-ITD-STA DT-12. 2002.

Las trabas no arancelarias en el comercio bilateral agroalimentario entre Venezuela y Colombia (Spanish). Alejandro Gutiérrez S. INTAL-ITD-STA DT-11. 2002.

The Outlier Sectors: Areas of Non-Free Trade in the North American Free Trade Agreement (English). Eric Miller. INTAL-ITD-STA WP-10. 2002.

A ALCA no limiar do século XXI: Brasil e EUA na negociação comercial hemisférica (Portuguese). Antonio José Ferreira Simões. INTAL-ITD-STA DT-09. 2002.

Metodología para el análisis de regímenes de origen. Aplicación en el caso de las Américas (Spanish). Luis J. Garay S. and Rafael Cornejo. INTAL-ITD-STA DT-08. 2001.

¿Qué hay de nuevo en el Nuevo Regionalismo de las Américas? (Spanish). Robert Devlin and Antoni Estevadeordal. INTAL-ITD-STA DT-07. 2001.

What's New in the New Regionalism in the Americas? (English and Spanish). Robert Devlin and Antoni Estevadeordal. INTAL-ITD-STA WP-06. 2001.

The New Regionalism in the Americas: The Case of MERCOSUR (English). Antoni Estevadeordal, Junichi Goto and Raúl Saez. INTAL-ITD WP-05. 2000.

El ALCA y la OMC: Especulaciones en torno a su interacción (Spanish). Jaime Granados. INTAL-ITD DT-04. 1999.

Negotiating Preferential Market Access: The Case of NAFTA (English). Antoni Estevadeordal. INTAL-ITD WP-03. 1999.

Towards an Evaluation of Regional Integration in Latin America in the 1990s (English). Robert Devlin and Ricardo Ffrench-Davis. INTAL-ITD WP-02. 1998.

Una evaluación de la homogeneidad macroeconómica y del desarrollo de la región centroamericana (Spanish). Florencio Ballestero. INTAL-ITD DT-01. 1998.

Occasional Papers - Special Initiative on Trade and Integration (SITI)

International Arbitration Claims against Domestic Tax Measures Deemed Expropriatory or Unfair and the Inequitable (English, only in PDF format). Adrián Rodríguez. INTAL-ITD OP-SITI-11. 2006.

The Entrance to the European Union of 10 New Countries: Consequences for the Relations with MERCOSUR (English). Renato G. Flôres Jr. INTAL-ITD OP-SITI-10. 2005.

Principales retos de la negociación de un tratado de libre comercio con Estados Unidos: disciplinas en materia de inversión (Spanish). Jaime Zabludovsky and Sergio Gómez Lora. INTAL-ITD DD-IECI-09. 2005.

The Production and Financing of Regional Public Goods (English). Vito Tanzi. INTAL-ITD OP-SITI-08. 2005.

The Harmonization of Indirect Taxes in the Andean Community (English and Spanish). Luis A. Arias, Alberto Barreix, Alexis Valencia and Luiz Villela. INTAL-ITD OP-SITI-07. 2005.

Globalization and the Need for Fiscal Reform in Developing Countries (English and Spanish). Vito Tanzi. INTAL-ITD OP-SITI-06. 2004.

Latin American Industrial Competitiveness and the Challenge of Globalization (English and Spanish). Sanjaya Lall, Manuel Albaladejo and Mauricio Mesquita Moreira. INTAL-ITD OP-SITI-05. 2004.

El nuevo interregionalismo trasatlántico: La asociación estratégica Unión Europea-América Latina (Spanish). Luis Xavier Grisanti. INTAL-ITD/SOE IECI-DD-04. 2004.

A Key to Hemispheric Integration (English and Spanish). Herminio Blanco M., Jaime Zabludovsky K. and Sergio Gómez Lora. INTAL-ITD OP-SITI-03. 2004.

A New Approach to Trade Development in Latin America (English and Spanish). Martín Redrado and Hernán Lacunza. INTAL-ITD OP-SITI-02. 2004.

La coordinación y negociación conjunta de los países de la Comunidad Andina en el marco del ALCA y la OMC (Spanish). Victor Rico. INTAL-ITD DD-IECI-01. 2004.

Occasional Papers

Agriculture in Brazil and China: Challenges and Opportunities (English, only in PDF format) Mario Queiroz de Monteiro Jales, Marcos Sawaya Jank, Shunli Yao and Colin A. Carter. INTAL-ITD OP-44. 2006.

Apertura e inserción internacional en la estrategia de desarrollo de Uruguay (Spanish, only in PDF format) Paolo Giordano and Fernando Quevedo. INTAL-ITD DD-43. 2006.

El proceso de negociación de un tratado de libre comercio con Estados Unidos: la experiencia del Tratado de Libre Comercio entre Centroamérica, Estados Unidos y República Dominicana (Spanish, only in PDF format) Anabel González. INTAL-ITD DD-42. 2006.

International Remittances and Development: Existing Evidence, Policies and Recommendations (English, only in PDF format). Ernesto López-Córdova and Alexandra Olmedo. INTAL-ITD OP-41. 2006.

Comercio bilateral Argentina-Brasil: Hechos estilizados de la evolución reciente (Spanish, only in PDF format). Ricardo Carciofi and Romina Gayá. INTAL-ITD DD-40. 2006.

The Relative Revealed Competitiveness of China's Exports to the United States vis á vis other Countries in Asia, the Caribbean, Latin America and the OECD (English, only in PDF format). Peter K. Schott. INTAL-ITD OP-39. 2006.

Achievements, Prospects and Challenges of Hemispheric Cooperation (English and Spanish, only in PDF format). Roberto Iannelli. INTAL-ITD OP-38. 2006.

Libre Comercio en América Central: ¿Con quién y para qué? Las implicancias de CAFTA (Spanish, only in PDF format). Manuel Agosín and Ennio Rodríguez. INTAL-ITD DD-37. 2006.

Fear of China: Is there a Future for Manufacturing in Latin America? (English, only in PDF format). Mauricio Mesquita Moreira. INTAL-ITD OP-36. 2006.

The Role of Geography and Size (English, only in PDF format). David Hummels. INTAL-ITD OP-35. 2006.

Assessing the Impacts of Intellectual Property Rights on Trade Flows in Latin America (English, only in PDF format). Juan S. Blyde. INTAL-ITD OP-34. 2006.

Recientes innovaciones en los regímenes de origen y su incidencia en el proceso de verificación: el caso del CAFTA (Spanish) Rafael Cornejo. INTAL-ITD DD-33. 2005.

Achievements and Challenges of Trade Capacity Building: A Practitioner's Analysis of the CAFTA Process and its Lessons for the Multilateral System (English) Eric T. Miller. INTAL-ITD OP-32. 2005.

Una aproximación a desarrollo institucional del MERCOSUR: sus fortalezas y debilidades (Spanish). Celina Pena and Ricardo Rozemberg. INTAL-ITD DD-31. 2005.

Jamaica: Trade, Integration and the Quest for Growth (English). Anneke Jessen and Christopher Vignoles. INTAL-ITD OP-30. 2005.

Trade Related Capacity Building: An Overview in the Context of Latin American Trade Policy and the MERCOSUR-EU Association Agreement (English). Robert Devlin and Ziga Vodusek. Intal-itd op-29. 2005.

Barbados: Trade and Integration as a Strategy for Growth (English). Anneke Jessen and Christopher Vignoles. INTAL-ITD OP-28. 2004.

Mirando al MERCOSUR y al mundo: estrategia de comercio e integración para Paraguay (Spanish). Paolo Giordano. INTAL-ITD DD-27. 2004.

El tratamiento de las asimetrías en los acuerdos de integración regional (Spanish). Paolo Giordano, Mauricio Mesquita Moreira and Fernando Quevedo. INTAL-ITD DD-26. 2004.

Centroamérica: La programación regional (2001) y las actividades del Banco (2001-2003) (Spanish). Ennio Rodríguez. INTAL-ITD DD-25. 2004.

Brazil's Trade Liberalization and Growth: Has it Failed? (English). Mauricio Mesquita Moreira. INTAL-ITD OP-24. 2004.

Trinidad and Tobago: Trade Performance and Policy Issues in an Era of Growing Liberalization (English). Anneke Jessen and Christopher Vignoles. INTAL-ITD OP-23. 2004.

The Trade and Cooperation Nexus: How Does MERCOSUR-EU Process Measure Up? (English). Robert Devlin, Antoni Estevadeordal and Ekaterina Krivonos. INTAL-ITD-STA OP-22. 2003.

Desigualdad regional y gasto público en México (Spanish). Rafael Gamboa and Miguel Messmacher. INTAL-ITD-STA DD-21. 2003.

Export Processing Zones and Other Special Regimes in the Context of Multilateral and Regional Trade Negotiations (English and Spanish). Jaime Granados. INTAL-ITD-STA DD-20. 2003.

The External Dimension of MERCOSUR: Prospects for North-South Integration with the European Union (English). Paolo Giordano. INTAL-ITD-STA OP-19. 2003.

Regional Aspects of Brazil's Trade Policy (English). Eduardo A. Haddad (coord.), Edson P. Domínguez and Fernando S. Perobelli. INTAL-ITD-STA OP-18. 2002.

El proceso de integración Argentina-Brasil en perspectiva: El ciclo cambiario y la relación público-privada en Argentina (Spanish). Ricardo Rozemberg and Gustavo Svarzman. INTAL-ITD-STA DD-17. 2002.

A Study on the Activities of IFIs in the Area of Export Credit Insurance and Export Finance (English). Malcom Stephens and Diana Smallridge. INTAL-ITD-STA OP-16. 2002.

Diseños institucionales y gestión de la política comercial exterior en América Latina (Spanish). Jacint Jordana and Carles Ramió. INTAL-ITD-STA DD-15. 2002.

Mercosul em sua primeira década (1991-2001): Uma avaliação política a partir do Brasil (Portuguese). Paulo Roberto de Almeida. INTAL-ITD-STA DD-14. 2002.

The Trade Policy-Making Process Level One of the Two Level Game: Country Studies in the Western Hemisphere (English and Spanish). INTAL-ITD-STA OP-13. 2002.

Search for a New Partnership in Trade and Investment between Latin America and Asia-Pacific (English). Mikio Kuwayama. INTAL-ITD-STA OP-12. 2001. (Spanish version: only in PDF format)

Regional Public Goods in Official Development Assistance (English). Marco Ferroni. INTAL-ITD-STA OP-11. 2001.

Breaking from Isolation: Suriname's Participation in Regional Integration Initiatives (English). Anneke Jessen and Andrew Katona. INTAL-ITD-STA OP-10. 2001.

NAFTA and the Mexican Economy: Analytical Issues and Lessons for the FTAA (English). J. Ernesto López-Córdova. INTAL-ITD-STA OP-09. 2001.

La integración comercial centroamericana: Un marco interpretativo y cursos de acción plausible (Spanish). Jaime Granados. INTAL-ITD DD-08. 2001.

Negotiating Market Access between the European Union and MERCOSUR: Issues and Prospects (English). Antoni Estevadeordal and Ekaterina Krivonos. INTAL-ITD OP-07. 2000.

The Free Trade Area of the Americas and MERCOSUR-European Union Free Trade Processes: Can they Learn from Each Other? (English). Robert Devlin. INTAL-ITD OP-06. 2000.

The FTAA: Some Longer Term Issues (English). Robert Devlin, Antoni Estevadeordal and Luis Jorge Garay. INTAL-ITD OP-05. 1999.

Financial Services in the Trading System: Progress and Prospects (English). Eric Miller. INTAL-ITD OP-04. 1999.

Government Procurement and Free Trade in the Americas (English). Jorge Claro de la Maza and Roberto Camblor. INTAL-ITD OP-03. 1999.

The Caribbean Community: Facing the Challenges of Regional and Global Integration (English). Anneke Jessen and Ennio Rodríguez. INTAL-ITD OP-02. 1999.

ALCA: Un proceso en marcha (Spanish). Nohra Rey de Marulanda. INTAL-ITD DD-01. 1998.

Contents

INTAL/INT/SOE PUBLICATIONS

Euro-Latin Study Network on Integration and Trade (ELSNIT)

Issues Papers. Third Annual Conference (English). INTAL-ITD-SOE. 2006.

Issues Papers. Second Annual Conference (English). INTAL-ITD-SOE. 2005.

Issues Papers. First Annual Conference (English). INTAL-ITD-SOE. 2004.

Contents

INT PUBLICATIONS

Working Papers

MERCOSUR: Achievements and Challenges. Carlos Sepúlveda and Arturo Vera Aguirre. Working Paper # 222. September 1997 (also available in Spanish).

Transport Infrastructure in Latin America. Arturo Vera Aguirre. Working Paper # 221. July 1997 (also available in Spanish).

Convergence and Divergence Between NAFTA, Chile, and MERCOSUR: Overcoming Dilemmas of North and South American Economic Integration. Raúl A. Hinojosa-Ojeda, Jeffrey D. Lewis and Sherman Robinson. Working Paper # 219. May 1997.

Towards Free Trade in the Western Hemisphere: The FTAA Process and the Technical Support of the Inter-American Development Bank. Enrique V. Iglesias. Working Paper # 217. July 1997 (also available in Spanish)

Economic Integration and Equal Distribution. Willem Molle. Working Paper # 216. May 1997.

What can European Experience Teach Latin America About Integration. L. Alan Winters. Working Paper # 215. May 1997.

Facts, Fallacies and Free Trade: A Note on Linking Trade Integration to Labor Standards. Donald J. Robbins. Working Paper # 214. May 1997.

From Miami to Cartagena: Nine Lessons and Nine Challenges of the FTAA. Robert Devlin and Luis Jorge Garay. Working Paper # 211. July 1996 (also available in Spanish).

Common Market of the Southern Cone: MERCOSUR. Martin Arocena. Working Paper # 204. September 1995 (also available in Spanish).

Special Publications

Periodic Note on Integration and Trade in the Americas (also available in Spanish and 1997 versions also in Portuguese).

The Euro and its Effect on the Economy and the Integration of Latin America and the Caribbean. Roberto Zahler. Paper presented at the Seminar "Euro and its International Impact" on occasion of the Annual Meetings of the Boards of Governors. France, March 16, 1999 (also available in Spanish).

Extract from the Bank's 1996 Report on Economic and Social Progress in Latin America, Part II, Chapter 2: Trade Liberalization, 1996 (also available in Spanish).

European Economic and Monetary Union: Recent Progress and Possible Implications for Latin America and the Caribbean. March 1997 (also available in Spanish).

Globalization and Regional Integration: Consequences for Latin America. Speech delivered by Enrique V. Iglesias at the Seminar on "A Critical View of Globality". Mexico City, November 1997 (also available in Spanish).

Protection, Preferential Tariff Elimination and Rules of Origin in the Americas - An Overview. Luis Jorge Garay and Antoni Estevadeordal. June 1995 (also available in Spanish).

The New Face of Regional Integration in Latin America and the Caribbean. Speech delivered by Enrique V. Iglesias at The Annual World Bank Conference on Development in Latin America and the Caribbean. Montevideo, July 1997 (also available in Spanish).

Free Trade Area of the Americas: From Miami to Belo Horizonte. Speech delivered by Enrique V. Iglesias at the III Business Forum of the Americas. Belo Horizonte, May 1997 (English, Portuguese and Spanish).

Transpacific Partnership: Latin America's Role. Speech delivered by Enrique V. Iglesias at the XII International General Meeting of the Pacific Economic Cooperation Council (PECC XII). Santiago, September, 1997 (also available in Spanish).