The XXVI MERCOSUR Summit
and the challenges to Latin American
and Caribbean integration

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This document, which has been prepared by the Permanent Secretariat of SELA, was foreseen as one of the expected results of the revised Work Program for 2004. It analyses some of the major conclusions reached at the recent MERCOSUR Summit of Heads of State and Government (Puerto de Iguazú, July 2004).

The first part of the paper analyses some of the background to this meeting and goes on to highlight the main agreements and decisions adopted at this meeting of presidents. This paper ends with a few observations relating to the “expansion” process that this integration block has experienced. With regard to this point, an analysis is made of several issues relating to the gradual linking between CAN and MERCOSUR. In its conclusions, the study addresses certain ideas surrounding the challenges to Latin American and Caribbean economic integration within the current global context.
I. INTRODUCTION

According to ECLAC\(^1\), the last quarter of the twentieth century has witnessed the consolidation of a third phase of internationalisation – currently known by the term "globalisation" – whose major characteristics are as follows:

- The gradual generalisation of free trade.
- The growing presence in the international arena of transnational companies working as integrated production systems.
- The expansion and considerable mobility of capital, and
- A remarkable trend toward the homogenisation of development models.

Unlike earlier historical periods, the current "wave of globalisation" has spread side by side with the persistence of severe restrictions to the movement of labour. This modern-day feature has important implications that largely explain the reason for the sharp increase in social heterogeneity worldwide\(^2\).

This global context has been at the root of the changes that have shaped economic integration processes in Latin America and the Caribbean (LAC). At the same time, it would seem that, more than ever before, globalisation is demanding a strengthening of the integration-related effort being carried out within LAC in order to overcome the challenges facing the development of the region and to change the fragile entry of our nations into the global economic system.

This paper summarizes the main results achieved at the recently concluded XXVI Meeting of the Common Market Council of MERCOSUR, which was held on 8 July 2004 in the Argentinian city of Puerto de Iguazú. It should be highlighted that, as part of the ongoing efforts to expand this South-American block, this very important meeting was attended not only by the Heads of State of the two countries with associate status in MERCOSUR (Chile and Bolivia), but also by the presidents of Venezuela and Mexico and by top-level representatives from Colombia and Peru.

The first part of this document offers a summary of certain factors that may serve as a background to facilitate an understanding of the relevance of the Puerto de Iguazú Summit. Immediately following this, an analysis is conducted of the major agreements and decisions adopted at this meeting and, subsequently, certain ideas surrounding the MERCOSUR "expansion" process are presented. The final part of this document will particularly address, on an analytical basis, a number of issues relating to the gradual linkage between CAN and MERCOSUR, which may eventually constitute the embryo of a future South American economic space.

\(^1\) ECLAC (2002). Globalisation and Development. LC/G.2157(SES.29/3), Santiago, Chile, 9 April.

\(^2\) The segmentation of labour mobility – as a result of the non-liberalisation of labour flows and the biased regulation of migration flows against unskilled labour – is broadening wage differences arising from levels of skill both in host and in home country.
II. REGIONAL ECONOMIC INTEGRATION PROCESSES AND THE DEVELOPMENT OF MERCOSUR

During the first half of the 1990s, the different subregional integration processes undertaken advanced at a rapid pace. With the joining of Paraguay and Uruguay in 1991, the 1986 bilateral agreement between Argentina and Brazil soon became the Treaty of Asunción, on the basis of which MERCOSUR was founded.

Similarly, near the end of 1989, the meeting of presidents of the Andean countries, which was held on the Galapagos Islands, helped to breathe fresh life into the Andean Pact which, years later, became the Andean Community of Nations (CAN). The Central American Common Market (CACM) and the Caribbean Community (CARICOM) went through similar processes.

In late 1994, MERCOSUR became a free trade area – albeit with some exceptions – and its member countries all pledged to establish a common external tariff (CET). In the first five years of the 1990s, the Andean countries were able to liberalize the essential items of their reciprocal trade, and, in the year 2002, a major step was taken within the group with the agreement on a CET for the community.

The negotiations that have been carried out since the mid-1990s with the purpose of enabling the CAN and MERCOSUR to converge toward a free trade area – and, perhaps, a South American common market – had been advancing at a sluggish pace, until a few years ago. The holding of the two summits of South American Heads of States and Government in 2000 and 2002 gave a political boost to this rapprochement between these two economic integration processes within the area.

Within the general framework of these trends, intra-regional trade underwent a recovery from the sharp deterioration experienced in the 1980s and rose to very high levels. However, the crisis that developed in late 1997 and continued through 1998, adversely affected joint trade relations, most notably in South America, where the growth in intra-zone commercial transactions was particularly rapid. Trade flows within the different integration schemes not only grew in a very dynamic fashion but also focused fundamentally on industrial goods, particularly on those with a higher technological content.

Meanwhile, the dynamism of trade flows and the development of new regulatory frameworks for foreign investment gave rise to a boom in intra-regional direct investment. While still modest in volume terms when compared with overall FDI flows toward the region, these flows are noteworthy because of certain attributes that make them particularly vital to the effective integration of the production and commercial machinery of LAC. This "intra-regional" investment process is part of a broader set of company responses in the face of the new context, that ranges from strategic alliances between companies located in different countries to industrial concentration processes in which a number of Latin American and Caribbean companies have played a significant role.

In this period, a “juxtaposition” has arisen between many integration-related commitments of most of the countries of the region. In addition to the North American Free Trade Agreement (NAFTA), other forums, such as the Association of Caribbean States and the Group of Three were created, and a growing number of free trade and economic cooperation agreements (bilateral, trilateral or bi-regional) between different countries or subregional systems went into effect. Indeed, it is estimated that there are currently over 40 preferential trade-related instruments in existence throughout the hemisphere. This
situation undoubtedly becomes more complex within the framework of the negotiations – now at a standstill – on the formation of the Free Trade Area the Americas (FTAA).

Although, there are those who now believe that the different spheres of external relations are, at least in theory, compatible and mutually complementary, such spheres may actually prove to be otherwise unless each country or subregional group adopts a whole set of coherent decisions offering clear definitions of desirable strategies.

- **MERCOSUR**

The Southern Cone Common Market (MERCOSUR), which was created by means of “Treaty of Asunción” of March 1991, consisted of Argentina, Brazil, Paraguay and Uruguay, its founders and full members. The explicit and overall objectives of this agreement were to promote the economic integration of its members and to achieve the formation of a common market to be set up by 31 December 1994.

According to the Treaty of Asunción, this Common Market would involve the following:

a) The free circulation of goods, services and production factors between the countries by, among other means, the elimination both of customs duties and non-tariff restrictions to the circulation of goods and of any other similar measure.

b) The establishment of a common external tariff and the adoption of a common trade policy with regard to third-party states or groupings of states and the coordination of positions in regional and international commercial economic forums.

c) The coordination of macroeconomic and sectoral policies among party states, and

d) The commitment of the party states of harmonizing their legislations in the relevant areas, with a view to strengthening the integration process.

Like all other integration institutions in Latin America and the Caribbean, MERCOSUR has faced serious challenges as a result of the economic imbalances that have been experienced by its members and that may, in part, be ascribed to the negative impact of an adverse international economic situation. Indeed, several deadlines that have been set to solidify the “progress made in actual economic integration” have been extended over time, and the economic ties between the member countries of the block have been adversely affected. Yet, in spite of these obstacles, the group has actually been able to maintain its cohesion, especially in the most trying times. The presidents of the four member countries, together with their associates (Chile and Bolivia up till late 2003), have systematically held meetings and, at each of these meetings, have reiterated their decision and determination to continue deepening the integration process.

This grouping – that may be considered “successful” in spite of its limitations and contradictions – faces inevitable challenges that may become increasingly complex as it pushes forward with its strategy of expanding “the scope of MERCOSUR.”

MERCOSUR has indeed progressed on key questions that have hampered the blossoming of integration in recent years, despite the aforementioned economic

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3 The MERCOSUR experience may be considered successful since MERCOSUR has been the subregional scheme exhibiting the highest growth in trade among its members in the last ten years and because its has stood out as a “unique” speaker for its member countries in practically all existing extra-regional trade negotiations.
difficulties experienced by its partners, the cyclical asynchronism among its members and the existing structural asymmetries that have been reflected in major trade-related frictions and disputes between its members. Further, the scope of the integration mission and its "flexible" organic structure have allowed MERCOSUR to extend the effects of its joint efforts to a large number of other spaces, including the social and political spheres that have traditionally failed to play any important role in economic integration experiences within the region.

III. MAIN DECISIONS ADOPTED AT THE IGUAZÚ SUMMIT

The most recent MERCOSUR presidential summit was, as is the custom, preceded by a two-day meeting (7 and 8 July 2004) of the Common Market Council (CMC). The CMC is the major organ responsible for political and decision-making activities within MERCOSUR. It is habitually assisted by the plenary meetings of the foreign and economy ministers of member countries who propose the decisions to be adopted and relevant actions to be taken by heads of state and government. During the inaugural address, the Argentine Minister of Foreign Affairs, Rafael Bielsa, asserted that the challenges facing the block involved "giving the integration scheme a broader institutional context, which would make it possible to consolidate the MERCOSUR process internally. This means resolving once and for all the internalisation of the norms set out within the sphere of MERCOSUR, defining common customs code, going ahead with the elimination of the double collection of the Common External Tariff (CET), ensuring the free circulation of products, enhancing macroeconomic coordination and striving to achieve tax harmonization".  

Only a few days prior to this meeting, trade-related tensions had begun to surface between the parties, a situation that generated growing concerns regarding the future of the commitments assumed when MERCOSUR was formed. Thus, the Argentine government was forced to impose tariff obstacles to household imports from Brazil, in view of the political pressure mounted by local producers vis-à-vis the stiff competition from their Brazilian counterparts. This "trade protection" measure also generated "inertias" with regard to the strategic yet complex automobile sector, a development which was interpreted as an attempt by Buenos Aires to renegotiate the trade liberalisation agreement governing both the automobile and textile industries.

Notwithstanding the afore-mentioned conflicting context, the meeting of the CMC – and the Puerto Iguazú Summit – may be described as highly positive. The main CMC-level agreements that have been signed by the Heads of State and included in the joint communiqué issued by the presidents of the party States of MERCOSUR include – among others – the following points:

1. The countries reiterated the need to perfect the instruments in place to ensure the free circulation of goods within MERCOSUR. In this regard, they acknowledged

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4 Taken from http://www.econosur.com/docoi/XXVIcumbmerc.htm.

5 In addition to these contradictions is the request by Paraguay that Brazil should remove certain tax barriers imposed on a number of imports coming from Paraguay. For its part, Argentina had been asking Uruguay to review its decision to prohibit Argentinean meat imports for health reasons. Finally, Uruguay was unable to reach an agreement with Peru concerning a list of products that would be subject to lower customs duties on the basis of negotiations carried out with a view to forging an eventual Free Trade Agreement between CAN and MERCOSUR.
the importance of the progress made in the design of mechanisms geared toward
the integration of production processes, which would lead to the gradual creation
and development of “value chains” at the entire subregion level.

2. The members were gratified at the implementation of the Olivos Protocol
concerning the resolution of disputes within MERCOSUR, which undoubtedly
represents a concrete step forward in regulatory and institutional terms.

3. The Heads of State acknowledged the convenience of identifying those points in
the Ouro Preto Protocol that might necessitate a revision of the protocol, in light of
the recent institutional progress made within MERCOSUR. In this sense – and in
a subsequent meeting held by the Presidents of Brazil and Argentina in New York,
within the framework of the Fifty-Ninth General Assembly of the UN in September
of 2004 - it was agreed that every effort should be made to promote an “Ouro
Preto II”, which would involve a political redefinition of the treaty responsible for
the institutional birth of MERCOSUR, in order to “advance toward the maturity of
the system”.

4. The preliminary draft of the protocol for the constitution of the MERCOSUR
Parliament was adopted.

5. The importance of moving forward on macroeconomic coordination among the
member countries was reiterated again, as this is undoubtedly an extremely
complex process and, at the same time, one of the major shortcomings of the
scheme.

6. Reference was made to the need for prompt ratification of the Montevideo
Protocol on Trade in Services and to the willingness to move forward on the
liberalization of trade in services.

7. The holding of the Fifth Meeting of the Administration Commission of the
Economic Complementation Agreement (ECA) No. 36 between MERCOSUR and
Bolivia was highlighted. The meeting made noticeable advances in granting
Bolivia additional preferential treatment for the entry of its products to the rest of
MERCOSUR.

8. Emphasis was placed on the importance of continuing to push ahead with regard
to consolidation of ECA No. 35 between MERCOSUR and Chile.

9. It was also reiterated that there was an urgent need to proceed to the prompt
protocalisation of the Free Trade Agreement between MERCOSUR and Peru, so
that the latter country’s status as an “associate member” may take effect.

10. Given that, for all practical purposes, the negotiations for a free trade agreement
between Venezuela and the MERCOSUR had ended, and considering that
Venezuela had formally requested admission as an “associate state”, the heads
of state welcomed Venezuela as the newest partner of MERCOSUR.

11. Mexico was also accepted as an associate state, a status that would later take
effect upon conclusion of the respective free trade agreement between Mexico
and MERCOSUR.

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6 Consequently, the corresponding court for the resolution of trade-related conflict between partners was
created and was scheduled to take effect from 15 August 2004.

7 On this occasion, the Brazilian foreign minister pointed out that the idea of an increased and more effective
institutionalisation of MERCOSUR would be discussed at the end of the current year at another meeting in
Ouro Preto, which would coincide with the tenth anniversary of the founding of MERCOSUR.

8 This association will also take effect when the respective agreement has been protocolised before ALADI.
In addition, it should be borne in mind that, within the context of this summit, the CMC adopted several decisions intended to strengthen MERCOSUR institutionally. CMC decision No. 01 / 04: “Regime of Origin of MERCOSUR” strengthens the norms of MERCOSUR concerning origin. CMC decision No. 02 / 04: “Integration of production processes in several party states of MERCOSUR with the use of non native materials”, entrusts the Trade Commission of MERCOSUR (TCM) with the design of a regime that favours the implementation of “value chains” within the region. Likewise, CMC decision No. 03 / 04 regulates the functioning of the Commission of Permanent Representatives of MERCOSUR and of its presidency. Finally, CMC decision No. 22 / 04 “Validity and Application of the Norms Emanating from the Organs with Decision-Making Capabilities of MERCOSUR”, establishes an effective, flexible mechanism for the application of the norms of MERCOSUR.

With regard to the deepening of trade liberalisation between the parties, it should also be stressed that the CMC took note of the preliminary work prepared by the MERCOSUR Secretariat, which outlines a number of scenarios for the elimination of the double collection of the CET and the distribution of customs duties. Based on the proposals made by party states of MERCOSUR with regard to the circulation of goods, the delegations also agreed on the need to continue working on this issue in order to make substantial progress on it before the holding of the twenty-seventh meeting of the CMC.

In general, most analysts have acknowledged that the two major achievements of the Puerto Iguazú Summit are the following:

a) Despite the conflicts and difficulties, the members of MERCOSUR pledged to deepen the integration process.

b) The trade block accomplished its expansion objective, a feat which allows it to increase its economic, trade and strategic leverage in the international arena.

Yet, in spite of all this, there seems to be some consensus that, internally, it is essential to continue strengthening and deepening the integration-related commitments assumed by MERCOSUR, a need that becomes more important with the gradual expansion of the block. Hence, the question as to whether MERCOSUR will be able to continue expanding while it strengthens internally encapsulates the fundamental challenge facing the block at the present time.

IV. THE “EXTERNAL” RELATIONS OF THE COUNTRIES OF MERCOSUR AND THEIR EFFORTS TO “EXPAND” THE BLOCK

Since the foundation of MERCOSUR, the four founding countries that enjoy “full membership” status within the scheme have demonstrated their interest in making the scheme open to other countries in the area. Indeed, the Treaty of Asunción specified that “(...) the present agreement will, through negotiation, be open to membership by the other member countries of the Latin American Integration Association – ALADI – whose

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9 The basic function of the Trade Commission of MERCOSUR (TCM) is to ensure the fulfilment of intra-MERCOSUR trade agreements and, in this regard, to assist the Common Market Group (CMG).
applications may be examined by the party States after this treaty \(^{10}\) has been in effect for five years.” This, together with the short-term successes achieved by MERCOSUR during the first stage of its existence (until around 1998) and the presence in the scheme of two of the three most important LAC economies, gave the block a “major appeal” from its very beginning.

In light of the above, it came as no surprise that Chile decided in 1996 \(^{11}\) to join as an “associate member” of the block. This was also very significant, given the highly flexible and pragmatic “trade policy” of this country which espouses particular views about “open regionalism”. Later on, in 1997 \(^{12}\), Bolivia – a full member country of the Andean Community – but one enjoying very strong trade and economic ties with Argentina and Brazil, also joined MERCOSUR in the capacity of “associate state”.

More recently, given the complexities of the CAN-MERCOSUR negotiations and the afore-mentioned elements relating to the “incentives” for joining MERCOSUR, the government of Peru decided to move ahead “bilaterally” to also forge an agreement with MERCOSUR. Peru was eventually granted “associate member” status within the scheme. However, strictly speaking, Peru is still not an associate member because, as the ministers acknowledged at the meeting of the Common Market Council held on 7 and 8 July 2004 in Puerto Iguazú, it is important to proceed to the prompt protocollisation before ALADI of the agreement signed by both parties. Once this formality has been completed, and should ALADI give the go-ahead, Peru will automatically be granted the status of “associate member of MERCOSUR” for all purposes.

The category of “associate state” is, of course, a lower level and therefore involves lesser commitments with regard to policy and external insertion than those assumed by the full members or “party states”. Where these kinds of processes are concerned, however, the idea is that associate members will “gradually” come closer “to becoming normal members” of MERCOSUR. This would be the natural outcome of the “deepening” of the free trade agreements (FTAs) in force among those associate states and the countries of MERCOSUR. It should be remembered that it is specifically the ALADI member countries with which MERCOSUR has signed trade liberalisation agreements that may apply for the status of Associate State within MERCOSUR.

In this respect, CMC Decision No. 18 / 04, “Participation Regime for Associate States in MERCOSUR”, was adopted at the most recent CMC meeting in Puerto Iguazú. Among other things, this decision points out that, besides the existence of the FTA with MERCOSUR, the countries interested in acquiring the status of associate state should accede to the Ushuaia Protocol on “Democratic Commitment in MERCOSUR, the Republic of Bolivia and the Republic of Chile”, and also to the “Presidential Declaration on Democratic Commitment in MERCOSUR”, which was signed on 25 June 1996 and to which the Republic of Bolivia and the Republic of Chile have already acceded. Article 9 of

\(^{10}\) In Puerto Iguazú, the CMC demonstrated its satisfaction with the progress made in the establishment of foreign relations with other countries and blocks. In this regard, it stressed the negotiations being held with member countries of ALADI with a view to forging free trade agreements with these countries.

\(^{11}\) The free trade agreement between Chile and MERCOSUR was signed in San Luis, Argentina, on 24 June 1996.

\(^{12}\) The free trade agreement between Bolivia and MERCOSUR was signed in Fortaleza, Brazil, on 16 December 1996 and took effect on 1 March 1997.
this decision also specifies that associate states of MERCOSUR shall be committed to making the greatest efforts to accede to the following instruments adopted within the sphere of MERCOSUR:

- Cooperation Protocol and Assistance in Civil, Commercial, Administrative and Labour Jurisdiction between the party state of MERCOSUR, the Republic of Bolivia and the Republic of Chile.
- Agreement on Mutual Judicial Assistance in Penal Matters between MERCOSUR, the Republic of Bolivia and the Republic of Chile.
- Cultural Integration Protocol of MERCOSUR.

This decision also sets out the participation regime of associate states in the meetings and organs of MERCOSUR. At the same time, it instructs the Common Market Group (CMG) to submit, prior to the twenty-seventh CMC meeting, a proposal for regulating the regime governing the settlement of disputes and the signing and implementation of agreements between MERCOSUR and associate states.

Nevertheless, it should be borne in mind that the agreements signed between the associate states and MERCOSUR are being perfected, and that other decisions made by the block favour broader participation of the nations enjoying “associate” status in the different integration-related projects and efforts being undertaken. Indeed, the respective economic complementation agreements between Chile and Bolivia and MERCOSUR have gradually been enhanced over time, in that they have helped to speed up the schedules for tariff reduction and to improve a number of these countries’ regulations. Of special significance is the fact that, in early 2002, the Common Market Council (CMC) agreed that the Forum for Consultation and Political Concertation (FCPC) of MERCOSUR should be independently responsible for the coordination and follow-up of non-economic and non-trade activities. This has made it possible for Bolivia and Chile to bolster their participation in the process in such areas as policy, social issues and policy coordination in which the integration commitments undertaken with the Andean Community – in the case of Bolivia – and the trade opening policies – in the case of Chile – do not openly clash with the decisions of MERCOSUR. Furthermore, the CMG’s involvement in these issues (Bolivia and Chile do not have access to the CMG) tends more toward the Forum for Consultation and Political Concertation (FCPC), in which the “associates” do take part.

Within the new context created by the Puerto Iguazú Summit, it should also be borne in mind that, in its wider perspective, MERCOSUR would, in the near future, include Mexico as an associate state as soon as the negotiations for the signing of an FTA agreement between this country and MERCOSUR have ended. This would clearly represent a

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13 The Common Market Group (CMG) is an executive organ that ensures fulfilment of the integration-related objectives established. It is formed by four officials representing the government of each party state. It reports directly to the Common Market Council (CMC).

14 In which only the full member countries can participate.

15 In 2002, Mexico signed an economic complementation agreement and another agreement on the automotive sector with MERCOSUR. These have paved the way for the present negotiation of a free trade treaty.
concrete advance with regard to the “extension” of the agreement. In addition to the positive effects to be derived from expanded commercial links between Mexico and its MERCOSUR partners, it would seem that the Mexican option also has much to do with the increased presence and strength of MERCOSUR in international economic negotiations. Clearly, Mexico's contribution to the block is not insignificant and, in any case, would, along with Venezuela, considerably boost the economic, commercial and strategic leverage of MERCOSUR in the future.

Besides the debates for the establishment of a free trade agreement between CAN and MERCOSUR, which are of the greatest importance to the members of both integration blocks – and which will be analysed in the following section of this paper – the negotiations undertaken with the European Union as part of MERCOSUR's external relations have acquired special relevance. It should be borne in mind that the European Union represents the main destination for and source of the exports and imports for the party states of MERCOSUR. Europe has also been the source of a highly significant proportion of foreign direct investment (FDI) flows to these countries in recent years.

Indeed, at the Puerto Iguazú meeting, the CMC reiterated the commitment of signing, by the end of October 2004, the Agreement for Inter-regional Association with the European Union, and, in this respect, the governments stressed the need to continue working on an agreement that is “wide-ranging, fair, and beneficial to both parties.”

Clearly, these very complex negotiations have been bedevilled by problems that still do not seem to have been fully resolved. The fundamental causes for these contradictions are rooted in the following factors:

- The scope of the contents of the negotiation, which surpasses the limited traditional spaces of free trade agreements, although negotiation includes an FTA between both blocks.

- The structural asymmetries existing between and within the European Union and the MERCOSUR, which give rise to recurrent conflicts of interests and demands for commercial treatments that may not be acceptable to the other counterpart.

- The European policies on protection and subsidies for the livestock and agricultural sector, which is the wellspring of MERCOSUR's quintessential “comparative advantages” in world trade and in mutual trade.

It is therefore not surprising that, despite the countries' apparent political will, it is not very likely that the deadline set for obtaining the signing of the agreement next October will be met. For the time being, MERCOSUR's final offer list for access to markets for agricultural products, industrial goods, services, investment, and government procurements was formally submitted to the European Commission on 24 September 2004. However, after an initial evaluation of the final offer presented by the EU to the MERCOSUR countries, the latter considered the EU offer to be “far below the quantitative levels expected, especially in view of the announcement made by the EU in early September”. In order to continue with the classic demands embodied in this kind of negotiation, Arancha González, the trade spokesperson of the European Commission,
recently made the following statement to the press: “(Our proposal) may improve... but the other side\textsuperscript{16} must also make improvements”.

IV. CAN-MERCOSUR NEGOTIATIONS AND THE SOUTH AMERICAN ECONOMIC SPACE

Since the signing of the agreements between Chile and Bolivia and MERCOSUR – which was essential to their being granted the status of “associate members” within the scheme – MERCOSUR has ascribed special importance to negotiations with the Andean Community (CAN). The two groupings (MERCOSUR and CAN) have held talks aimed at the signing of a joint free trade agreement. This would constitute the “embryo” of a South American block, an intention that has generally been expressed in the political commitments emanating from the two South American summits of Heads of State and Government, the first of which was held in Rio de Janeiro in 2000 and the second in Guayaquil in 2002.

It should be recognized that the initial efforts to foster closer ties and greater convergence between the CAN and MERCOSUR have been determined by the history and experience of both schemes in spheres ranging from free trade areas to “imperfect” customs unions. Thus, in November of 1996, negotiations were officially held between CAN and MERCOSUR. However, it was not until 16 April 1998 that a framework agreement for the creation of the Free Trade Area was signed in Buenos Aires between the two subregional groupings. This agreement provides for negotiations in two stages:

1. The negotiation of an agreement on tariff preferences, on the basis of “historical patrimony\textsuperscript{17}”, with the possibility of including new products.
2. The negotiation of a free trade agreement that would include the full range of the tariff universe.

However, this agreement includes other objectives, the most outstanding of which are the following:

a) The effort to develop the physical infrastructure needed for integration, through the creation of “South American corridors”.
b) The promotion of reciprocal investments on the basis of an established and appropriate legal framework.
c) The coordination and reconciliation of positions vis-à-vis continental integration issues and debates in multilateral forums.

From the very beginning, it was clear that the negotiations would be formidable and, consequently, that they would require a considerable input of political will. The “initial hurdles” that both blocks had to overcome stemmed essentially from the following:

a) The aspiration of the CAN to be granted special treatment in view of the difference in the levels of relative development between its member countries and most of the members of MERCOSUR.


\textsuperscript{17} “Historical patrimony” is used in reference to the concessions of the trade agreements negotiated on a bilateral basis between the countries of the CAN and those of MERCOSUR within the framework of ALADI.
b) The insistence of the CAN that, in relation to the foregoing, it should be allowed to implement measures to protect its agricultural production, a sector in which MERCOSUR possesses obvious comparative advantages.

c) The debates surrounding the convenience of greater flexibility by MERCOSUR, with regard to the “norms of origin”.

d) The profile of the agreement and the “organizational” modalities of the negotiation. In fact, at the beginning, it was debated whether the agreement should be type “4 + 1” or type “4 + 5”. After the initial debates, it seemed that the “double scheme” would be accepted, as long as each country of the CAN individually negotiated its concessions and liberalisation calendar with MERCOSUR. However, as regards “norm-related” factors (for example, those associated with norms of origin, safeguard clauses, dispute settlement, etc), approach “4 + 5” was agreed upon.

At the end of the first stage dealing with the establishment of an agreement on tariff preferences (April 2001), the discussions were resumed with a view to completing the second stage. In spite of the various obstacles, the negotiations have continued unhindered by the problems posed by the differences of interests of the various counterparts.

And it does seem that it is political will that will help overcome the obstacles that continue to bedevil the completion of this FTA between the two integration blocks. Indeed, the foreign ministers of the member countries had already implemented the Mechanism for Dialogue and Political Concertation between the Andean Community-MERCOSUR and Chile. The activities to be developed within this context are geared toward the creation of a South American Zone of Peace and Cooperation, in which cooperation would be included in socio-cultural and information-related activities. The recently held MERCOSUR CMC meeting in Puerto Iguazú adopted CMC decision No. 21 / 04 on the “Institutionalisation of Political Dialogue Between the CAN and the MERCOSUR”, a norm that provides for an invitation to the Republic of Chile to participate fully in all the various aspects of the process.

It should be borne in mind that, over the past few years, there has been a noticeable rise in trade between the countries belonging to the integration schemes. However, the respective mutual importance in bilateral trade (CAN-MERCOSUR) continues to be rather modest. During the period 1991-2000, with regard to average exports, MERCOSUR absorbed only 3.6 percent of Andean external sales, while the CAN absorbed 4.4 percent of exports coming from the former scheme. As for imports, MERCOSUR was the origin of an annual average of 7.7 percent of total imports from the Andean Community, while the CAN accounted for merely 2.3 percent of the external purchases made by the countries of MERCOSUR. In light of the above, it is clear that the period was marked by a persistent, structural external trade deficit of the CAN in relation to MERCOSUR. Apart from this imbalance, one of the other features that have typified CAN-MERCOSUR trade is the very high “concentration” of trade in terms of products and destinations. Venezuela is by far the main Andean exporter to MERCOSUR whose fundamental “market” is the

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18 Which, in fact – and as a result of the difficulties – assumed the initial form of an economic complementation agreement between Brazil and the CAN (ACE 39, which was signed in August 1999) in ALADI, a similar agreement between Argentina and the CAN (January 2000), and a subsequent ALADI-style economic complementation agreement between MERCOSUR and the CAN (December 2002).
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Brazilian market. Brazil, which also stands out as a supplier to the CAN, has doubled its exports to the community over the last decade.\(^{19}\)

In the last two years (2002 and 2003), CAN-MERCOSUR trade flows fell by almost 7 percent, a situation that stemmed essentially from the severe economic difficulties experienced by some of the most important economies in each of these two schemes.\(^{20}\) In spite of this, signs point to a perceptible rise in reciprocal trade during the current year. This is due in part to the remarkable recovery of internal demand in several of the member countries and also to certain political agreements intended to increase trade between Venezuela and the four “party states” of MERCOSUR.

Obviously, the potentialities to be derived from an FTA between MERCOSUR and the CAN would have a multiplying effect on trade and economic interaction throughout in South America. In general, the entry of new members to a commercial integration scheme that guaranteed its members much more “favourable” conditions would be accompanied by a series of economic advantages. Such advantages would arise from a certain “virtuous trilogy” in the sense that “expanded” trade could increase income, have a positive effect on the creation of employment, and boost the overall productivity of the various sectors.

According to the “classical” theoretical assumption, the rise in trade flows in South America would have positive effects because of the “expansion of the market” that such a rise would entail. Under certain conditions, this would, in turn, foster an increase in economic activity in the countries belonging to the block, thereby enabling them to respond to the increased global demand for goods. Nevertheless, it should be borne in mind that potential access to important external markets does not always automatically entail actual access in the short term. It would also be necessary to consider the impact that the expected rise in imported goods and services from the other “partners” of the new South American FTA would have on the economic structure of the member countries. In the end, as has been recognised in the research done by international institutions, processes of this kind tend to bring about readjustments in the distribution of the revenues earned and may even be negative for certain social and economic sectors.\(^{21}\)

It should be hoped that, in the long term, the growth in market demand arising from increased levels of external demand will generate enough incentives to expand the production base of member countries and, eventually, will boost employment in the labour force. However, with respect to this assumption, it should be remembered that studies carried out by international agencies – not necessarily on the Latin American experience – demonstrate that, in certain cases, increased demand is fulfilled to a greater extent by imports because of certain “rigidities” on the supply side.


\(^{21}\) In recent years, the WTO and the World Bank have published several studies on the relationship between commercial opening – or the increase in the weight of foreign trade – in developing countries and income distribution and poverty.
To a certain extent, the foregoing “developments” are linked to the potential short-term impact of “trade creation” processes arising from the new trade relations that would be generated by the “expanded membership” of a South American FTA. Notwithstanding, as the traditional theories of international trade have taught us, this scenario, too, would be affected by the development of “trade deviation” processes, though only in static terms. The impact of trade deviation could affect the current trade partners of South American countries given the entry of new competitors under new conditions (the “new members”) in that destination market.

However, it should be observed that, of equal or greater importance than the static effects of the creation and deviation of trade referred to above, are the dynamic effects that could develop as a result of the “new trade relations” between the countries of CAN and MERCOSUR. In the long term – and according to the traditional theory – these dynamic effects could, in turn, generate fresh trade and investment flows with several of the countries in the area.

Indeed, there are several long-term factors or elements that help foster development and that may arise from the active participation of developing countries in dynamic international markets. These include gains in efficiency, the strengthening of innovation and creativity, increases in technical, professional and institutional excellence, etc, all of which definitely tend to boost the potential for economic growth to a significant degree.

In this regard, “South American” regional integration would appear to be the means of enhancing the “quality of trade” and of developing new competitive strategies that will make it possible to overcome the earlier pattern of international specialization which has characterized most of the countries in the area. Progress in this direction should be achieved on the basis of diversification efforts that can give rise to an increase in “intra-industrial trade” flows, thus overcoming the predominant trade pattern between South American countries, which has essentially been “inter-industrial”.

It should also be remembered that, according to the precepts of the theories of international trade that are based on the principle of gravitation, trade between two countries is determined largely by the size of their economies and the geographical distance between them. On the basis of these precepts, a relatively intense trade may be expected between the economies of a MERCOSUR that includes its current members and all the countries of the CAN, but one that, in principle, demonstrates a certain tendency to strengthen trade flows and investment between bordering countries and amenable even to the formation of “bi-national or plurinational nuclei” of integration that may be central to the coordination of a deepened economic interaction in the future. Nevertheless, in its most rudimentary form, this theory fails to offer a satisfactory explanation of the full dynamics of trade between countries situated “near” to each other.

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22 This may involve adapting to the case we are concerned with, which deals with the static effects of trade opening or liberalisation, i.e. the creation and deviation of trade flows.

23 “Intra-industrial trade” may be defined as the simultaneous export and import of manufactured goods within the same industrial branch. This “intra-industrial trade” accounts for the most dynamic component world trade, and, at the same time, the highest concentration of trade between countries possessing relatively similar resources and production structures.

24 For its part, “inter-industrial trade” characterised the typical pattern of North-South trade in the sense that it relates to trade flows involving products from different production branches.
For a better understanding of this fact, it should be borne in mind that, among other factors, geographical distance is only one approximation to the concept of economic distance that considers all the costs involved in the trade between specific countries.

In any case, it is useful consider this analytical perspective within the scope of an FTA that, in essence, encompasses all of South America. One study that applied the gravitational model to a possible CAN-MERCOSUR trade determined that there was a strong potential for trade between these countries provided that the signing of an FTA agreement between the two blocks was brought to a successful conclusion. In summary, the study estimated that a broader opening and commercial integration between the two groupings would have the medium-term effect of boosting the volumes of trade conducted between them, which ranges between 1.42 and 9.78 percent on the basis of the volume and structure of the trade verified at the end of the nineties. However, it should be stated that there are two other small nations – Guyana and Suriname – which should play a very important role in any creation of a South American economic space, in spite of the fact that none of the two currently belong to either the CAN or MERCOSUR. The relevance of these two countries to the formation of an integrated South American space would not be based so much on their economic importance, but rather – and above all – on their political and cultural significance to such a block. The participation of these nations in a space of this kind would attest to the true scope of the integration of the sub-continent, which would reap the additional benefits of increased cultural diversity to be derived from the presence of these “Caribbean” nations. Furthermore, it should be borne in mind that Guyana and Suriname – two countries that are fully integrated in CARICOM which, for its part, is one of the subregional schemes that boasts a long history in the integration experience of Latin America and the Caribbean – could contribute invaluable experiences to the development of South American integration.

V. CONCLUSIONS

- The problems of integration into the global economy must be considered as part of the overall development objective. Under the current circumstances, all nations require an active participation in international flows (production, technological, commercial, financial, and other flows) to advance materially and otherwise. Yet, not all form of integration into the actual international economy goes hand in hand with development.

- In spite of certain “operational advances” in trade integration efforts among countries in Latin America and the Caribbean, today we can still see only scant development of the full potential of these countries and, above all, a perhaps dangerous “fragmentation” taking place within Latin American and Caribbean region, which also exhibits a very vulnerable pattern of insertion into the international trade system.

- Any effective and conscious effort to foster the integration of the countries throughout the region would make it possible to gradually correct the weaknesses

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that have undermined the insertion of Latin America and the Caribbean into the broader international arena. This is so because first, as demonstrated earlier, expanded regional markets would seem to be the “natural destination” to look for the competitiveness of the manufactured and high-tech goods of regional enterprises; second, economic integration could result in the strengthening of the business and production structure of Latin American through joint investment and strategic alliances; and finally, the effective integration of the countries of Latin America and the Caribbean would enable the region to strengthen its international negotiating power, which is a pre-requisite for correcting the asymmetries of the current international system.

• Along this path, the drive toward a renewed integration could stem from a MERCOSUR that succeeds in establishing closer ties with the CAN, while deepening its internal agreements and consensus. The recently concluded Puerto Iguazú Summit constituted an important point both in the elimination of friction between the members of the scheme and in the “expansion” of the scheme itself. However, careful thought must be given to the necessary active participation of Guyana and Suriname for the achievement of a complete South American economic space in the future.

• In order to prevent these commendable and vital undertakings from protracting the fragmentation that our region has been exhibiting over the last few years, no effort should be spared to push ahead with the necessary integration of Latin America and the Caribbean. Only thus – and through effective coordination and with the united presence of the region in the international arena – can any attempt be made to balance the asymmetrical ties of power that characterize the current global system. The various measures that must be implemented to secure the achievement of this objective include both prioritising the search for consensus within Latin America and the Caribbean to move toward convergence between the existing subregional schemes and fostering regional coordination on the different issues addressed in multilateral and continental forums. The latter would also have a direct influence on the feasibility of any attempt to promote the integration of our nations.

• In this context, new challenges seem to have emerged to the formation of a unified social and economic space in Latin America and the Caribbean – which will not spring up in a spontaneous way, but should be the result of political will and solidarity and cohesion among the region’s countries. Among those challenges attention should be paid to the possible effects of fragmentation stemming from the proposal to create a Free Trade Area of the Americas (FTAA). For this reason, it is absolutely necessary for the governments and the various social forces in Latin America and the Caribbean to make a joint effort in order to promote regional integration, so as to incorporate and take full advantage of all the advances achieved in the area of integration, while reformulating and perfecting the scope and the institutional framework of the integration process. In this connection, SELA – as the organisation which groups together the largest majority of countries in Latin America and the Caribbean – could play a highly relevant role as a forum for discussion and catalyst of those political actions that its Member States may decide to undertake in this area.