

Talking Points

Commercial Developments in MERCOSUR

By Jorge Pérez, Estudio Torrent Auditores

Since its creation in 1991, MERCOSUR (acronym in Spanish for Mercado Común del Sur or Common Market of the South) has been developing at an uneven pace.

MERCOSUR, initiated in a restrictive framework by Argentina and Brazil, now includes four South American countries (Argentina, Brazil, Paraguay, and Uruguay) with Chile and Bolivia as associate members. Venezuela's formal admission to the organization has been ratified by the parliaments of Brazil, Argentina, and Uruguay but is pending approval by the Paraguayan legislature.

The MERCOSUR area comprises 67% of the surface of South America and a population of about 246 million people. With an aggregate GDP of about \$1 trillion, the regional bloc represents the world's sixth largest economy.

The framers of MERCOSUR sought to create a customs union and a free trade zone that would form one of the world's most integrated regional blocs. But the achievements of MERCOSUR have fallen short of its original goals. The free trade area that eliminates duties on goods produced within the zone exempts automobiles and sugar, two of the region's most important industries. The MERCOSUR customs union also functions imperfectly. In theory, all goods entering

member countries are subject to a common external tariff. But in practice, the uniform external tariff displays numerous exceptions in economic sectors that are considered sensitive to national interests.

Notwithstanding MERCOSUR's halting progress towards regional integration, the bloc plays an increasingly important role in the global economy. This article explores the factors that have impeded regional integration in the Southern Cone, MERCOSUR's relations with other regional organisations, and the bloc's economic growth prospects.

Barriers to Regional Integration

South America has important advantages with regard to regional integration schemes: territorial contiguity; only two major languages; no military tensions or border disputes; and a common cultural background.

But erratic national policies and volatile exchange rates have hindered macroeconomic coordination and prevented MERCOSUR from enacting sustainable regional agreements. The integration process initiated by the original member states (Argentina, Brazil, Paraguay and Uruguay) nearly 20 years ago has confronted a series of setbacks reflecting persistent political tensions and wide economic disparities.

Brazil holds two-thirds of MERCOSUR's total land and more than three-fourths of its population and GDP. Argentina represents 29 percent of the bloc's territory, 20 percent of its GDP, and 17 percent of its aggregate population. Uruguay and Paraguay together represent little more than 4 percent of MERCOSUR's territory and population and less than 3 percent of its GDP. These stark differences in market size provide obvious advantages to Brazil and Argentina with regard to scale economies and capacity to attract foreign investment.

Brazil's standing as MERCOSUR's dominant economy undermines the bloc's perceived value to other member states. Brazil's growing trade surpluses with Uruguay and Paraguay are seen in the latter countries as a demonstration that MERCOSUR provides few benefits to small members. Even Argentina, whose economy is much larger than those of Uruguay and Paraguay, fears that increasing penetration of Brazilian manufactured goods will threaten its own manufacturing sector.

These asymmetries have produced conflicts within MERCOSUR over the treatment of nationally sensitive sectors (sugar, chemicals, electrical appliances, footwear and automobiles). The member states have established a series of working groups to

resolve these issues, and senior political leaders in the bloc have periodically intervened to keep regional cooperation on track. But national authorities in the MERCOSUR zone show no indication of a willingness to relinquish sovereign control of economic policy or to create supranational institutions comparable to the ones established by the European Union.

The small member states have called for reforms of the structure and rule making procedures of MERCOSUR. The pending admission of Venezuela and the association of Chile and Bolivia may strengthen the hand of MERCOSUR's small members and provide a counterweight to Brazil and Argentina. The expansion of the bloc's membership may also alter the dynamics of the often-conflictual relationship between the latter two countries.

Relations with Other Regional Organisations

In a difficult global environment that does not favour multilateral trade liberalisation, MERCOSUR is pursuing a range of bilateral and regional trade pacts. MERCOSUR signed a free trade agreement with Israel in 2007 and continues negotiations with the Cooperation Council for the Arab States of the Gulf, Morocco, Egypt, Pakistan and Mexico. Disputes within MERCOSUR complicate these efforts to forge trade pacts outside the region, as evidenced by Uruguay's requests since 2008 to negotiate separate agreements and conflicts between Brazil and Argentina in recent meetings of the World Trade Organization.

The most consequential of MERCOSUR's international trade initiatives is the one with the European Union. EU-MERCOSUR talks began in 1995 and went through different stages until 1999, when negotiations were conditioned on the outcome of the WTO's Doha Round. MERCOSUR's talks with the European Union floundered in 2004, as the two organisations were unable to resolve differences over agricultural subsidies and industrial tariffs.

European companies have invested heavily in the automobile industry of the Southern Cone. They would like to liberalise MERCOSUR's automotive sector, where high tariffs prevent them from importing models that are not manufactured in Argentina or Brazil. Furthermore, MERCOSUR's local content rules force European car manufacturers to procure

parts from local suppliers instead of sourcing them from the EU. The European Union also seeks to expand access to MERCOSUR's markets in financial services, telecommunications, satellite services, and maritime transportation.

MERCOSUR has already agreed to eliminate tariffs on 90 percent of products imported from Europe, including a significant share of EU automotive trade and other import-sensitive industries like textiles, footwear, chemicals, and machinery. But MERCOSUR officials insist on phasing these tariff reductions over a 15 year period instead of the usual ten years.

For its part, MERCOSUR seeks increased EU access by its highly efficient and globally competitive agricultural and food industries. Agriculture remains a very sensitive issue in the European Union, particularly in France whose farm lobby has strenuously opposed both multilateral and regional trade liberalisation.

Recent developments signal a possible break in the EU-MERCOSUR impasse. Some members of the European parliament have voiced their support of a revision of the EU's agricultural subsidy programme. Meanwhile, occupation of the current EU and MERCOSUR presidencies by Spain and Argentina has imparted momentum to trade talks between the two organisations. The governments of both countries have affirmed their intention to resume inter-bloc negotiations during a May 2010 meeting in Madrid.

Growth Prospects in MERCOSUR

The MERCOSUR countries are showing clear signs of recovery from the 2008-09 economic downturn. ECLAC (Economic Commission for Latin America & the Caribbean) projects 2010 GDP growth rates of 5.5 percent in Brazil, 5.0 percent in Uruguay, 4.5 percent in Bolivia and Chile, and 4.0 percent in Argentina. Internal trade in the bloc is also expected to expand this year and surpass the record intra-regional turnover of \$42 billion set in 2008.

MERCOSUR's manufacturing sector (particularly automotive) continues to capture the bulk of foreign investment reaching the bloc. Despite its widely publicised problems in the U.S. and Europe, General Motors has announced a \$1 billion investment in Brazil to support its growth plan in MERCOSUR. Nissan is also expanding its MERCOSUR footprint with the

intention of assembling premium cars in the zone. Augmenting these initiatives by foreign car manufacturers, the Argentine government has announced a soft loan programme to bolster the local auto parts industry.

Energy plays a critical role in MERCOSUR's rebound from the global recession. With the region's large rivers, the MERCOSUR countries rely heavily on hydropower, which generates 75 percent of regional electricity. Hydrocarbons also figure prominently in MERCOSUR's energy portfolio. Both Brazil and Venezuela boast enormous oil reserves that create major growth opportunities for the petroleum industry. Venezuela is already a major oil exporting country with estimated reserves of 280 thousand millions of barrels. A January 2010 study by the United States Geological Service estimated that Venezuela's recoverable oil reserves could double, which would put Venezuela ahead of Saudi Arabia. Petrobras (the state owned Brazilian oil company) announced in 2008 the discovery of offshore reserves that will turn Brazil into an oil exporting country on the level of the Persian Gulf countries.

Agriculture and food industries are fundamental for MERCOSUR, representing more than 10 percent of the bloc's GDP. Nearly 40 percent of global soybean production and nearly 20 percent of world production of beef come from MERCOSUR. The member countries enjoy a competitive advantage in exporting a variety of agricultural and food products such as soft oilseeds, beef and preserved meat, tobacco, coffee, sugar and honey, and fruit juices. Between 35 and 50 percent of MERCOSUR's agriculture/food exports go to the European Union, a trade volume that would certainly rise if the envisaged trade pact is consummated. China is also an attractive trading partner to the MERCOSUR countries, reflecting that country's rapidly growing demand for agricultural goods and food stuffs.

Conclusion

Political tensions and economic disparities have frustrated MERCOSUR's drive toward regional integration. But while MERCOSUR is highly unlikely to approach the degree of integration achieved by the European Union, the bloc's market size, resource base, and competitive assets underscore its growing importance as a global player.

About the Author

Jorge Pérez is the Head of the International Office of Estudio Torrent Auditores, RSM International's member firm in Argentina. He has an extensive career experience in international tax planning, tax advice, transfer pricing strategies and VAT. Jorge is Adjunct Professor of Tax at the University of Buenos Aires and has also had faculty appointments at Universidad del Salvador (Buenos Aires) and has co-authored books and a number of articles on taxation issues. He can be contacted on:
+54 11 50311150
jorge.perez@torrent.com.ar

About RSM International

RSM International is a worldwide member organisation of independent accounting and consulting firms. RSM International is represented in 76 countries and brings together the talents of over 32,000 individuals worldwide. The organisation's total fee income of US\$3.8bn places it amongst the top six international accounting organisations worldwide. Member firms are driven by a common vision of providing high quality professional services, both in their domestic markets and in serving the international professional service needs of their client base.
www.rsmi.com

About Estudio Torrent Auditores

Estudio Torrent Auditores, a pillar in the national accounting scene for over 60 years, is among the top auditing and consulting firms in Argentina. The firm provides a broad range of professional services to meet the business needs of international and domestic companies in Argentina with staff of over 70 professionals. Their culture is client-driven attaching great importance to becoming involved in their client's businesses delivering comprehensive and personalised attention.
www.torrent.com.ar

RSM International is the name given to a network of independently owned and managed accounting and consulting firms each of which practices in its own right. RSM International does not exist in any jurisdiction as a separate legal entity. The network is administered by RSM International Limited, a company registered in England and Wales (company number 4040598) whose registered office is at 11 Old Jewry, London EC2R 8DU. Intellectual property rights used by members of the network including the trademark RSM International are owned by RSM International Association, an association governed by articles 60 et seq of the Civil Code of Switzerland whose seat is in Zug.

© RSM International Association, 2010