THE EU-MERCOSUR ASSOCIATION PROCESS. AN ANALYSIS OF BILATERAL TRADE.

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Abstract

This study presents the evolution and actual situation of EU-MERCOSUR association process. The focus here is on trade relations according to the different technology intensities of the exchanged goods. The analysis results are used to evaluate the strength and weaknesses of the first inter-continental integrated area and to gain some preliminary insights on MERCOSUR growth prospects within the agreement frame.

The final section, moreover, shows some future avenues for research.
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1 Introduction

The very recent evolution of international relations shows a clear trend towards the achievement of economic and cultural integration made by means of bilateral “talks” more than through a multilateral integration system. The strong revival in regionalism in the recent decades shows, probably, that in front of globalization countries need an intermediate step in order to better accomplish their integration into the world economy.

After that countries, in the 90s, joined into integration agreements, the very recent evolution of regionalism sees integrated blocs, instead of individual countries, dealing to join other blocs in order to exploit possible complementarities and to move a step ahead in the globalization process.

In this frame, the most interesting events of the last ten years for the Latin American region a move from the so-called South-South integration\(^1\), to the new phase of North-South agreements. Roughly speaking, the latter involves Southern integrated blocs negotiating economic and political agreements with Northern blocs, i.e. North America (namely the U.S.) and the EU. In this complex system of intra and inter-regional relations, the ongoing agreement of MERCOSUR with the EU can be considered the most interesting event according both to the size of the blocs\(^2\) involved and to the delicate topics on the agenda. The integration process among these two giants gains more relevance when one thinks of the other great inter-bloc negotiation represented by the Free Trade Area of the Americas (FTAA).

Aim of the present work is to have a closer look at the recent evolutions of EU-MERCOSUR relations mainly focusing on what has been achieved in trade integration during the recent years in order to draw some insights on what the consequences of the total achievement of such an agreement might be.

Thus, in the next section, after a quick review of Latin American regionalism in the 90s the main features of North-South the features of the agreements with the U.S. and the EU will be presented. Then, the update of the negotiations between EU and MERCOSUR will be discussed and compared to possible achievements with the FTAA.

The following section will deal with the main focus of this work, i.e. the analysis of EU-MERCOSUR bilateral trade. A conclusive section will discuss perspectives and challenges for this scheme of integration.

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\(^1\)Regarding the formation (as for MERCOSUR) or the re-formation (as for the Central American Common Market and the Andean Pact) of blocs involving countries in the same region.

\(^2\)And within each bloc, the countries.
2 The recent Evolution of new Regionalism. Alternatives integration schemes for MERCOSUR

With special concern to the Latin American region the last 20 years have been characterized by a radical change of the development model. The Import Substitution Industrialization (ISI) strategy of development was left in the 80s for a more market based policy regime. In this sense one of the pillar of the structural reform was the lowering of external tariffs to trade and a more liberal treatment of investments from abroad. As a complementary strategy to globalization, regionalism came across with the renewal of some of the already existing agreements. These had achieved no results up to the 80s because of the same ISI system which represented an obstacle to the creation of integrated sub-regional markets. As a matter of fact this was the case for the Latin America Free Trade Area (LAFTA) and for the Andean Pact (AP). Although both of them came to existence from the 60s they never succeeded in fostering intra-regional trade. The Central American Common Market (CACM) lived a different story because regional integration and industrialization started at the same time and regional integration helped the development of the national production structures. Only recently, in the end of the 80s, the need to integrate into a world more and more globalized led Latin American countries to restart these regional initiatives and to create new ones as in the case of MERCOSUR, where Argentina, Brazil, Paraguay and Uruguay signed a the treaty of Asunciôn in 1991 with the precise target to form a deeply integrated bloc similar to what had been achieved on the other side of the Atlantic, although lacking of the same deep institutional setting.

The so called “new regionalism” was meant to strengthen the structural reforms efforts, especially the commitment to trade liberalization, and to allow for the achievement of a greater variety and dynamism in the production sector. It was meant not only to solve the problem of a vulnerable production structure for the countries in the region but as well as a tool to improve Latin American countries insertion into the world economy by means of a stronger negotiation position backed by growing integration and common interests. Other possible gains from Latin American regionalism in the 90s were the chance to attract FDIs and the possibility of cooperation among partners for the building up of regional public goods.

\footnote{Giordano(2003) shows that tariff protections decrease after the second half of the 80s and that tariff preferences accorded to trade partners in South-South Agreements are sensibly lower than MFN tariffs.}
Despite all these positive features, a few concerns remain because of some general dark sides of South-South agreements. In this line, some studies (Worldbank 2000, 2003) show how South-South Agreements are potentially more trade-diverting than North-South ones. This concern could be overcome thinking that trade diversion is a static notion and that dynamic gains might arise if South-South Regional Integration Agreements help building up a diversified production structure by means of the promotion of dynamic comparative advantages. Despite this, South-South integration might, in theory (Venables 2002), foster concentration of production in the most advanced countries within the same bloc thus causing a growing divergence among partners; moreover, increasing dependence on the sub-regional market could make partners more vulnerable to each others’ recessions if goods exchanged in the sub-regional market are not very dynamic, i.e. the world demand for them is low and grows very little. The existing evidence on LAC sub-regional integration schemes supports the idea of South-South agreements being trade diverting, while as far as long run dynamic effects are concerned Chudnovsky et al. (2003), reporting on transnational corporations’ rationalization strategies, suggest that industrial production tends to concentrate in the most efficient partners within MERCOSUR.

So, although trade introversion grew substantially in the nineties (see figure 1), generally, the region is not really satisfied with results of such kind of integration and now looks at North-South integration with North America, namely the U.S., and the E.U. as a fundamental step to accomplish to insert their own economies into the global system.

The idea of a huge continental FTA involving all the American countries took off at the 1994 Miami meeting of the representatives of 34 countries although the very origin can be traced back to the Economic Initiative for the Americas of the U.S. president George Bush in 1990.

The U.S. shift in policy making in the 90s, more akin to trade agreements than to the promotion of the multilateral process, was due to different events taking place in the same years.

While Europe was walking towards the strengthening of the integration process, the multilateral system was at a halt with the never ending negotiations of the Uruguay Round. At the same time, the EU was starting accelerating its cultural and economic relations with the LAC sub-continent thus threatening, in a way, U.S. influence on the region. All these elements led the U.S. to realize that if the world trade had to be ruled by trade blocs and not by the WTO then it was time to build up its own bloc and the project of FTAA.

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4For the Andean Pact see Cernat (2001), for MERCOSUR see Yeats(1998) and for CACM see Nicholls(1998).
came about (cfr. Roy (2003)). This project, however, stimulated EU foreign trade policy as well, since the possibility to lose out access to such a huge market as the Latin American one represented a fearful opportunity. Thus, in the 90s EU renewed the rules of the Generalized System of Preferences for the ACP countries and at the same time negotiated a FTA with Mexico\(^5\) and Chile\(^6\). Moreover EU political talks with trade blocs started both in Central and South America. Initially, the main difference between the U.S. and the EU approach to negotiation of North-South integration was quite marked. On one hand, the U.S. strategy aimed at creating a sort of “enlarged” NAFTA treaty with the accession of LAC countries in order to maintain a light integration scheme, with no institutional deepening, mainly based on economic incentives and on tariff elimination. On the other hand, the EU strategy was based on the creation of political and economic areas where the focus of integration was not only on trade preferences but on cooperation as well. The “Bi-regional Strategic Association” between EU and LAC is based on agreements of different depths\(^7\). Another difference lies in the European will to negotiate with country blocs as opposed to U.S. attitude

\(^{5}\)Achieved in 2000.

\(^{6}\)Achieved in 2004.

\(^{7}\)EU negotiation strategy is based on the negotiation of agreements of different “generation” according to the different depth to achieve through the agreement. So while the fourth generations ones include an economic chapter, the third generation one only deals with politics and cooperation.
of negotiating with individual countries. The institutional imprint of EU negotiations pushed the U.S. towards the enrichment of the regional proposal to Latin America as well as the U.S. fast negotiation rhythm pushed EU to accelerate the pace of the negotiating process with the region.

2.1 Alternative Scenarios for MERCOSUR.

In this frame, the EU fourth generation “Agreements on the Political Dialogue, Economic Association, Free Trade and Cooperation” are meant to be a tool to deep inter-continental integration. As previously stated, the agreements with Mexico and Chile were enforced respectively in 2000 and 2003, while the agreement with MERCOSUR is meant to be achieved within 2004. For this, although the inter-regional political dialogue started in the second half of the 90s, the negotiation started only in 1999 and, differently from the FTAA, which was originally meant to end in 2005, was not provided with a specific deadline\(^8\). The fundamental feature of this agreement is the notion of “Economic and Political Association” \(^9\). The agreement on the chapters on politics and cooperation was achieved in 2002, but the most difficult part is the conclusion of the economic part of the agreement. The focal points are, on one hand, agriculture for which MERCOSUR claims more access to the EU protected market and, on the other hand, the Southern Common Market difficulties in definitely accomplishing the process of integration thus leaving unsatisfied EU demands for negotiations with a unique counterpart.

Because of the relevant weight of agriculture the pace of the negotiations is necessarily affected by the one realized in the multilateral system, for this reason the intercontinental negotiation suffered a halt after Cancun failure while, very recently, and is supposed to benefit from the advances realized in the WTO in August 2004\(^{10}\).

The evolution of intercontinental, sub-regional and multilateral negotiations are reciprocally affected, moreover the steps ahead made by the FTAA affect

\(^8\)Although the new Brussels Programme, resulting from the EU-MERCOSUR negotiation of November 2003, provided the implicit deadline of October 2004.

\(^9\)The EU supported MERCOSUR integration process since its very beginning contributing with technical and institutional support. The EU-MERCOSUR Interregional framework cooperation agreement signed in 1995 in Madrid actually rules the relationship between the two blocs. After a provisional enforcement period started in 1996 the agreement fully entered into force in 1999 and is based on three main pillars: the political dialogue, cooperation and trade issues.Cfr.europa.eu.int/commm/external_relations/mercosur/intro/index.htm

\(^{10}\)The Economist of the 2nd of August 2004 reports that the EU and US made important concessions in agriculture. This should imply a faster move towards the conclusion of inter-blocs negotiations both for the EU-MERCOSUR project and for the FTAA.
EU pace of negotiation with the region and the reverse is true as well. As mentioned before, the conclusion of the agreement between EU and Chile before the latter could achieve an agreement with U.S. meant a significant change in EU external policy after the negotiation of NAFTA with the Western European bloc loosing ground in the LAC region. It is worth mentioning that the reciprocal influences of EU on US negotiations with the region led US to start talking about cooperation in order to win the distrust engendered by the deceptive results of NAFTA for Mexican development.

To sum up, the actual negotiating situation of MERCOSUR is of partial isolation\(^1\) within the context of FTAA mainly due to the Brazilian opposition to the project of a hemispheric FTA led by the US. Despite this, the day after president Bush’s re-election the American ambassador in Brazil re-affirmed the American will to achieve the FTAA although it’s obvious that January 2005 is not a likely deadline for the project.

While the pending project of a FTA between CAN and MERCOSUR was achieved in September as a step towards the formation of the South American Community of Nation expected for December 2004, MERCOSUR has been looking at an agreement with the EU as the most viable evolution of its external relations. Actually many could be the gains obtainable through such an agreement.

Giordano (2003) points out that, on one hand, the agreement could help MERCOSUR countries to strengthen the integration process taking advantage of EU integration experience, and to restore and develop their credibility in the international setting. On the other the EU could use the North-South model of integration as a model to re-propose for other developing areas\(^2\).

\(^1\) Despite the original project of a single regional agreement, the U.S. changed their negotiation strategy and in 2003 announced that they would start bilateral talks with single countries. Moreover, very recently the U.S. and the five CACM countries negotiated the CAFTA.

Actually, after the Miami meeting of 2003 members of FTAA abolished the “all or nothing” approach, i.e. a package of disciplines applied to all countries and encompassing a broad range of areas. The approach was abandoned because of the Brazilian desire to keep services, investments and intellectual property rights out of the agreement and the U.S.’s insistence on negotiating any reduction in agricultural subsidies- the key Brazilian interest- at the WTO rather than in the FTAA. As a result, in order not to collapse the negotiation, it was decided that countries would commit to minimum set of common obligations and if they want to undertake additional obligations can do so at their discretion.

\(^2\) Such as for the CAN and the Central American blocs which signed a third generation agreement on political dialogue and cooperation with EU in the second part of the 90s. These countries will face the deadline of their preferential accession to the EU market at the end of 2004 and although the European Commission proposed to extend it up to 2014, the preferential access conceded by EU is not that great in terms of number of products. The pending project of the FTAA could push again EU to establish a switch to fourth
Moreover it could be useful to develop the already existing natural links between the ex-colonies and the continental countries. The largest difficulties, though, concern the economic part of the agreement. At the moment parts in the negotiation have decided to delay the completion of the agreement and to go on negotiating. In September 2004 MERCOSUR offered the EU a preferential treatment in government procurement and the possibility for EU telecommunication companies to provide the service inside the bloc without implementing a stable infrastructure. Moreover MERCOSUR liberalized the conditions for the instalment of EU banks within the bloc. These offers seem to be the largest concession ever made by MERCOSUR both in the FTAA project and within MERCOSUR as well. In exchange for this EU offers in market access for agriculture and manufacturing products do not seem to satisfactory for MERCOSUR. The latter would like to benefit from an enlargement of the quotas on primary products (e.g. meat) and of a wider access for its manufactures.

Now, in order to understand the terms of the negotiations and the potential problems, benefits and prospects of this inter-continental integration scheme, trade patterns between EU and MERCOSUR will be presented in the next section.

3 Analysis of Trade Flows between EU and MERCOSUR.

Despite the extraordinary growth of Latin American exports during the 90s, Europe lost importance on behalf of North America and intra-regional LAC export markets. Moreover while the region as a whole was exporting primary goods to EU, the latter was exporting manufactures to LAC countries. Due to the heterogeneous trade specialization within the region, Central America, especially Costa Rica and Mexico, succeeded in exporting manufactures produced by the “maquila system” while South America exported primary goods. The relevance of EU as export market decreased substantially for more or less all the countries in the Southern Cone with the Andean Community showing the sharpest decline in exports to EU.

MERCOSUR export growth to EU was quite sluggish. On the import side, despite, the importance of EU as a source for imports substantially declined for all the countries in the region, for MERCOSUR the share of imports coming from EU remained more or less the same for all the 90s (IADB (2002)).
The IADB(2004) reports that while MERCOSUR exports to EU increased 1.8% per annum between 1991 and 2000, exports to US and to Canada were much more dynamic recording an annual growth respectively of 6.1% and 7.2% and, as clear from graph 2 EU exports to the subregion were much more dynamic.\textsuperscript{14}

Here MERCOSUR trade with EU is shown. Although trade generally increased, the Southern Common Market ended up with a trade deficit with EU in the second part of the 90s with a peak of about six million dollars between 1997 and 1998.\textsuperscript{15}

Graph 3 shows the evolution of EU and MERCOSUR reciprocal market shares.\textsuperscript{16} EU market share in the Southern Cone Common Market increased by 23% between 1990 and 1997. MERCOSUR market share in EU is very small and loses ground going from 1.57 in 1990 to .98 in 1997.\textsuperscript{17}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{EU-Mercosur-Trade.png}
\caption{EU-Mercosur Trade}
\end{figure}

\textsuperscript{14}IADB (2004) reports that they grew by an annual average of 10.2%, while imports from US and Canada respectively grew by 10.7% and 10.5%.
\textsuperscript{15}1997 has seen as the best year in term of performance of the whole region. The recovery from the trade deficit in the last years of the 90s was due to the general deceleration of the subregion.
\textsuperscript{16}By market share is meant the ratio of imports coming from the partner on imports coming from the world.
\textsuperscript{17}Actually the graph shows MERCOSUR market total share in Western Europe which means EU with Switzerland and another couple of small countries like Monaco in France, thus actually MERCOSUR market share into EU market might be slightly different and
up, while MERCOSUR did not penetrate strongly into EU market during the 90s, EU exports to the sub-region became quite important. IADB (2004) claims that the Southern Common Market manufactured exports to EU would be constrained because of tariff and non-tariff barriers in the Western Europe market: while 49% of MERCOSUR exports to the world are represented by manufactures the corresponding share going to EU is only 32% of total exports with primary products playing a major role. Despite this, in 1999 the average tariff rate applied on non-agricultural products was 4.5% and the European Commission official data show that in 2000 61% (59% of manufactured goods and 63% of agricultural goods) of products coming from MERCOSUR entered the Community duty free (Cepal (2003))\(^{18}\). So, it would be worth to further investigate how the loss in importance of EU market for MERCOSUR manufacturing exports is determined by European protectionism and to what extent, instead, it might be due to MERCOSUR actually higher. Anyway IADB (2004) reports that although EU stays as the most relevant trade partner for MERCOSUR, its relative weight in the latter’s exports decreased from 32% in 1991 to 22% in 2000.

\(^{18}\)This occurs in general thanks to the binding in WTO of EU tariffs on some products at 0 rate and to the concessions granted to some countries in the Generalized System of Preferences. The same data report that 90% of goods coming from the Andean Community entered EU duty free in that same year.

countries' strategy of exploitation of the protected sub-regional market as absorption market for their own production. In this respect, Benavente (2001) underlines how the sub-regional evolution of trade in manufactures in the 90s in LAC was explained more by the existence of preferential agreements negotiated in the region than by the unilateral effort of liberalization. The latter was able to boost imports but did not seem to be enough to boost exports of manufactures outside the region.

To have a better understanding of how the structure and the evolution of trade patterns can affect the inter-blocs relations it can be useful to disaggregate the analysis in order to appreciate the quality of trade occurring between the two blocs. Quality here is established having regard to the increasing technological content. To this purpose the next to graphs present the evolution of exports by category between the two markets. Categories are obtained from the the disaggregation of traded products, listed under SITC Rev.2, in six different groups according to their own technological content: primary products, manufactures based on natural resources, low, medium and high technology manufactures. With the exception of low technology manufactures, MERCOSUR exports to EU increase in all sectors although the most relevant role is plaid by primary products and manufactures based on natural resources. As far as EU exports to MERCOSUR are concerned the story is slightly different with manufactures playing the largest role. More specifically, EU medium technology manufactures exports to the Southern Common Market sharply increased after 1990 thus representing the largest share of EU exports in the sub-region, moreover, while primary goods and low technology products are not that relevant, manufactures based on natu-

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19Namely Argentina and Brazil.
20Another reason for MERCOSUR manufactures to be left out EU market might be the general appreciation of MERCOSUR countries’ real exchange rates during the first part of the 90s although the very low dynamism shown by these goods in the world markets might be the real cause to the decline of their relative importance in the developed markets.
21The classification has been proposed by ECLAC (ECLAC (2003)). The primary goods category contains fresh fruit, meat, rice, cocoa, tea, coffee, wood, crude oil, gas, concentrated minerals, etc., the category of manufactures based on natural resources regards goods prepared with fruit and meat, drinks, products in wood, vegetal oils, basic metals (except steel), oil derivatives, cement, precious stones, glass. Low technology manufactures concern textiles, clothes, shoes, travel bags, leather manufactures, ceramics, simple metal structures, furniture, jewellery, games, plastic products. Medium technology manufactures are passengers vehicles and their parts, commercial vehicles, motorbikes and their parts, synthetic fibres, chemicals and paints, fertilizers, plastics, iron, steel and tubes. Machines and engines, industrial machines, bombs, ships and watches. The last category of manufactures, the high tech one contains telecommunication and data processing machines, television sets and transistors, turbines, energy generating sets, pharmaceutical, airplanes, optical instruments, cameras.
ral resources and high tech manufactures increase for all the first part of the 90s with the latter keeping stable even after 1997 Asian crisis. Now, tables

![Figure 4: MERCOSUR Exports to EU by Category](image)


![Figure 5: EU Exports to MERCOSUR by Category](image)


1 and 2 respectively show EU and MERCOSUR reciprocal market shares in all sectors. Although very low, MERCOSUR market shares in EU primary and resource based manufactured products are quite stable during the 90s while EU market share in manufactures based on natural resources declines. In general EU
Table 1: MERCOSUR: Market Shares in EU

<table>
<thead>
<tr>
<th>Category</th>
<th>1985</th>
<th>1990</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prim.Prod.</td>
<td>4.089</td>
<td>4.324</td>
<td>4.265</td>
</tr>
<tr>
<td>MBNRs</td>
<td>0.832</td>
<td>0.952</td>
<td>1.02</td>
</tr>
<tr>
<td>LTM</td>
<td>0.812</td>
<td>0.746</td>
<td>0.574</td>
</tr>
<tr>
<td>MTM</td>
<td>0.429</td>
<td>0.425</td>
<td>0.351</td>
</tr>
<tr>
<td>HTM</td>
<td>0.198</td>
<td>0.173</td>
<td>0.236</td>
</tr>
</tbody>
</table>

Source: TradeCAN(ECLAC).

Table 2: EU: Market Shares in MERCOSUR

<table>
<thead>
<tr>
<th>Category</th>
<th>1985</th>
<th>1990</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prim.Prod.</td>
<td>3.83</td>
<td>3.55</td>
<td>4.36</td>
</tr>
<tr>
<td>MBNRs</td>
<td>29.45</td>
<td>28.04</td>
<td>21.50</td>
</tr>
<tr>
<td>LTM</td>
<td>33.81</td>
<td>24.74</td>
<td>23.55</td>
</tr>
<tr>
<td>MTM</td>
<td>40.26</td>
<td>35.72</td>
<td>32.22</td>
</tr>
<tr>
<td>HTM</td>
<td>31.96</td>
<td>26.01</td>
<td>25.92</td>
</tr>
</tbody>
</table>

Source: TradeCAN(ECLAC).

loses ground in MERCOSUR market in the 90s with respect to the previous ten years. Although slightly, EU market share decreases in all the categories of manufacturing.

Finally, tables 3 and 4 show, for each bloc and category, the relative importance of exports going to the trade partner on total exports going to the world. In this respect while for all the 90s EU accounted for almost 50% of MERCOSUR primary goods exports going to the world, the share of manufactures based on natural resources going to EU stayed at a low level but

Table 3: MERCOSUR:Share of Exports going to EU by Category.

<table>
<thead>
<tr>
<th>Category</th>
<th>1985</th>
<th>1990</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prim.Prod.</td>
<td>67.35</td>
<td>55.76</td>
<td>53.45</td>
</tr>
<tr>
<td>MBNRs</td>
<td>12.17</td>
<td>12.46</td>
<td>15.24</td>
</tr>
<tr>
<td>LTM</td>
<td>8.44</td>
<td>11.12</td>
<td>8.87</td>
</tr>
<tr>
<td>MTM</td>
<td>7.85</td>
<td>11.42</td>
<td>10.7</td>
</tr>
<tr>
<td>HTM</td>
<td>1.61</td>
<td>2.22</td>
<td>4.9</td>
</tr>
</tbody>
</table>

Source: TradeCAN(ECLAC).
Table 4: EU: Share of Exports going to MERCOSUR by Category.

<table>
<thead>
<tr>
<th>Category</th>
<th>1985</th>
<th>1990</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prim.prod.</td>
<td>8.5</td>
<td>4.94</td>
<td>2.26</td>
</tr>
<tr>
<td>MBRN</td>
<td>20.9</td>
<td>23.42</td>
<td>17.06</td>
</tr>
<tr>
<td>LTMs</td>
<td>6.47</td>
<td>7.91</td>
<td>8.74</td>
</tr>
<tr>
<td>MTMs</td>
<td>46.74</td>
<td>47.1</td>
<td>46.42</td>
</tr>
<tr>
<td>HTMs</td>
<td>16.76</td>
<td>15.85</td>
<td>24.44</td>
</tr>
</tbody>
</table>

Source: TradeCAN(ECLAC).

increased from about 15% in 1991 to 17% in 2001 of all the exports in the category.
The Southern Common Market, instead, accounted for a large share of EU exports of medium technology manufactures (see table 4), passing from about 48% in 1991 to 46% in 2001. Finally the share of EU high technology exports going to MERCOSUR on total EU exports in the category sharply increases from 15.85% in 1990 to 24.44% in 2001.

To sum up, from the previous analysis the following features emerge: firstly, EU exports to MERCOSUR increased more than MERCOSUR exports to EU and while MERCOSUR exports primary products to EU, the latter exports high and medium technology manufactures to MERCOSUR; secondly, despite the relevance of EU as import source for these categories of goods, EU looses market shares on behalf of the sub-regional import sources; finally, MERCOSUR looses market shares in EU as well, although the EU becomes less important compared to other export markets, such as MERCOSUR itself and Asia. Tables 6, 7 and 8 show that as far as the medium and high technology manufactures in the 90s EU lost ground on behalf of imports coming from within MERCOSUR and from Asia with the former increasing relevantly its participation in the sub-regional market in the 90s. As far as low technology manufactures are concerned again the sub-regional market is dominated by Asia and MERCOSUR countries with the former gaining ground at the expenses of all the Northern exporters in the 90s. Finally, figure 6 shows the evolution of MERCOSUR intra-regional trade by category.

Now two main issues arise. The first is relative to the fact that the increased introversion (see section 1) among MERCOSUR countries, the decreasing importance of EU as export market for their own manufacturing sector and the view by Benavente(2001) of the sub-regional market as an extension of the local market achieved through preferential arrangements lead to wonder whether this occurs by natural factors or it is due to protection achieved
through the Common External Tariff. Moreover it might be due to protectionist policies in Northern countries. Table 5 shows the Grubel-Lloyd index of intra-industrial trade between Argentina and Brazil, i.e. the largest sources of manufacturing trade within MERCOSUR. It can be noticed how between 1990 and 2001 the index average value doubles for medium and high-tech manufacturing products showing a trend towards increased intra-industrial trade between the two MERCOSUR countries. The same goes for the remaining categories. The standard deviation suggests in all the cases that within each category some lines of products are traded internally more than others. The index in table 5, then, gives support to the idea that the loss of market share in the EU market concerning medium and high technology manufactures might be due more to the enforcement of MERCOSUR than to EU protectionism in the industrial sector. The analysis of which products make up intra-industrial trade within MERCOSUR together with the analysis of MERCOSUR and EU tariff structures in the relevant goods would be a necessary base to further ascertain the reasons behind such a pattern of trade in these two categories. This, however, is left for future research.

The second issue is related to the increase of EU exports in high and medium technology manufactures, with EU gaining ground as export destination for MERCOSUR high technology manufactures. In this respect, it might be interesting to check whether exports to sub-regional markets are made by transnational corporations or foreign firms based in MERCOSUR countries.

### Table 5: MERCOSUR-Intra-Industrial Trade Argentina-Brazil.

<table>
<thead>
<tr>
<th>Category</th>
<th>year</th>
<th>1985</th>
<th>1990</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>MBNRs</td>
<td>average</td>
<td>0.14</td>
<td>0.19</td>
<td>0.37</td>
</tr>
<tr>
<td></td>
<td>st.dev.</td>
<td>0.23</td>
<td>0.28</td>
<td>0.34</td>
</tr>
<tr>
<td>LTMs</td>
<td>average</td>
<td>0.09</td>
<td>0.10</td>
<td>0.32</td>
</tr>
<tr>
<td></td>
<td>st.dev.</td>
<td>0.20</td>
<td>0.22</td>
<td>0.28</td>
</tr>
<tr>
<td>MTMs</td>
<td>average</td>
<td>0.23</td>
<td>0.26</td>
<td>0.54</td>
</tr>
<tr>
<td></td>
<td>st.dev.</td>
<td>0.31</td>
<td>0.32</td>
<td>0.30</td>
</tr>
<tr>
<td>HTMs</td>
<td>average</td>
<td>0.15</td>
<td>0.18</td>
<td>0.37</td>
</tr>
<tr>
<td></td>
<td>st.dev.</td>
<td>0.23</td>
<td>0.25</td>
<td>0.32</td>
</tr>
</tbody>
</table>

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22For every three digit category of SITC Rev.2 the index was calculated using data on Argentina and Brazil bilateral trade flows. Consequently, the four different manufacturing groups, i.e. low, medium and high-tech manufacturing products and manufactures based on natural resources, were formed. The table shows the average and the standard deviation of the index by category for 1985, 1990, and 2001.
In other words, these trade flows might be, partially, determined by exports coming from foreign firms based in MERCOSUR which on the import side draw inputs and capital goods from the matrix and on the other sell their products in MERCOSUR internal market.

As far as the relevant increase in EU exports in medium and high technology manufactures is concerned, the increase of imports is a phenomenon which is both general and common to all of the LAC countries and can be related by the strong effort of unilateral import liberalization in the more general frame of the structural reforms. Moreover, the real exchange rate appreciation, due to the process of restructuring in itself and made more harsh because of the relevant weight of developed countries in trade for the whole region, in the same moment that explains the loss of competitiveness of MERCOSUR products, in the same way it can explain the rise in imports from EU. Capital goods coming from abroad became cheaper, tariffs on imports were very low and the obvious evolution of this was the increase in imports in manufactures. This phenomenon, together with the increased relevance of intra-regional trade might make one think of a relevant role plaid by the presence of transnational corporation subsidiaries within the integrated bloc.

23These are essentially the goods contained in the category of medium technology manufactures.
Table 6: Low technology manufactures market shares MERCOSUR

<table>
<thead>
<tr>
<th>PARTNERS</th>
<th>1985</th>
<th>1990</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>33.8</td>
<td>24.7</td>
<td>23.5</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>26.96</td>
<td>26.4</td>
<td>26.2</td>
</tr>
<tr>
<td>CACM</td>
<td>0.038</td>
<td>0.095</td>
<td>0.139</td>
</tr>
<tr>
<td>NAFTA</td>
<td>18.9</td>
<td>19.1</td>
<td>17.5</td>
</tr>
<tr>
<td>CAN</td>
<td>2.39</td>
<td>1.6</td>
<td>0.7</td>
</tr>
<tr>
<td>ASIA</td>
<td>11.6</td>
<td>18.4</td>
<td>26.2</td>
</tr>
</tbody>
</table>

Table 7: Medium technology manufactures market shares in MERCOSUR

<table>
<thead>
<tr>
<th>PARTNERS</th>
<th>1985</th>
<th>1990</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>40.2</td>
<td>35.7</td>
<td>32.2</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>11.5</td>
<td>13.4</td>
<td>18.8</td>
</tr>
<tr>
<td>CACM</td>
<td>0.003</td>
<td>0.072</td>
<td>0.006</td>
</tr>
<tr>
<td>NAFTA</td>
<td>27.6</td>
<td>27.9</td>
<td>25.8</td>
</tr>
<tr>
<td>CAN</td>
<td>0.252</td>
<td>0.632</td>
<td>0.586</td>
</tr>
<tr>
<td>ASIA</td>
<td>13.3</td>
<td>14.6</td>
<td>15.6</td>
</tr>
</tbody>
</table>

Table 8: High technology manufactures market shares variations in MERCOSUR

<table>
<thead>
<tr>
<th>PARTNERS</th>
<th>1985</th>
<th>1990</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>31.9</td>
<td>26</td>
<td>25.9</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>4.3</td>
<td>3.6</td>
<td>5.8</td>
</tr>
<tr>
<td>CACM</td>
<td>0.01</td>
<td>0.02</td>
<td>0.15</td>
</tr>
<tr>
<td>NAFTA</td>
<td>36.8</td>
<td>38.1</td>
<td>37.9</td>
</tr>
<tr>
<td>CAN</td>
<td>0.11</td>
<td>0.14</td>
<td>0.09</td>
</tr>
<tr>
<td>ASIA</td>
<td>21.7</td>
<td>25.7</td>
<td>26.1</td>
</tr>
</tbody>
</table>
this reason an analysis of trade flows cannot be conducted separately from an analysis on FDI. Although the most of European investment was realized in the service and energy sectors important investments were realized in the manufacturing sector as well. The question is then whether the two booms of imports and investments coming from EU can be related under the notion of intra-firm trade. Chudnovsky et al.(2003) report that TNCs have increased their share in foreign trade flows in the 90s. It is estimated that in Argentina their share of export switched from 32% in 1990 to 54% in 1998, in Uruguay from 26 to 30% between 1992 and 1998, in Paraguay from 32 to 54% in the same period and for Brazil from 48 to 53% in the period between 1989 and 1997. As far as their import share is concerned, this went from 62 to 72% in Argentina, from 53 to 63% in Brazil, from 6 to 11% in Paraguay and from 22 to 24% in Uruguay. In general transnational corporations in the sub-region show a trade surplus with respect to MERCOSUR and a trade deficit with respect to their home countries.

4 Conclusions

The present work meant to provide an overall view of the actual situation of EU-MERCOSUR association process in order to draw some insightful conclusion on the achievement of the first inter-continental bloc.

To this purpose the different sections dealt with different aspects of this process. Firstly the recent evolution of regionalism in the Americas was presented, secondly the actual MERCOSUR negotiating situation within the FTAA and the inter-continental agreement with the EU was depicted and finally the evolution of bilateral trade flows between these last two blocs were discussed having care to the different technology intensity of the goods exchanged.

From the above discussion, then, the following issues emerged. Firstly, MERCOSUR need for wider access in the EU market for its primary and manufacturing products and the EU resistance to allow more market access caused the negotiation process to last more than expected and, thus, to be still on-going. Despite the importance of agricultural products in the Southern bloc external trade relations, the previous analysis showed how transnational corporations actually might play a relevant role in determining a country’s geographical pattern of trade and the average export and import propensity. In this context, a very important step ahead for a better growth prospect of MERCOSUR countries would be to push transnational corporations’ subsidiaries placed within MERCOSUR to improve and modernize their products quality and competitiveness in order to re-direct exports to external
market. This circumstance would help to dramatically modify the situation above described with the Southern bloc specializing in primary products and importing high and medium technology manufacturing products. Liberalization of capital flows together with trade liberalization and the massive wave privatization in MERCOSUR countries, led the industrial and services sectors to be ruled by foreign investors while the national productive resources became relatively more and more shifted to the primary production. This meant the emerging specialization of the bloc in primary products thus leading to an unbalanced trade exchange both in terms of goods exchanged and destination countries provided.

The example of the automotive industry is quite enlightening. Despite the sector enjoys a special and protected regime within the bloc, the increased liberalization together with a change in the rules of the game for world car producers meant a shift in the national production systems in Argentina\(^\text{24}\) and Brazil with market efficiency strategies leading to the shrinking of the number of industrial operations accomplished within the MERCOSUR countries boundaries. Moreover, being MERCOSUR itself the main export destination market for producers in the sector the kind of cars realized within the bloc find serious obstacles in penetrating extra-bloc foreign markets. In this respect, probably, a more joint action between transnational corporations and policy makers might make a big difference in the effects of foreign presence within MERCOSUR. The overcoming of MERCOSUR internal difficulties, then, represents a “conditio sine qua non” for the bloc to act jointly in order to reap the highest benefits from European investments. This regards sectors others than the automotive one as well, such as the shoe sector and the electrical equipments.

Finally, another extension of this work would be to highlight how the formation of MERCOSUR affected the concentration of industrial production in the larger countries with the smaller specializing intra-regionally in primary products as Venables(2002) predicted. If this is the case, as actually it seems to be\(^\text{25}\), an interesting implication might be the need for a redistribution process within MERCOSUR. More interestingly, the association agreement with the EU, with its chapters on cooperation and cohesion, represents a very important opportunity for Uruguay and Paraguay for their interests to

\(^{24}\)In a recent seminar on Argentina taking place at ECLAC, Santiago, the responsible of ECLAC office in Buenos Aires lamented that with reform process the technology of process was substituted by product technology thus leaving Argentina internal market with high technology products and a very tiny industria sector producing them in terms of number of production phases developed internally.

\(^{25}\)Chudnovsky et al.(2004) actually report how foreign presence in some industrial sectors actually shrank in Uruguay thanks to intra-regional trade liberalization.
receive more guarantees.  
Summing up, two are the main further avenues for research coming out from the previous analysis. The first is related to the evolution of MERCOSUR intra-regional trade and its determinants in terms of MERCOSUR own protection and EU protection in order to highlight, at a very disaggregate level, to what extent intra-regional trade plaid a substitutive role for extra-regional one due to EU protectionist barriers. This would help ascertain what in general are the causes of MERCOSUR products to be confined to the sub-regional market. The second research line deals with the effects of MERCOSUR on the concentration of industrial production. Such an evaluation is needed in order to better understand the likely benefits accruing to MERCOSUR countries from the intra-bloc negotiation and direct the future evolution of EU-MERCOSUR association process.

References


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26Actually what the automotive sector shows is that intra-regional exchange is determined by MERCOSUR own protection and the low dynamism of the produced cars.


