

## POLICY BRIEFING

# STRUCTURE AND COMMERCIAL POLICY OF MERCOSUR

### **ABSTRACT**

There are hundreds regional organizations in the world, each with different interests. These types of organizations are united by several factors such as the limited geographical context, the states membership to the same geo-political region and the community of interests and objectives among the members. As far as Latin America is concerned, Mercosur is probably one of the most significant attempts of regional organization and it will be the subject of analysis of this work. The Southern Common Market's main objective is the creation of a common market in which goods and services can circulate freely among member states (Argentina, Brazil, Paraguay and Uruguay).

After a brief introduction about the creation of the major organizations that compose Latin America, the second chapter analyses the history of Mercosur, the treaties that led to its creation, its full and associated members, with a particular focus on Venezuela (currently suspended from Mercosur) and finally, the institutional structure of this regional organization.

In the third chapter, instead, the commercial part of Mercosur is taken into account, with particular attention to the trade within and outside the block, showing its evolution over the years.

At the end the conclusions.



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## TABLE OF CONTENTS:

1. INTRODUCTION.....	4
2. MERCOSUR.....	5
2.1. History.....	5
2.2. Full members and associated countries.....	6
2.3. The case of Venezuela.....	6
2.4. The institutional structure of Mercosur.....	7
2.5. The decision-making and normative system.....	8
3. COMMERCIAL ISSUES WITHIN MERCOSUR.....	8
3.1. General overview.....	8
3.2. The commercial policy.....	9
3.3. Intra-zone trade.....	10
3.4. Extra-zone trade.....	12
4. CONCLUSIONS.....	13
5. WEB SOURCES.....	13

## 1. INTRODUCTION

In the current world there is a continuous trend towards the formation of regional blocks. Latin America does not escape to these integration process, which, although based on purely economic objectives, also respond to multiple interests such as political, cultural or environmental aspects. It seeks the incorporation of new consumer markets for its products, the increase in the sources of work and the possibility of greater profits when negotiate in bloc at the international level. All this would allow improving the quality of life of the population of the region. The first antecedents in Latin America go back to the 1960s with the creation of the main agreements, among which there are:

- Central American Common Market (MCCA, 1960)
- Latin American Free Trade Association (ALALC, 1961)
- Andean Pact (1969)
- Caribbean Community (CARICOM, 1973)

Not all these initiatives achieved all their objectives, due to external and internal causes. Among the external causes are the fall of international prices of raw materials and the world economy crisis. Among the internal causes, we can mention the presence of military governments in most of the countries and the application of protectionist schemes into the economies of Latin America.

Since the 1980s, the challenge of Latin American integration was facilitated by political and economic circumstances. Among the political circumstances, important has been the return of democratic governments to most of the countries. On the economic plan, the abandonment of that protectionism, the reduction of tariffs, the adoption of policies in order to give stability to the economies and the economic opening abroad, presented the path of integration as one of the best options for growth.

For these reasons, the previous regional agreements were modified:

- The Central American Common Market and the Caribbean Community increased their objectives over the years, always with a view to achieving the economic, social and sustainable development of the countries that make it up.
- The ALALC was replaced in 1980 by the Latin American Integration Association (LAIA), which continues with the project to achieve a long-term, gradual and progressive Latin American common market. It allows to its member countries to conclude bilateral integration agreements that can be extended to third countries.
- The Andean Pact changed its name 1995 to that of the Andean Integration System, whose main objective is to intensify the process of regional integration and cooperation.

### **What is a regional block?**

When we talk about regional blocks, we refer to a group of different countries that, sharing common interests in different areas such as the economic, social, political, environmental ones, decide to form what is called a regional block, reaching, in this way, different types of agreements between member countries with the objective of achieving greater decisional weight in international or planetary geopolitics.

In this new global era, an important part of the growth of the countries depends on the success or failure of the regionalization processes in which they are immersed.

In Latin America, the main regional blocks are:

- USAN (Union of South American Nations);
- MERCOSUR (Southern Common Market);
- Andean Community;

- LAIA (Latin American Integration Association);
- CELAC (Community of Latin American and Caribbean States);
- NAFTA (North American Free Trade Agreement).

The formation of economic blocs and regional markets constitutes a response of the different countries to face the conditions of competitiveness that globalization impose. Integration ensures countries an expanded market by eliminating customs borders, and this allows the inclusion of a greater number of consumers.

With the integration, countries and their industries try to obtain economic advantages, and an increase of the national and foreign investment expectations. In this way, greater possibilities appear to incorporate new technologies and a greater circulation of people, goods, capital, information and technology between companies and countries.

The last decade of the 20th century has witnessed a political economic initiative, unprecedented in the history of the countries of the Southern Cone: the formation of Mercosur, which means an association among the countries of the region never established before.

## 2. MERCOSUR

### 2.1. HISTORY

Mercosur was formed on March 26, 1991 after the signing of the Treaty of Asunción by the Argentine Republic, the Federative Republic of Brazil, the Republic of Paraguay and the Oriental Republic of Uruguay.

Its founding objectives are:

- The creation of a Common Market, which implies the free circulation of goods, services and productive factors among the member states;
- The establishment of a Common External Tariff (CET);
- The adoption of a common commercial policy towards third parties;
- The coordination of macroeconomic and sectorial policies;
- The commitment to harmonize legislation in the pertinent areas.

Celebrated in 1994, the Ouro Preto Protocol (POP) is another key agreement for the bloc, as it defines Mercosur's institutional structure, establishing the attributions and the decision-making system of its main bodies. The Ouro Preto Protocol attributed international legal personality to Mercosur.

Although the block begins with an economic and commercial impulse, over the last two decades regional integration has deepened, also, in other areas of a social and civic nature, such as the cultural, educational, structural and productive dimensions.

<b>Some briefs data about Mercosur</b>	
<b>Headquarters:</b> Montevideo (Uruguay)	
<b>Membership:</b>	
4 members (Brazil, Argentina, Paraguay, Uruguay)	
1 suspended (Venezuela)	
5 associated (Chile, Bolivia (Protocol of Accession), Peru, Colombia, Ecuador)	
2 observers (Mexico, New Zealand)	
<b>Official languages:</b> Spanish, Portuguese, Guarani	
<b>Total area:</b> 13,771,194 km <sup>2</sup>	
<b>President <i>pro tempore</i>:</b> Horacio Cartes	

Figure 1: some data about Mercosur

## 2.2. FULL MEMBERS AND ASSOCIATED COUNTRIES



Figure 2: Mercosur composition (Source: <http://www.young-diplomats.com/mercursosur-challenges-simple-analysis/>)

The Founding States Parties of Mercosur and signatories of the Treaty of Asunción are Argentina, Brazil, Paraguay and Uruguay.

Given that the Treaty of Asunción is open to the accession of other member states of the Latin American Integration Association (LAIA), Venezuela was the first Latin American State to sign the Protocol of Accession in 2006, and more recently Bolivia. Venezuela concluded the accession process and acquired the status of State Party in 2012. However, the Protocol of Accession of Bolivia to Mercosur was already signed by all of the States Parties in 2015 and is now in the process of being incorporated by the congresses of the States Parties.

The Associated States are those members of LAIA with which Mercosur subscribes free trade agreements and which subsequently request to be considered as such. The Associated States are authorized to participate in meetings of Mercosur bodies that deal with issues of common interest. This is the current situation of Chile, Colombia, Ecuador and Peru.

Likewise, Associated States may also be those countries with which Mercosur enters into agreements under Article 25 of the Montevideo Treaty of 1980 (Agreements with other States or Economic Integration Areas of Latin America). Such is the case of Guyana and Suriname.

## 2.3. THE CASE OF VENEZUELA

In a meeting held in São Paulo on August 5, 2017, the foreign ministers of the States Parties of Mercosur - Argentina, Brazil, Paraguay and Uruguay - decided, unanimously, to suspend the Bolivarian Republic of Venezuela in all its rights and obligations inherent to its status as a State Party of Mercosur. Apparently, Venezuela has not accommodated and complied with the

obligations it had assumed upon entering the international organization, both economic and of human rights. The decision was made based on compliance with the second paragraph of Article 5 of the Protocol of Ushuaia<sup>1</sup>, on Democratic Commitment in Mercosur.

Venezuela had already been suspended from the exercise of its rights as a State Party to Mercosur previously, on December 2016, due to the breach of commitments assumed in its Protocol of Accession.

Since 2012, Venezuela socioeconomic and political crisis extended over the years under both Hugo Chávez and Nicolás Maduro presidency. During the year 2016, for example, inflation reached 800% becoming the highest in the world, the economy contracted by 18.6% (due to the low petroleum price and its strong dependence on oil, which generates about 96% of its export revenues), and hunger escalated to the point that population lost weight due to a lack of proper nutrition leading people to eat garbage or kill animals to survive. The crisis has affected the average life of Venezuelans on various levels. The rise of unemployment resulted in the emergence of social movements aimed at both changing the economic and productive model, as well as questioning the political system and demanding a democratic renewal. Political corruption, scarcity of basic products (such as milk, meat, coffee and rice, but also basic necessities like personal hygiene products and medicine) and health care, closure of companies, deterioration of productivity and competitiveness, and high dependence on oil are other problems that have also contributed to the worsening crisis. All this was the cause of Maduro's bad policy of repression against opponents and its anti-democratic drift.

This crisis situation has clearly alarmed other states, especially those with strong commercial ties with Venezuela as for example the members of the Mercosur organization who, frightened by the fact that the internal crisis in the country could have repercussions on their economies, were forced to take strict measures.

## 2.4. THE INSTITUTIONAL STRUCTURE OF MERCOSUR

The organizational structure of Mercosur is defined in the Protocol of Ouro Preto (POP) signed on December 17, 1994. This Protocol provides for bodies of a decision-making nature and are:

- **Common Market Council:**

The Council is the highest-level agency of Mercosur with the authority to conduct its policy, and responsibility for compliance with the objects and timeframes set forth in the Asunción Treaty. The Council is composed of the Ministers of Foreign Affairs and the Economy (or the equivalent) of each member states. Member states preside over the Council in rotating alphabetical order, for a six-month periods. The current Mercosur President pro tempore in charge is Horacio Cartes from Paraguay. Council members and Heads of States shall meet whenever necessary, but at least twice a year.

- **Common Market Group:**

It is composed of Secretaries of State. It depends on the Common Market Council and is the Mercosur's executive body. It has decision-making and normative functions. It pronounces

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<sup>1</sup> The Protocol of Ushuaia is a Protocol signed on July 24, 1998 in the Argentine city of Ushuaia by the four member countries of Mercosur (Argentina, Brazil, Uruguay and Paraguay) and two associated states (Bolivia and Chile) reaffirming the democratic commitment among the signatory states. There the "Democratic Clause" was established, which determines the exclusion, from the block, of the country where the democratic order is broken, including the application of trade sanctions or the closing of borders.

itself through resolutions that are obligatory for the member countries. It meets ordinarily every three months and extraordinarily when necessary.

- **Trade commission:**

It is composed of the undersecretaries of state. It is the body in charge of ensuring the application of the common commercial policy instruments agreed by the member countries. It meets at least once a month and deliberates taking into account the directives established by the council, which are binding for all member countries.

## **2.5. THE DECISION AND NORMATIVE SYSTEM**

Mercosur is an intergovernmental integration process, where each State Party has one vote, and decisions must be taken by consensus and with the presence of all States Parties.

Once the rules have been negotiated and approved by the decision-making bodies of the bloc, they are mandatory and, when necessary, they must be incorporated into the national legal systems through the procedures provided by the legislation of each country.

## **3. COMMERCIAL ISSUES WITHIN MERCOSUR**

### **3.1. GENERAL OVERVIEW**

With over two decades of existence, the Southern Common Market (Mercosur) is the most comprehensive initiative of regional integration implemented in Latin America.

Mercosur members encompasses approximately 72% of the territory of South America (12.8 million km<sup>2</sup>, equivalent to three times the area of the European Union); 70% of the South American population (275 million inhabitants) and 77% of South America's GDP in 2012 (US\$ 3.18 trillion from a total of US\$ 4.13 trillion, according to World Bank data).

If taken as a whole, Mercosur would be the fifth largest economy in the world, with a GDP of over US\$ 3 trillion. Mercosur is the leading receiver of foreign direct investment (FDI) in the region. The bloc received 47.6% of all the FDI flow directed to South America, Central America and Mexico in 2012 (UNCTAD data). The bloc constitutes a privileged space for investments, through purchase, share control, and association of companies from member States. The expansion of the economic integration agenda, in the last decade, has contributed to a significant increase of direct investments assigned by member States to other parties of the bloc.

The bloc can be characterized as a customs union in the process of consolidation, with common market features, with the elimination of obstacles to the circulation of factors of production, as well as the adoption of a common tariff policy regarding third countries, through a Common External Tariff (CET).

In a little more than twenty years, Mercosur has proved to be a great success in economic and commercial terms. Intra-bloc trade was multiplied by more than ten times, jumping from US\$ 5.1 billion (1991) to US\$ 58.2 billion (2012). In the same period, world trade grew only five times. Brazil's trade with Mercosur was multiplied by close to ten times – while with the rest of the world it increased eight times. Intra-bloc trade accounts for about 15% of Mercosur's global trade amount, and tariffs were almost completely reduced for trade among the bloc members.

At first glance, it may seem that the initiative has commercial/trade objectives, but Mercosur is much more than that. Since its origins, Mercosur has been based on a political and strategic integration project in which the trade aspect is added to other spheres of equal or higher importance.

Since its inception, the bloc has been marked by the symbolism of nations that have joined together around principles and objectives such as democracy and economic development – elements that have since come to characterize the bloc. Today, the democratic clause and the understanding that the economic development shall be accompanied by better living conditions of the populations are consolidated within Mercosur.

The treatment of asymmetries among the member countries receives special attention. The establishment of the Structural Convergence Fund for Mercosur (FOCEM), in 2005 aimed at financing programs to improve the infrastructure in the region, to develop the competitiveness, social cohesion, and institutional strengthening of the regional integration process. In operation since 2007, FOCEM counts on a portfolio of more than forty projects and initiatives in areas such as housing, transportation, incentives to small businesses, biosecurity, technological training, and sanitation infrastructure – mainly in the smaller economies of the bloc – in addition to financing projects that benefit border cities and communities.

Mercosur is vital for the industrial activity of the member States. In 2012, 92% of Brazilian exports to Mercosur, for example, were composed of manufactured and semi manufactured goods. One of the sectors that most benefited from Mercosur is the automotive industry, for the bloc made it possible for Brazil and Argentina to integrate their automobile productive chains. Brazil and Argentina together are the third biggest global market for automobiles (after China and the United States).

In brief, Mercosur is not limited to its economic and commercial dimension, comprising also of common initiatives from infrastructure to telecommunications; from science and technology to education; from family farming to the environment; from border cooperation to the fight against transnational crimes; from gender policies to the full promotion of human rights. This is what makes Mercosur one of the broadest integration projects in the world.

In Mercosur resides the concern of making a common project of social and economic development for the integration, which aims at having a direct impact on people's lives. Together the member states are committed to South America's engagement in a process of economic growth, social development, and democracy.

### **3.2. THE COMMERCIAL POLICY**

It can be said that Mercosur's trading system revolves around the Common Foreign Tariff which is applied from free zones and special customs areas to goods from third countries.

Rates currently range between 0% and 20%, with an average of 12%. The goods in which the Common Foreign Tariff is applied can circulate freely within Mercosur's member states, it is then envisaged the adoption of a common external commercial policy to form a custom union with respect to third countries.

To the Common External Tariff and to the list of exceptions, other instruments must be added to ensure the integrity of the common commercial policy of the custom union. The main objective is to succeed in reach the full functionality of the customs union. To this end, particular attention is paid to:

- a) Establish full control in the four States of the Mercosur Customs Code;
- b) Conclude the elaboration of the rules for the application of the customs code;
- c) Refine the implementation of integrated border controls and adopt measures to accelerate relations;
- d) Developing the interconnection of the IT systems of the national administrations of the Member States;
- e) Developing an effective coordination to prevent and combat fraud and customs offenses;
- f) Refining the uniform application of the customs valuation rules and criteria.

These measures aim to achieve a uniform treatment for imports from third countries.

Free trade zones have been created within the customs union area where goods produced by member countries are normally subject to the common foreign tariff, but they are entitled to apply safeguard measures if they consider that they create disturbances to the internal market.

The only exceptions are the special custom areas of Manaus (Brazil) and Tierra del Fuego (Argentina) which, for particular geographical reasons, can freely circulate their goods in the country they belong to.

The conferences of the Council of Ministers in Buenos Aires and Ouro Preto in 1994 have highlighted the need to adopt common commercial policy instruments both to ensure greater solidity in the commercial policy itself and to promote productive complementarity, sectorial specialization and the diffusion and development of new technologies.

For some productive sectors, special conditions are applied to favour their adaptation to the customs union:

- a) In the agricultural sector, policies are implemented to increase productivity throughout the Mercosur area, to encourage the free circulation of products and institutions to satisfy internal needs;
- b) In the industrial sector, an attempt is being made to stimulate the restructuring of the industry itself in order to pursue a certain competitiveness also on the international market.

The process of integration with the outside requires a prudent coordination of national policies and standards to achieve sustainable regional development.

### **3.3. INTRA-ZONE TRADE**

A set of countries constitutes a natural economic block if an important part of the trade they carry out is intra-zone, that is, between the members that make up that agreement. The intra-zone trade, among other possible advantages, not only favours the process of integration in itself but also allows taking advantage of the economies of scale and generating specialization and complementation in the regional value chains, which will facilitate their insertion in an increasingly competitive world.

In the case of Mercosur, its intra-zone trade has grown very notably in the 2000s, except for the year 2009 in which the consequences of the international financial crisis are recorded, as showed in the graphic below. From 1994 to 2001, intra-zone trade grew at an annual average of 3.7%, while from 2002 to 2010 it did so at a rate of 18.5%.

Since its creation, Brazil and Argentina have led regional trade, while Uruguay and Paraguay have registered a less influential share in intra-zone trade. In these considerations, it must be taken into account that Mercosur has very different economies in size, with two large and two small partners, and while the smaller partners (Paraguay and Uruguay) are very commercially integrated into Mercosur, the two largest (Argentina and Brazil) are at a more modest level.

Thus, for example, exports from Argentina and Brazil to Mercosur over the total exports of both countries represented, respectively, 30.3% and 13.6% in 1994, while those same percentages were 24.4% and 10.9% in 2010. On the other hand, for this last year Paraguay destined 48.4% of its sales abroad to Mercosur countries, while Uruguay 31.9%.

Again, the decrease observed in intra-zone trade for Argentina and Brazil, especially since 2002, has a lot to do with the increase in the prices of primary goods.

Since the main raw materials that are exported, by both Argentina and Brazil, are not destined for Mercosur, the good performance exhibited by the extra-zone exports of both countries has as a counterpart the decrease in intra-zone trade mentioned.

The fact that it is a relatively new block - more if compared to the EU - and the recurrent instability experienced by its economies are factors that, among others, have exerted influence so that the intensity of trade is not greater.

### EVOLUCIÓN DEL COMERCIO INTRAZONA DEL MERCOSUR EN MILLONES DE DÓLARES CORRIENTES

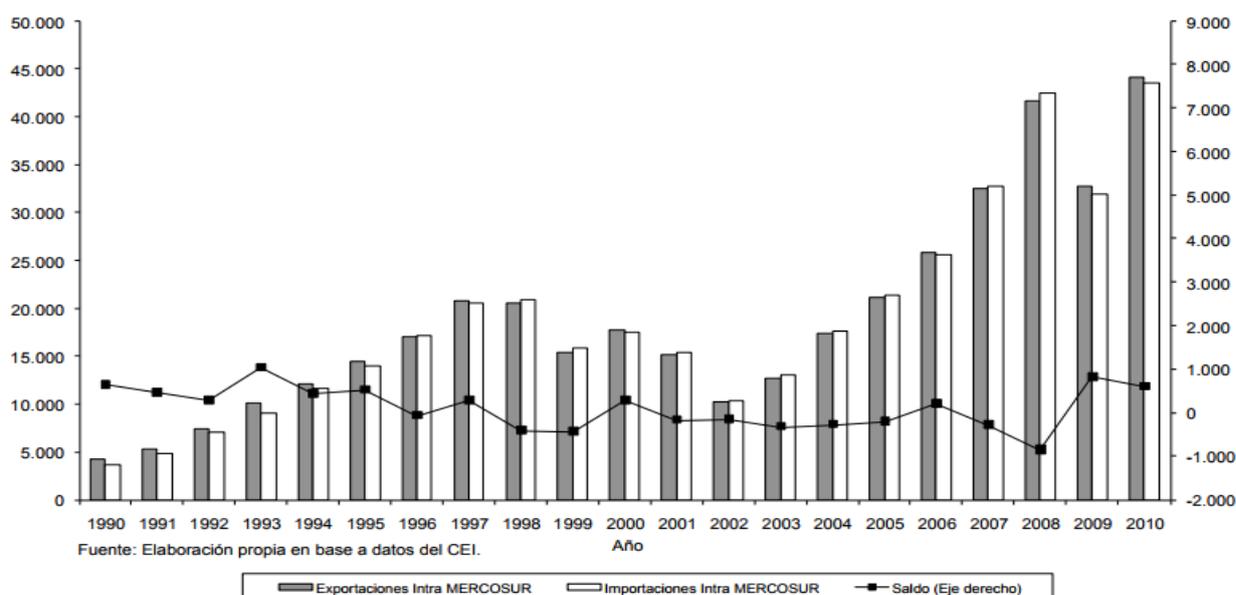


Figure 3: intra-zone trade evolution in Mercosur in millions of current dollars (Source: <http://cuadernos.uma.es/pdfs/pdf753.pdf> )

### 3.4. EXTRA-ZONE TRADE

The extra-zone trade shows the exchange of merchandise with those countries that are not members of Mercosur. In other words, extra-zone trade registers all those destinations (countries) that are outside the agreement and, therefore, suggests, under certain assumptions, how the pattern of comparative advantages is operating. Like intra-zone trade, also extra-zone trade has grown and has done so in a very remarkable way. As shows the chart below, from 1994 to 2001, extra-zone trade grew at an annual average of 5.3%, while from 2002 to 2010 it did so at a rate of 17.3%. The extra-zone trade had a negative balance between 1995 and 2000, to show then a surplus until the end of the period.

As regards the participation of each Mercosur country in extra-zone trade, Brazil has always been leader, maybe because it is the largest economy of the bloc. Its share in the total exported to the rest of the world has almost always exceeded 70% of the total exported to that destination, with an upward trend that is accentuated from 1999. Argentina has a participation that ranges between 20% and 30% of the total exports of Mercosur to the rest of the world. Uruguay shares with Argentina that decline in participation, which reaches a maximum of 4.5% in 1998 and drops to 2.8% in 2010. Paraguay shows a certain stability in its participation, which never exceeds 1%.

As far as the main destinations of extra-regional exports are concerned, 24% went to the EU; 16% for China; 14% for the member countries of NAFTA, that is, Canada, the United States and Mexico; the Andean Community of Nations (CAN) took 4%; while the Rest of the World reached 26% of the total exported by the South American block.

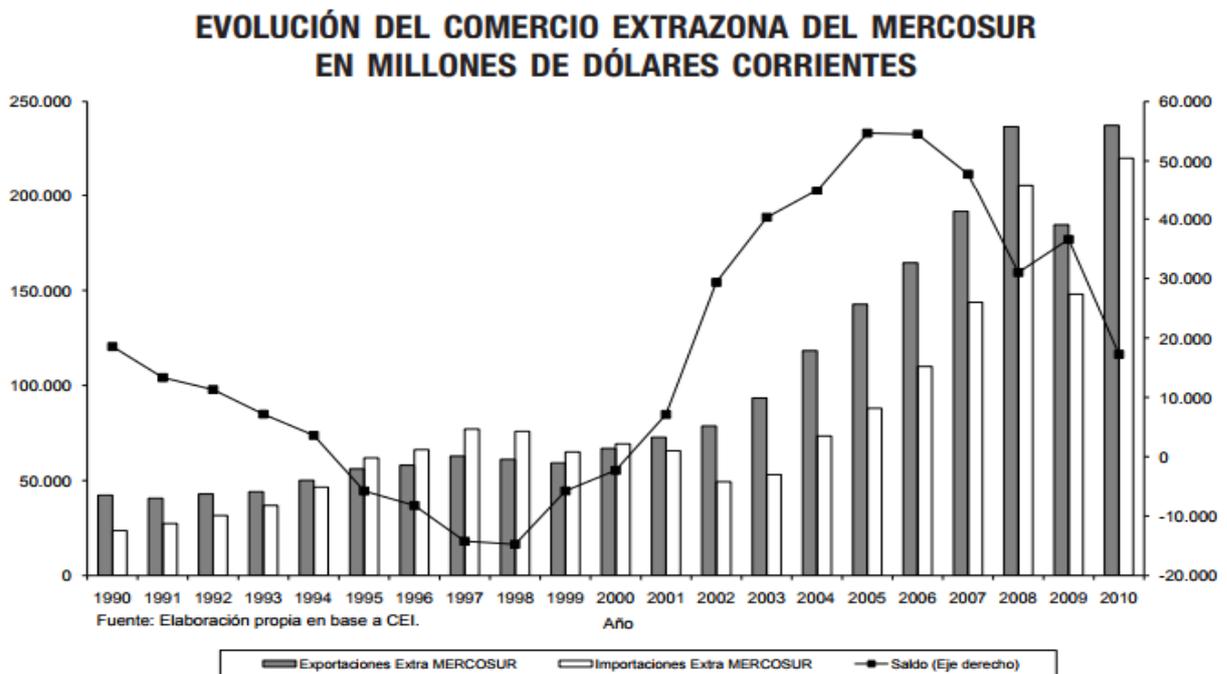


Figure 4: extra-zone trade evolution in Mercosur in millions of current dollars (Source: <http://cuadernos.uma.es/pdfs/pdf753.pdf> )

